

# The Investor View

Chelsea  
Summer 2014

BOROUGH OF CHELSEA  
KING'S ROAD  
S.W. 3



Douglas  
& Gordon

Good to know.

## Introduction

Anyone who owns a property in London is a property investor and it's often useful to take an investor's view of the market before making big decisions. To produce this report we've worked closely with the experts at D&G Asset Management, a company we co-founded in 2005. They invest in London residential property all the time – so are constantly analysing different areas, and assets within those areas, seeking to maximise returns.

As well as publicly available sources, we've used proprietary data that we've been capturing since 1996, to help us make decisions and advise our clients. D&GAM has helped us focus on the data that counts, and we think the results make fascinating reading.

### How an investor looks at the market

Residential property investors use two key measures to assess property – the capital value and the net

## Property Values

## Smaller units will outperform during the rest of 2014 due to threat of mansion tax.

### Q1 performance and outlook

Over the course of a full cycle, real annualised capital values normally rise in line with the real long term (10 year) trend. When, at a specific point in the cycle, real annualised growth is below the long term trend, rapid nominal growth is probable. Once the real annualised growth is aligned with the real long term trend, a pause is likely. Therefore, it's possible to forecast which assets might have further to run and those that are likely to stall.

Recent strong nominal growth in Chelsea must be viewed in the context of long term and real annualised growth rates since the start of this latest market cycle in 2007 (when property prices last peaked).

In Chelsea, all units, with the exception of one bedroom flats, have either reverted to or exceeded their long term growth rates. The exception – one bedroom flats – are close to their long term trend and, as discussed in our Q1 Investor View, we believe the impact of the unfolding credit cycle will be that smaller (and less expensive) unit sizes will start to outperform the larger, more expensive ones.

### Implications

**Owners of larger Chelsea flats and houses, who are not looking to hold long term and/or are considering a move to a different part of the UK, might find this a good moment to sell.**

Government Policy uncertainty remains for properties over £2m and is likely to be the cause of stagnating capital growth rates. However, our view is that there is growing consensus amongst the political parties that higher taxation on residential property will be undertaken via a Council Tax solution.

| Chelsea Property Values |                        |            |                |
|-------------------------|------------------------|------------|----------------|
|                         | Real Annualised Growth |            | Nominal Growth |
|                         | 10 year                | This cycle | Q1 2014        |
| 1 Bed Flat              | 2.00%                  | 1.61%      | 0.84% ↑        |
| 2 Bed Flat              | 3.00%                  | 4.00%      | 1.03% ↑        |
| 3 Bed House             | 6.00%                  | 8.55%      | 3.51% ↑        |

Source: D&G proprietary data, ONS

We suspect the extra levy on properties in the initial £2m-£4/5m will not be as bad as feared under the original mansion tax proposal. We think it will be designed to encourage mainstream developers (Land Securities) in London and remove the risk of those "accidentally" living in properties at this level being forced into penury.

We predict it will be the higher bands (£5m-£10m) and £10m+ properties that bear most of the load of the extra taxation. Although this is unlikely to be confirmed until closer to the May 2015 general election, we feel this makes properties in the £2m-£4m range likely to benefit most from the lifting of this policy uncertainty.

rental yield (the annual rent, less expenses, divided by the property's capital value).

Both of these measures are important, and are influenced by a number of factors including: supply of new properties, infrastructure projects, demographics of the area, the economy (in particular, interest and tax rates) and the wider geopolitical picture. It's the interplay of these factors that determines investment returns and makes property investment decisions so interesting.

### The importance of market cycles

Successful investors will always maintain a keen awareness of market cycles and long term trends. It is therefore important to look at the recent growth trends of capital and rental values in Chelsea when managing your property assets.

We are recommending investors look at the year when property values last peaked (2007) and treat this as the start of the most recent cycle.

## Rents at a steady growth rate across most unit sizes.

## Rental Growth & Yield

### Q1 performance and outlook

Over the course of this lettings cycle, rents in Chelsea have risen across all unit sizes. For example, between 2003 and the end of 2013, nominal rents rose between 20%+ for three bedroom houses and 45% for two bedroom flats.

Rental values increased during the period of tight credit (2008-2012) as frustrated buyers were forced to rent. As credit has eased and confidence has returned so tenants have become owner/occupiers, leading to capital values rising and rents stabilising or even falling. Over the same period, employees/tenants experienced salaries stagnating in real terms meaning affordability was stretched.

With earnings in the City now picking up and more demand from overseas executives, we believe that rents in Chelsea will continue to rise.

### Implications

In order to benefit from stronger rental market conditions, landlords must continue to invest in their properties to meet the expectations of an increasingly discerning pool of tenants.

**Landlords must appreciate that those still opting to rent have more property to choose from and will be more demanding than a few years ago.**

Note: When renting out a property, investors will look at current rental yield, (see below) however they also need to take a view on how much rents will grow. It's this "rental growth" that maintains real income and yield over time.

#### Chelsea Nominal Rental Growth

|             | Dec 2003 - Dec 2013 | Q1 2014 |
|-------------|---------------------|---------|
| 1 Bed Flat  | 32.35%              | 0%      |
| 2 Bed Flat  | 47.37%              | 7.14%   |
| 3 Bed House | 21.05%              | 4.35%   |
| 4 Bed House | 33.33%              | 8.33%   |

Source: D&G proprietary data

#### Current Rental Yields March 2014

|                     |             |
|---------------------|-------------|
| One Bed Flats       | 2.5% - 3.7% |
| Two Bed Flats       | 2.2% - 3.5% |
| Three Bed Houses    | 2.2% - 3.2% |
| Four Bed Houses     | 2.2% - 3.2% |
| 10 Yr UK Gilt Yield | 2.7%        |
| FTSE All Sh Yield   | 3.45%       |
| UK Base Rate        | 0.5%        |

**Never has the difference between London and regional property prices been so great.**

Every Spring we co-host the 'Move to the Country Show' with The London Office. The show is held in Battersea and gives our clients and members of the public an opportunity to meet local independent estate agents from across our UK network.

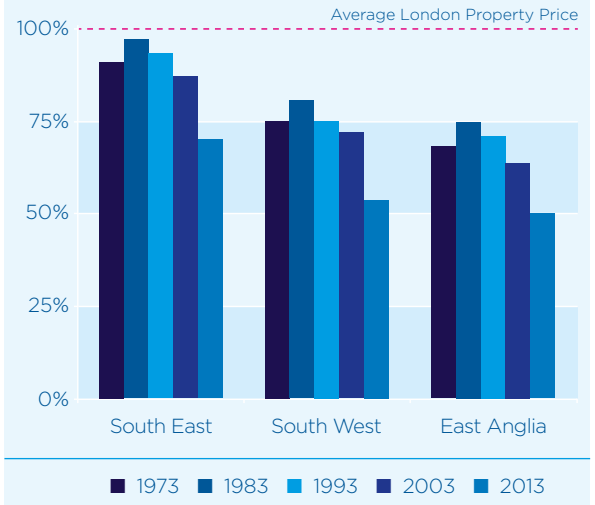
The show is an important date in our calendar as every year a proportion of our vendors sell up and leave London.

For many, the timing of that move involves a number of practical considerations such as schooling and space.

For others, it is an important investment decision where a London property is sold and part of the money deployed into a regional retirement property. The remainder often forms part of a pension pot, so the timing of the move is crucial.

*Although we remain positive about London prices over the long term, the current relative gap between London and regional property prices may well provide an opportunity for those looking to move out of London and top up their savings/pension pots.*

**Regional property prices relative to London property prices**



Source: ONS average property prices.

**Chelsea key facts & figures**

Here are the key facts and figures anyone investing in the property market needs at their fingertips.

**Nominal Rental Income Growth to Dec 2013**

|              | 2013 | 5 years | 10 years |
|--------------|------|---------|----------|
| 1 Bed Flats  | -10% | 0%      | 32%      |
| 2 Bed Flats  | -7%  | 12%     | 47%      |
| 3 Bed Houses | -18% | 5%      | 21%      |
| 4 Bed Houses | -14% | 7%      | 33%      |

**Nominal Capital Returns to Dec 2013**

|              | 2013 | 5 years | 10 years |
|--------------|------|---------|----------|
| 1 Bed Flats  | 5%   | 40%     | 70%      |
| 2 Bed Flats  | 8%   | 56%     | 86%      |
| 3 Bed Houses | 4%   | 111%    | 148%     |
| 4 Bed Houses | -1%  | 58%     | 139%     |

**Other Assets Capital Returns to Dec 2013**

|                 | 2013 | 5 years | 10 years |
|-----------------|------|---------|----------|
| Nationwide HPI* | 8%   | 15%     | 30%      |
| Halifax HPI*    | 6%   | 8%      | 22%      |
| FTSE100         | 14%  | 52%     | 51%      |
| RPI             | 3%   | 19%     | 38%      |

\*House Price Index

**Chelsea 2014  
Our view**

- Sub-£2m to continue to be hottest market followed by sub-£4m
- Rents to rise from 2013 levels
- Larger units will require policy uncertainty to lift before growth continues

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