

Balham   **Battersea**   Battersea Park   Chelsea   Clapham   East Putney   Fulham   Hammersmith & Shepherd's Bush  
Kensington   Notting Hill   Pimlico & Westminster   South Kensington   Southfields   West Putney

# The Investor View

**Battersea**  
Autumn 2014

**NORTHCOTE ROAD, S.W.**



**Douglas  
& Gordon**

Good to know.

# Introduction

Anyone who owns a property in London is a property investor. Our lives and plans often depend on the performance of what is likely to be the largest asset we own. So perhaps it will be helpful to take more of an investor's view of the market.

To produce this report we worked closely with D&G Asset Management, a company we co-founded in 2005. They deploy money into London residential property all the time, so they are constantly analysing different areas and the assets within those areas, seeking to maximise returns.

As well as publicly available sources, we have used the proprietary data that we have been capturing since 1996 to help us make decisions and provide advice and guidance to our clients.

D&GAM has helped us focus on the data that counts and we think the results make fascinating reading.

If you would like to learn more about the Battersea area, please contact our office on Northcote Road. Contact details for this office can be found on the back page.

## Property Values

### In Q2 capital values plateaued.

#### Q2 performance and outlook in context

This quarter, Battersea has seen no capital growth, a stark contrast to Q1 when prices across all unit sizes enjoyed a strong start to 2014. This slowdown in growth is not unique to Battersea.

On average across all Douglas & Gordon offices, North and South of the river, capital values have grown by +2% in Q2 compared to +7% in Q1.

#### Why? Buyer response to new price levels and 'noise'

During Q2, buyers have taken stock of recent price rises and probably started to revisit their own personal financial calculations. This is a rational response to the following recent policy announcements, often accompanied by sensational 'bubble bursting' media commentary:

- | The Mortgage Market Review (MMR). Mortgage applicants now need to establish their net income positions.
- | The Bank of England Financial Policy Committee's new 'macro-prudential' regulations. These steer the major lending banks towards lending no more than 4.5 times net income and testing mortgage affordability at an interest rate 3% higher than today's.
- | Future interest rates. Consensus has moved to interest rates rising sooner.
- | Potential new/higher property taxes next year (Labour and Liberal Mansion tax proposal and/or higher council tax rates).
- | The upcoming general election in June 2015. With Labour still ahead in the polls, there is the threat of higher personal taxation for many Londoners.

#### What next? No big fall in prices but fewer transactions. The next step in this cycle is likely to be determined by sellers

As Battersea has been re-rated, so a higher percentage of sellers tend to be discretionary.

#### Battersea Nominal Property Values

	Apr 09 - Jun 14	Q1 2014	Q2 2014
1 Bed Flats	100.00%	17.65%	0.00%
2 Bed Flats	97.37%	7.14%	0.00%
3 Bed Houses	130.77%	3.45%	0.00%
4 Bed Houses	118.75%	9.38%	0.00%

Source: D&G proprietary data

Often these owners are protected by large equity positions and/or low levels of debt compared to that equity. To this group can be added those who are 'trapped' in mortgage deals that, under the new regime (see above), they would not be able to access again if they moved to a new property. Many of these sellers will wait for the price they want rather than accept significant price reductions.

**A recipe for a reduction in transactions, not a major fall in prices.**

In the last month we conducted a survey across all Douglas & Gordon offices to test the current attitude of sellers. The results are pretty clear. At the moment they appear not to be minded to take big price cuts to shift their properties. In our Battersea office, 70% of vendors were either unwilling to drop their price at all or would only entertain a reduction of 5% to achieve a sale. We will report back on this to see who blinks first, buyers or sellers.

# How an investor looks at the market

Residential property investors use two key measures: the capital value of the property and its net rental yield.

You can make money from an increase in capital value and earn additional income by renting out a property you own. The net yield is the annual rent, less expenses, divided by the property's capital value.

Both are important and are influenced by many 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.

The interplay of these factors is what determines investment returns and what makes property investment decisions so interesting. We hope this report provides some help as you assess your options.

**Battersea has seen rental values rise rapidly since 2009, but stall in 2014.**

**Rental Growth & Yield**

## Long term performance and outlook

In the first half of 2014, average rental values across all Douglas & Gordon offices have risen by about 4%. However, in Battersea prices rose by less. This should be seen in the context of rental growth over the last five years (see chart below). As employment and real earnings pick up across the London economy we expect rental values in Battersea to rise again towards the end of 2014 and into 2015. We think this will show up first, and to the greatest extent, in the flats market which is more sensitive to the economic/employment cycle.

## The rise of the corporate tenant in Battersea

A very significant long term development for Battersea landlords is the emergence of corporate tenants. Five years ago, these tenants would have sought accommodation mainly in Kensington, Chelsea and Knightsbridge. This has changed.

*As different London areas have been re-rated so, in the search for value, an increasing number of corporate tenants have been housed in Battersea.*

We think this trend will develop further as the Battersea Power Station and Embassy Quarter developments mature.

## What does this mean for Battersea landlords?

Sometimes agreeing a tenancy with a corporate tenant can mean that the property requires a higher specification and the contractual terms can feel a bit one-sided. However, it is normally worth it in the long term. Corporate tenants offer: a) a better credit/rent covenant; and (b) greater likelihood of renewals.

Landlords in Battersea should insist that their lettings agent has a solid track record of dealing with corporate tenants.

### Battersea Nominal Rental Growth

	Apr 09 - Jun 14	YTD
1 Bed Flats	22.81%	1.45%
2 Bed Flats	25.71%	3.53%
3 Bed Houses	18.18%	0.00%
4 Bed Houses	20.00%	0.00%

Source: D&G proprietary data

### Current Rental Gross yields June 2014

1 Bed Flats	3.70% - 4.50%
2 Bed Flats	3.20% - 4.00%
3 Bed Houses	2.20% - 3.60%
4 Bed Houses	2.20% - 3.60%
10 Yr UK Gilt Yield	2.40%
FTSE All Sh Yield	3.45%
UK Base Rate	0.50%

## The emergence of a new 'prime' in London.

As the Financial Times has noted recently 'everyone is on bubble watch'.

We are not that concerned whether some commentators think there is a London-wide house price 'bubble'. Given that the London housing market is a series of distinct micro markets, what is more interesting is whether nominal values of real estate in the markets covered by Douglas & Gordon can ever 'burst' in the same way that, for example, listed shares or debt can.

Investors in a relatively illiquid asset class, like 'prime' London residential property, cannot go short and/or exit quickly. Historically in 'prime' markets, any pricing correction has been via a gentle fall in real terms as inflation rises quicker than the nominal value of the asset.

For a real estate market to suffer large nominal falls in values, two factors tend to be in place simultaneously: 1) over-borrowed/under-capitalised owners; and 2) over-supply of new, commoditised stock. This is why property in, for example, some Spanish and regional

*History shows that sellers of 'prime' real estate do not sell at any price.*

USA markets have been susceptible to big falls in nominal values, whereas 'prime' UK markets have not.

Today, many owners and buyers across the areas of London covered by Douglas & Gordon have very significant equity positions and very low levels of debt compared to the nominal value of the property.

Sellers in these 'prime' markets, with these strong household balance sheets, are more likely to take their property off the market than sell and realise losses.

Transaction levels may fall dramatically, but nominal prices are unlikely to do so.

Over the coming months we will have more to say about the differences between 'prime' and 'emerging prime' markets in London.

### Battersea 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	0%	17%	50%
2 Bed Flats	0%	21%	42%
3 Bed Houses	0%	18%	44%
4 Bed Houses	-3%	24%	53%

Nominal Capital Returns to Dec 2013			
	2013	5 years	10 years
1 Bed Flats	27%	70%	102%
2 Bed Flats	31%	75%	115%
3 Bed Houses	26%	115%	199%
4 Bed Houses	19%	100%	186%

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

### Battersea 2014 Our view

- Credit easing • Area re-rating to continue
- Capital values: Flats to outperform houses
- Rents to slowly pick up

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To get an investor's view of other areas in Central, West and South West London, visit [douglasandgordon.com](http://douglasandgordon.com)



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