The Investor View

Fulham
Autumn 2014

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 Fulham area, please contact our office on Fulham Road. Contact details for this office can be found on the back page.

Property Values

Capital value growth of flats plateaued in Q2.

Q2 performance and outlook in context

With the exception of four bedroom houses, this quarter has seen a slight reduction in growth rates, not a fall in values. This slowdown in growth is not unique to Fulham.

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

Fulham Nominal Property Values

	Apr 09 – Jun 14	Q1 2014	Q2 2014
1 Bed Flats	57.89% ↗	2.33% ↗	2.27% ↗
2 Bed Flats	92.00% ↗	3.70% ↗	2.86% ↗
3 Bed Houses	91.67% ↗	4.76% ↗	4.55% ↗
4 Bed Houses	170.27% ↗	0.00% →	8.11% ↗

Source: D&G proprietary data

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 Fulham office, 90% 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.

Rental values picked up in 2014.

Rental Growth & Yield

Long term performance and outlook

In the first half of 2014, average rents across all Douglas & Gordon offices have risen by about 4%. But in Fulham they have been stronger due, in part, to a pick up in the City. Putting things into perspective, however, rental value in Fulham have grown less than our Douglas & Gordon office average over five years (+35%). As employment and real earnings pick up across the wider London economy, we expect rental values in Fulham to remain firm for the rest of 2014 and into 2015.

The rise of the corporate tenant in Fulham

A very significant long-term development for Fulham 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 Fulham.

We think this trend will develop further as the wider London economy continues to expand and Fulham's value and proximity to 'prime' markets becomes established.

What does this mean for Fulham landlords?

Sometimes agreeing a tenancy with a corporate tenant can mean both 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 Fulham should insist that their lettings agent has a solid track record of dealing with corporate tenants.

Fulham Nominal Rental Growth

	Apr 09 – Jun 14	YTD
1 Bed Flats	10.00% ↗	10.00% ↗
2 Bed Flats	26.76% ↗	7.14% ↗
3 Bed Houses	30.00% ↗	8.33% ↗
4 Bed Houses	18.75% ↗	5.56% ↗

Source: D&G proprietary data

Current Rental Gross yields June 2014

1 Bed Flats	3.00% – 4.00%
2 Bed Flats	3.00% – 4.00%
3 Bed Houses	2.50% – 3.50%
4 Bed Houses	2.50% – 3.50%
10 Yr UK Gilt Yield	2.40%
FTSE All Sh Yield	3.45%
UK Base Rate	0.50%

Market Context

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.

Fulham key facts & figures

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

Nominal Capital Returns to Dec 2013

	2013	5 years	10 years
1 Bed Flats	10%	56%	87%
2 Bed Flats	29%	96%	125%
3 Bed Houses	30%	84%	104%
4 Bed Houses	32%	168%	164%

Nominal Rental Income Growth to Dec 2013

	2013	5 years	10 years
1 Bed Flats	-5%	0%	30%
2 Bed Flats	-3%	24%	47%
3 Bed Houses	-8%	21%	50%
4 Bed Houses	0%	20%	50%

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*

Fulham 2014 Our view

- **Capital values: smaller properties to start outperforming larger equivalents • Credit easing • Rents to slowly pick up**
- **Area to continue to emerge as 'Prime'**

Douglas &Gordon

Good to know.

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To get an investor's view of other areas in Central, West and South West London, visit douglasandgordon.com