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The Investor View

Chelsea
Winter 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 Chelsea area, please contact our office on Sloane Avenue. Contact details for this office can be found on the back page.

Property Values

The standoff between buyers and sellers continues.

Q3 performance and outlook in context

This quarter Chelsea has seen little or no growth in values. This pattern is not unique to Chelsea. On average across all Douglas & Gordon offices, north and south of the river, capital values have ground to a halt (+0.1%) in Q3 after capital growth rates slowed to +2% in Q2 compared to +7% in Q1.

Buyers have become risk averse ahead of the 2015 general election

In our last report we noted that the slowdown in the rate of capital growth in Q2 reflected a change in buyer sentiment. We wrote about a number of 'noise' factors that had caused buyers to stand back and reflect upon their position, particularly after five years of uninterrupted growth in the London property market. These included the Mortgage Market Review, the Bank of England's financial policy committee's announcements on mortgage lending as well as continuing concerns over issues such as a mansion tax, capital gains tax and Bank of England guidance on higher interest rates.

We think that this risk aversion will continue ahead of the 2015 general election. At the same time our most recent survey results of vendor sentiment from the Chelsea office show that most vendors continue to be either unwilling to drop prices, or may only reduce them by up to 5% to achieve a sale. This is a classic recipe for low volumes with the possibility of a slight softening of prices.

The standoff between buyers and sellers may lead to a slight softening of prices – but no crash.

Chelsea Nominal Property Values

	Apr 09 – Oct 14	H1 2014	Q3 2014
1 Bed Flats	42.17% ↗	0.84% ↗	-1.67% ↘
2 Bed Flats	58.40% ↗	1.03% ↗	0.51% ↗
3 Bed Houses	121.48% ↗	3.51% ↗	1.36% ↗
4 Bed Houses	63.27% ↗	1.27% ↗	0.00% →

Source: D&G proprietary data

Looking through the noise and beyond the election

We believe there are several factors that buyers and sellers should bear in mind:

- The geopolitical and economic uncertainties that exist across the globe (the Middle East, Ukraine, China/Hong Kong and the problems of the Eurozone economy); factors that have traditionally made London look attractive to overseas investors.
- A changed political landscape after the election and the fact that certain policy risks have already been priced in – see page 4 for our comments on mansion tax.
- Interest rates will remain lower than expected, for longer than expected.

Against this background we feel that Chelsea prices in the bracket below £4m will rally after the 2015 general election.

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.

In Q3, rental values for smaller properties improved.

Rental Growth & Yield

Long term performance and outlook

In the first three quarters of 2014 average rents across all Douglas & Gordon offices have risen by almost 7%. The situation in Chelsea has been that rents in the house market have been strong in the first half of this year; whereas the flats market was had a quiet H1.

What we have noted, however, is that rents in the Chelsea flats market have been firmer in Q3 – the result of a combination of strength in the London economy and a slowing of the sales market. With the continuing stand off between buyers and sellers (see page opposite), a number of potential buyers have decided to hold off on any purchases until after the general election.

The big picture for landlords – demographics

Owners of residential rental property, particularly in London, should always keep a close eye on employment levels, as this is one of the key factors underpinning rental values.

A strong economy and a slowing sales market will strengthen rental values.

According to a recent survey from the Boston Consulting Group and Total Jobs (an employment search website) high salary prospects are one of the key reasons that London is considered to be the best place in the world to work.

In the year to the end of June 2014, the number of jobs in London increased by 6.1% (source: ONS). Today, London's workforce stands at 5.6m people, almost 1m higher than June 2004; and looking forward, statisticians predict that this will continue to increase.

The post-crisis financial services sector now employs more people than in 2007 and London has also become an established global hub for the fast growing Technology, Media and Telecom (TMT) sector. These are encouraging statistics for the rental market.

Chelsea Nominal Rental Growth

	Apr 09 – Oct 14	H1 2014	Q3 2014
1 Bed Flats	11.76% ↗	0.00% →	5.56% ↗
2 Bed Flats	20.83% ↗	0.00% →	3.57% ↗
3 Bed Houses	18.18% ↗	4.35% ↗	8.33% ↗
4 Bed Houses	55.56% ↗	16.67% ↗	0.00% →

Source: D&G proprietary data

Current Rental Gross yields October 2014

1 Bed Flats	2.50% – 3.70%
2 Bed Flats	2.20% – 3.50%
3 Bed Houses	2.20% – 3.20%
4 Bed Houses	2.20% – 3.20%
10 Yr UK Gilt Yield	2.25%
FTSE All Sh Yield	3.40%
UK Base Rate	0.50%

Assessing political risk

What is the likely impact of the 2015 general election on the London property market?

Likelihood of HoC Control	Property Taxation	Impact on the Market
Labour Overall Majority (20%)	MT applied on basis of Council Tax bands: flat rates applied to each band.	10%+ relief rally for £2m-3m band.
Labour/Liberal Coalition (20%)	As above	As above
Conservative Overall Majority (25%)	Higher Council Tax bands but lower flat rates	10%-20%+ relief rally above £2m
Conservative/Liberal Coalition (35%)	As above	As above

- For properties below £3m the threat of higher taxation is over-stated. After an election campaign where 'English votes for English laws' will have been a dominant theme, we do not think Labour would introduce an aggressive property tax on London and the South East.
- Labour has announced that it will adopt a banded system with a maximum charge of £3,000 p/a for properties between £2m and £3m. We expect the Liberal Democrats to commit to something similar. We believe this will lead to a 'relief rally' of about 10% for that £2-3m band in the months following the general election. For properties above that £3m threshold there is more uncertainty and this is likely to lead to price weakness and reduced transactions ahead of the 2015 general election.
- Our core view is that there is now cross-Party convergence on the merits of new council tax bands for properties above £2m. We think the next government, irrespective of persuasion, will opt for this approach and the differences between the parties will boil down to the amount charged to each band.
- In short, we think that the landscape after the next UK general election will not be as gloomy for the properties below £3m/£4m as the market currently thinks and this provides a current investing opportunity. An investment in the £2m-£4m range looks the safest bet to benefit after the general election. If Labour do not figure in the next government, the £5m+ bracket could see the biggest post-election gains.

Chelsea 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	5%	40%	70%
2 Bed Flats	8%	56%	86%
3 Bed Houses	4%	111%	148%
4 Bed Houses	-1%	58%	139%

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%

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**

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

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