

The Investor View

Notting Hill
Summer 2014

PORTO BELLO
ROAD,



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

All units slowing in Q1. Smaller units will outperform others during the rest of 2014 due to the threat of mansion tax.

Q1 performance and outlook

In our Q1 2014 report, we made reference to the start of the new credit cycle and the strong performance of flats in 2013. The chart shows that one and two bedroom flats have continued to perform well in 2014 as the credit cycle unfolds.

We are, however, aware that the performance of these flats has been heavily influenced by their price bracket. Flats priced below £1m have shown a much better performance than those priced above £2m. This is explained by the fact that easier credit has a greater impact on cheaper properties, while those flats priced closer to £2m have remained stagnant in price terms due to concerns of a mansion tax.





For this reason, we think that flats priced significantly below the mansion tax threshold (£2m) will continue to remain strong going forward.

Mansion Tax and its implications

Government policy uncertainty remains for all properties (both flats and houses) over £2m and is likely to remain the cause of slowing 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.

We suspect the extra levy on properties in the initial £2m-£4m bracket will not be as bad as feared under the original mansion tax proposal. We think that 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.

Notting Hill Property Values – Flats

	Nominal Growth	
	Dec 2012 - Dec 2013	Q1 2014
1 Bed Flat	14.14% 	5.31% 
2 Bed Flat	11.43% 	12.82% 

Source: D&G proprietary data

We believe that properties in the £2m-£4m range are likely to benefit most from the lifting of policy uncertainty.

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 that 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 Notting Hill 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.

Should current trends continue during summer, rents will begin to rise across all unit sizes.

Rental Growth & Yield

Q1 performance and outlook

In our Q1 report, we spoke about the rise in rents in the second half of 2013 after a difficult year and three quarters. Rents in Q1 have remained firm in Notting Hill, which is consistent with the pick-up in the City.

It also reflects the fact that in Q1, stock levels have been low due to some landlords reconsidering their investments after recent capital increases. If stock remains at its current low level and corporate enquiries continue to rise, we would expect rents to rise as we move into the busier summer months.

Implications

Over the last two years Notting Hill has experienced rental growth across all unit sizes. But current and potential landlords should understand that rents can be volatile. In order to benefit from stronger rental market conditions, landlords must continue to invest in their properties to ensure tenants stay and/or pay more rent. "Accidental landlords" who during 2008-2012 rented properties out rather than sell them, and are not keen to invest capital into their properties, might choose to take advantage of a strong sales market and sell.

Notting Hill Nominal Rental Growth		
	Apr 2009 - Apr 2014	Q1 2014
1 Bed Flat	20.00%	0%
2 Bed Flat	33.33%	4.35%
3 Bed House	33.33%	4.35%
4 Bed House	14.29%	0%

Source: D&G proprietary data

With rent levels set to rise, landlords must appreciate that those still opting to rent 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.

Current Rental Yields March 2014	
One Bed Flats	2.5% - 3.7%
Two Bed Flats	2.1% - 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.

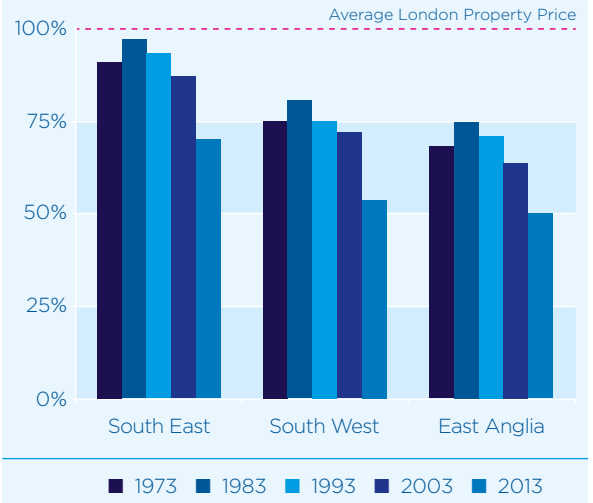
**Notting Hill
key facts & figures**

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	2 years	4 years
1 Bed Flats	0%	-5%	6%
2 Bed Flats	0%	-12%	15%
3 Bed Houses	28%	-4%	15%
4 Bed Houses	0%	-14%	-9%

Regional property prices of London property prices



Source: ONS average property prices.

Nominal Capital Returns to Dec 2013

	2013	2 years	4 years
1 Bed Flats	10%	15%	30%
2 Bed Flats	8%	19%	49%
3 Bed Houses	11%	31%	104%
4 Bed Houses	3%	29%	170%

Other Assets Capital Returns to Dec 2013

	2013	2 years	4 years
Nationwide HPI*	8%	7%	8%
Halifax HPI*	6%	8%	2%
FTSE100	14%	21%	25%
RPI	3%	6%	16%

*House Price Index

**Notting Hill
2014
Our view**

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

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