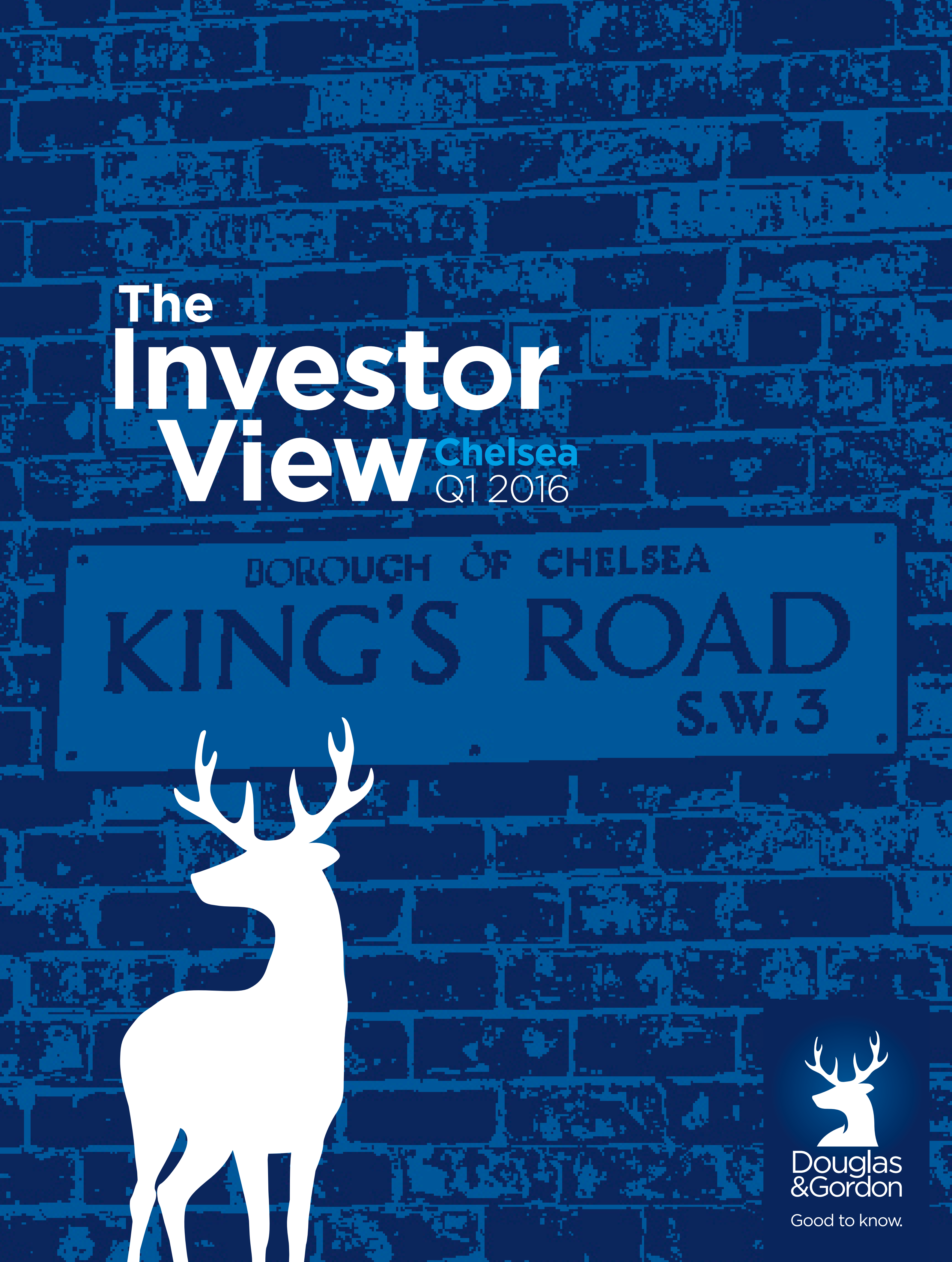
The Investor View

Chelsea
Q1 2016



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 do get in touch with one of our offices on Sloane Avenue. Contact details can be found on the back page.

Property Values

In 2015 capital values of flats in Chelsea recovered the losses of 2014

In Q4 2015, capital values ended the year on a mixed note. The year as a whole though saw modest increases, with the notable exception of larger properties.

Review of 2015 – A market divided by price

- The changes to SDLT in December 2014 defined the London residential sales market in 2015. Chelsea was no exception.
- The market below £1m, which benefited from lower SDLT rates, was reasonably buoyant.
- The Chelsea sales market between £1m and £2m experienced a standoff between price sensitive buyers and over optimistic sellers, with performance tapering off above £1.5m.
- The £2m+ sales market dramatically declined in volume with vendors and buyers remaining cautious over the new SDLT rates. Our data shows that in the last nine months of 2015, the number of sales of £2m+ properties across D&G Land dropped by 64% compared to the same period in 2013.
- It is important to note from our data that prices have effectively remained unchanged over the last two years in Chelsea (and Prime Central London as a whole). Values of larger properties have, however declined.

Looking ahead to 2016

- Chelsea remains a popular market for both investors and Pied-à-terre buyer. The proposed 3% increase in SDLT for buy-to-let investors and 2nd home buyers from April 2016, will lead to a rush to deploy capital in Q1 – thereafter the market is expected to quieten down.
- Such a dramatic decline in volume for the £2m+ market will have impacted revenues for the treasury. It is therefore possible that the government might consider lowering SDLT rates for higher priced properties.
- Since June 2014, sterling has declined by over 15% against the US$. The safe haven of Prime Central London residential property, has become even more attractive to overseas investors looking to ride out the current global political and economic turmoil.
- Additionally, the relative premium that Prime flats command over similar stock in some Emerging Prime areas of the capital is back at historic lows – this will also generate interest from investors.

Chelsea Nominal Property Values

	Q4 2015	2015	2014
1 Bed Flats	1.30% ↗	4.74% ↗	-5.07% ↘
2 Bed Flats	-0.69% ↘	2.59% ↗	1.36% ↗
3 Bed Houses	1.33% ↗	4.60% ↗	-4.08% ↘
4 Bed Houses	-1.84% ↘	-5.37% ↘	-2.32% ↘

Source: D&G proprietary data

> Prime Central London residential property has become even more attractive to overseas investors

- Interest rates will remain low for longer (see forecasts on Page 4), which will underpin the Chelsea property market.

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 average rental values declined in the Chelsea house market

Rental Growth & Yield

In Q4 2015, average rental values across D&G Land declined by 1.9%. Our Prime offices suffered the largest declines (-3.04%) but there was also weakness in Emerging Prime where on average, prices declined by 1.16%. Against this background, rents in Chelsea typified the weakness experienced across Prime in the last quarter of the year.

2015 in perspective

- As you can see from the table, 2015 delivered some pockets of weakness in Chelsea. Rental values are volatile, increasingly so in Prime, so 2015's weak numbers should be viewed in the context of 2014's strong performance.
- What stands out from the numbers, is that one bedroom flats have delivered the best performance over the last two years.
- The single largest theme of 2015 was the further tightening of corporate housing budgets.
- At the top end of the market, reduced corporate budgets have dampened the demand for family houses – particularly over the summer season.
- In order to comply with strict corporate accommodation budgets, a number of individuals are choosing to weekly commute. This is having a positive impact on the small flats market.

Looking ahead to 2016

- Companies will remain under financial pressure, and tighter accommodation budgets are likely to continue into 2016.

> One bedroom flats have delivered the best performance over the last two years

- Relocation agents will continue to steer clients to lower-priced locations in "Emerging Prime" London.

Chelsea Nominal Rental Growth

	Q4 2015	2015	2014
1 Bed Flats	-1.96% ↘	1.01% ↗	10.00% ↗
2 Bed Flats	-6.67% ↘	-6.67% ↘	7.14% ↗
3 Bed Houses	-4.35% ↘	-15.38% ↘	13.04% ↗
4 Bed Houses	-1.79% ↘	-1.79% ↘	16.67% ↗

Source: D&G proprietary data

Current Rental Gross Yields December 2015

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	1.76%
FTSE All Sh Yield (historic)	3.87%
UK Base Rate	0.50%

Source: D&G proprietary data

- Domestic budgets, which are fully stretched, will also remain tight.
- As further new build stock becomes available to the rental market, the standard and finish of properties will become more important.
- In this low inflationary environment, we remain cautious on rental growth in 2016 (see forecasts on page 4).

Market context

Route Map for 2016

As we enter 2016, the outlook from nearly all commentators on virtually every asset class is, at best, cautious.

This is how we see a number of major factors unfolding:

Interest rates

- Throughout 2015 the Governor of the Bank of England spoke of a buoyant UK economy and guided onlookers to expect interest rate rises. He has now changed his tune and coined the phrase "low for long".
- We have consistently argued that interest rates would not rise. A downward revision to GDP data, and worse than anticipated government borrowing figures released at the end of 2015, added weight to this analysis.

Currency

- Sterling weakness, caused in part by the Federal Reserves decision to raise interest rates in the US in December, will likely continue in the face of a slowing UK economy.

Political Factors

- It appears likely that in 2016 the UK will hold a referendum on whether or not to remain in the European Union – expect investors to stay on the side-lines during this process.
- Global political tensions will continue to be a focus throughout the year – watch out for pockets of trouble emanating from oil producing countries with possible knock on effects at the top end of the London market.

Investors will remain desperate for yield

- With benign UK interest rates and the possibility of dividend cuts in the equity markets, income will remain a major headache for many investors.

Many of the factors highlighted above are not necessarily negative for London real estate assets.

Forecasting a year ahead, is not a straightforward process. Often exogenous, or unexpected, factors can arise which have implications for asset prices. Our thoughts for next year, however, are as follows:

Forecasts for 2016:

Sales:

Up to £1.5m 0% – +5%	This part of the market will remain firm.
£1.5m – £5m Broadly flat.	Supply considerations may produce pockets of strength in Prime.
£5m + Broadly flat.	There is potential for distressed sellers, particularly from commodity producing countries, that may make headlines.

Rents:

0% – +2%	Low inflation and tightened budgets will lead to little rental growth.

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 December 2014

	2014	5 years	10 years
1 Bed Flats	4.74%	40%	149%
2 Bed Flats	2.59%	32%	116%
3 Bed Houses	4.60%	29%	133%
4 Bed Houses	-5.37%	16%	88%

Nominal Rental Income Growth to December 2014

	2014	5 years	10 years
1 Bed Flats	1.01%	1%	28%
2 Bed Flats	-6.67%	0%	22%
3 Bed Houses	-15.38%	-21%	0%
4 Bed Houses	-1.79%	-8%	28%

Other Assets Capital Returns to December 2015

	2015	5 years	10 years
Nationwide HPI*	4.50%	21%	25%
Halifax HPI*	9.50%	27%	22%
FTSE100	-4.93%	6%	11%
RPI	0.90%	14%	34%

**House Price Index*

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To get an investor's view of other areas in central, west and south-west London, visit douglasandgordon.com