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The Investor View

Fulham
Q4 2015



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 do get in touch with our office on Fulham Road. Contact details can be found on the back page.

Property Values

Q3 saw weakness in the Fulham large house market

In Q3 2015, after showing modest strength at the start of the year, capital values of flats and smaller houses in Fulham were unchanged. The story for larger houses was different, with prices down by around 5%.

There was a similar pattern across other Douglas & Gordon Emerging Prime offices where flats and smaller houses outperformed larger houses.

The Fulham sales market remains location and price sensitive

Property prices in the Fulham market fall into three brackets: up to £1.2m, £1.2m-£1.5m and £1.5m+.

The market below £1.2m continues to be steady. The top end of the market (£1.5m+), which had shown strength in Q2, has fallen back due to the recent increases in SDLT rates.

Q3 has been robust in the house market between £1.2m and £1.5m. This price bracket is benefiting from an affordability factor and buyers are happy to pay these prices to own in Fulham.

In Q3, Fulham saw a return to more normal property markets. Sensibly priced, well-located and well-presented properties, requiring little or no work, are achieving a good level of interest. Poorly located properties in bad condition are taking longer to sell.

Background factors in play

Homeowners across our Emerging Prime offices have large equity positions and are therefore discretionary sellers.

Land registry data shows that between H1 and H2 2014, sales volumes in Fulham declined: flats -25%, terraced houses -37% and semi-detached houses -55%.

Fulham Nominal Property Values			
	Q3 2015	YTD	Since Q2 2014
1 Bed Flats	0.00% →	5.56% ↗	5.56% ↗
2 Bed Flats	0.00% →	3.47% ↗	3.47% ↗
3 Bed Houses	0.00% →	2.17% ↗	2.17% ↗
4 Bed Houses	-5.00% ↘	-5.00% ↘	-5.00% ↘

Source: D&G proprietary data

Nervous buyers concerned about any pockets of weakness seen over the last 18 months, should note these volume numbers. From a market perspective, low volume sell-offs are a characteristic of "Prime" markets where demand is always out there and soon returns after a short period of adjustment.

Our research suggests that in Q3 2015 buyers were price sensitive as borrowers were wrongly guided to expect higher interest rates. See page 4 for our outlook on monetary policy.

In Q3 2015 buyers were price sensitive

Outlook

Sellers should remain realistic and ignore headlines about UK national house price rises as they do not apply to London. The bull market in Fulham ended in April 2014.

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 in the Fulham flats market were firm in Q3

Rental Growth & Yield

In Q3 2015, average rental values across D&G Land rose by 0.3%. Prime offices averaged growth of 0.9% and Emerging Prime offices produced a very small increase of 0.03%. Against this background, rental values in Fulham declined by an average of 4%. The breakdown of the numbers paints a complicated picture.

Corporate budgets are tightening

In our last report we described the Fulham house rental market as "showing signs of growth for the first time in four years". As Q3 2015 unfolded, pockets of real weakness started to emerge and the higher up the chain one went, the more acute the problem became. One reason for this is that domestic renters are becoming increasingly cash strapped. Another reason is that Fulham is one of our "core" Emerging Prime offices that has recently experienced a decline in corporate relocation budgets.

Over the past year we have written about the trend of corporate tenants looking for better value in lower-priced areas. We are now seeing more tightening of the belt, which will further impact the corporate rental market going forward. Investors need to think ahead.

Fewer corporates means landlords will need to invest in upgrading their properties to appeal to the decreasing pool of prospective tenants, and/or consider the growing professional sharer market.

Investors need to think ahead

Those house owners who have been averse to the sharers market will be interested to know that the demographics of this market are shifting. Our internal data shows that 52% of our tenants in Fulham are over 30 – the new so called "generation rent": people who aspire to buy and want to maintain excellent credit records but have to remain in rental accommodation for longer.

Fulham Nominal Rental Growth

	Q3 2015	YTD	Since Q2 2014
1 Bed Flats	2.86%	5.88%	9.09%
2 Bed Flats	4.00%	9.47%	15.56%
3 Bed Houses	-2.88%	3.85%	3.85%
4 Bed Houses	-20.00%	-15.79%	-15.79%

Source: D&G proprietary data

Current Rental Gross Yields October 2015

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	1.76%
FTSE All Sh Yield	3.60%
UK Base Rate	0.50%

Source: D&G proprietary data

On a brighter note for investors, rental values in the Fulham flats market were firm in Q3, as indeed they were across D&G Land. One explanation for this is that the sales market has not, as yet, taken off and people are staying put in rented accommodation.

Outlook

In this low growth and low inflationary environment, we remain cautious on rental growth.

In Q3 the global economic backdrop to the London property market was challenging (see chart). Some commentators believe that the recent turmoil in emerging market economies is the third stage of the global financial crisis that began in 2008. The implications of this are:

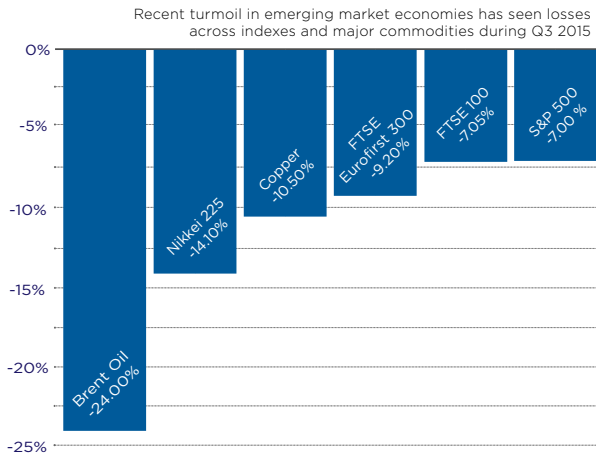
- Central banks across the world remain worried by no inflation:
 - In the USA: 2014 - 15 US median household income fell
 - In the Eurozone: Inflation turned negative in September 2015 (notwithstanding E 500 billion + of asset purchases by the ECB this year)
 - In Japan: The third quarter looks set to contract after the second quarter contracted 1.2% (notwithstanding \$665 billion of asset purchases by BOJ over the last year)
- Capital flight from emerging market economies will pose a major threat to global growth (between 2010 and 2015, China was responsible for 50% of global growth)
- There will also be renewed threats to capital adequacy of US/UK/European major banks.

These global downside pressures will inevitably dampen UK growth, employment and inflation.

A lone voice holding this view has been Andrew Haldane, Chief Economist at The Bank of England.

On 18th September, the day after the FOMC kept US interest rates on hold, he said “In my view the balance of risks to UK growth and to UK inflation at the two year horizon is skewed squarely and significantly to the downside ... there could be a need to loosen rather than

Global economic backdrop to Q3 2015



tighten the monetary reins as a next step to support UK growth and return inflation to target.”*

Since 2009 we have been arguing that the threat of deflation will overhang the global economy for many years and that there was no prospect of interest rate rises for years to come. We have also argued for the last two years that further QE and/or monetary loosening in the UK was likely, when others have been predicting rate rises and higher inflation.

Continuing and stabilising low borrowing rates will lead to a pick up in mortgage approvals and this will have greater effect on some parts of the UK housing market than others.

* Speech to Portadown Chamber of Commerce 18th September 2015

Fulham 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 2014			
	2014	5 years	10 years
1 Bed Flats	13%	13%	36%
2 Bed Flats	13%	28%	40%
3 Bed Houses	8%	24%	16%
4 Bed Houses	6%	12%	12%

Nominal Capital Returns to Dec 2014			
	2014	5 years	10 years
1 Bed Flats	5%	36%	100%
2 Bed Flats	7%	76%	129%
3 Bed Houses	10%	73%	147%
4 Bed Houses	8%	122%	176%

Other Assets Capital Returns to Dec 2014			
	2014	5 years	10 years
Nationwide HPI*	7.20%	16%	24%
Halifax HPI*	7.80%	12%	16%
FTSE100	-2.70%	21%	36%
RPI	1.6%	18%	36%

*House Price Index

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