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The Investor View

Notting Hill
Q4 2015

PORTOBELLO
ROAD,



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 Notting Hill area, please do get in touch with our office on Westbourne Grove. Contact details can be found on the back page.

Property Values

In Q3 2015 the flat market in Notting Hill saw capital value growth of 1.4%

In Q3 2015, capital values of flats in Notting Hill were firm, continuing their modest rise since the start of the year. As we have witnessed since Q1 2015, the house market was softer. The trend of flats outperforming the house market was a common theme in Q3 throughout our Douglas & Gordon offices, both north and south of the river.

The market in Prime remains challenging

- Property prices in Prime London fall into three brackets: up to £1m, £1m-£2m and £2m+.
- The market up to £1m is moving but between £1m and £2m it tails off as prices rise. The top end of the market (£2m) remains weighed down by increases to SDLT.
- Properties offering a refurbishment project have been in demand amongst developers and investors. This is because sensibly priced, well-located and well-presented properties, requiring little or no work, are achieving a good level of interest.
- Overall, the supply/demand balance is firmly tilted towards supply. There is plenty of property on the market but few buyers are willing to pay the prices that vendors are wanting to achieve.

What is happening in the background?

- A characteristic of the Prime market and something that we constantly refer to, is that many owners have large equity positions and are therefore discretionary sellers.
- In Q3 last year, when market conditions were similar, we conducted a survey across our offices to gauge sellers sentiment. It showed that most vendors in Notting Hill were either unwilling to drop their prices,

Sophisticated buyers are ready to move for competitively priced stock

Notting Hill Nominal Property Values			
	Q3 2015	YTD	Since Q2 2014
1 Bed Flats	1.59%	4.19%	9.27%
2 Bed Flats	1.21%	4.51%	5.03%
3 Bed Houses	-1.45%	1.49%	1.49%
4 Bed Houses	-3.75%	-3.75%	0.43%

Source: D&G proprietary data

or would only consider a small reduction of 5%. Our most recent survey suggests that this has not changed.

- In addition, market feedback from Q3 suggests that there is a sophisticated pool of price sensitive buyers waiting in the wings. They are watching property prices closely and are ready to move when they see more competitively priced stock.
- With this standoff in mind, we have two observations:
 - Property prices in Prime London have historically been influenced by macro events, particularly global monetary policy. In Q3 2015, buyers were wrongly guided to expect higher interest rates. However, there is now a strong argument that future monetary policy may well underpin specific parts of the Prime market. See page 4 for our outlook.
 - Serious sellers should be realistic and understand that over-pricing denies the market the opportunity to work properly. It is important to set a price that will attract a number of buyers and allow market psychology to take over.

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 in Notting Hill declined in the flats market

Rental Growth & Yield

In Q3 2015, average rental values across D&G Land rose by 0.3%. Prime offices averaged a growth of 0.9% but the Emerging Prime offices produced a very small increase of 0.03%. Against this background, average rental values increased in Notting Hill by 0.3%. The breakdown of the numbers illustrates the volatility of the rental market.

Corporate budgets are tightening

In our last report we commented on the strength of the house market. As Q3 2015 unfolded, although there was an average increase of 2.09%, pockets of weakness started to emerge. One reason for this is that domestic renters are becoming increasingly cash strapped. Another reason is that Notting Hill is one of our many offices that has recently experienced a decline in corporate budgets.

Over the past year, we have written about the trend of corporate tenants looking for better value in lower-priced areas. Our view is that the \$1Tr global M&A deals that have taken place in the corporate sector in Q3 2015, signal that corporate accommodation budgets will come under further pressure.

Investors need to think ahead

Fewer corporates means that many landlords will need to invest in upgrading their properties in order to attract top quality tenants and achieve the highest prices.

In Q3, the flats market in Notting Hill was weaker, against the trend of our other Douglas & Gordon offices where rents were firm.

One explanation for this is that other areas have become more fashionable. Another, entirely avoidable reason, is that in too many instances

landlords fail to maintain their properties to the correct and desired standard.

Outlook

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

Notting Hill Nominal Rental Growth

	Q3 2015	YTD	Since Q2 2014
1 Bed Flats	-1.10% ↓	-4.26% ↓	-3.23% ↓
2 Bed Flats	-1.79% ↓	-3.51% ↓	0.00% →
3 Bed Houses	4.17% ↑	8.70% ↑	4.17% ↑
4 Bed Houses	0.00% →	7.27% ↑	-9.23% ↓

Source: D&G proprietary data

Current Rental Gross Yields October 2015

1 Bed Flats	2.50% - 3.70%
2 Bed Flats	2.10% - 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	3.60%
UK Base Rate	0.50%

Source: D&G proprietary data

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.

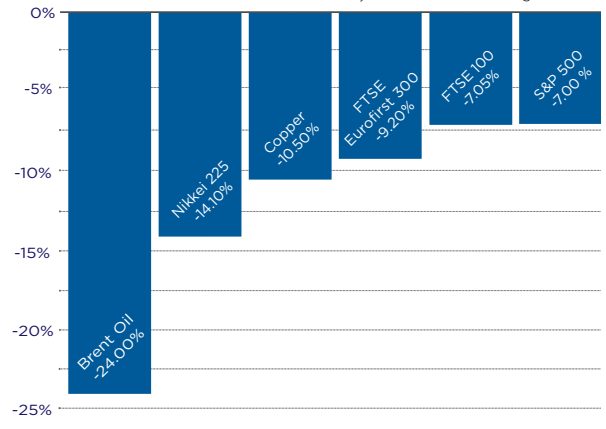
These global downside pressures will inevitably dampen UK growth, employment and inflation.

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

Recent turmoil in emerging market economies has seen losses across indexes and major commodities during 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

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 2014			
	2014	5 years	10 years
1 Bed Flats	6%	12%	n/a
2 Bed Flats	3%	19%	n/a
3 Bed Houses	-13%	0%	n/a
4 Bed Houses	-6%	-14%	n/a

Nominal Capital Returns to Dec 2014			
	2014	5 years	10 years
1 Bed Flats	7%	68%	184%
2 Bed Flats	5%	39%	125%
3 Bed Houses	2%	47%	161%
4 Bed Houses	12%	61%	189%

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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