The Investor View

Southfields
Q3 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 Southfields area, please do get in touch with our office on Replingham Road. Contact details can be found on the back page.

Property Values

Capital values were strong in Q2 but are unchanged on a 12 month basis.

Q2 2015 performance

As you can see from the chart, capital values of flats and houses were strong in Q2, following a similarly strong Q1. Southfields was one of our best performing Emerging Prime offices. Average prices rose by 1.81% in Emerging Prime, driven by flats and smaller houses.

In the context of the last 12 months

- House and flat prices in Southfields are significantly above levels in December 2014, although both remain little changed from 12 months ago.
- There are, however, concrete signals that confidence has returned to the Southfields market, with a record price recently paid for a house in the grid (on a £ per square foot basis).
- In the previous Investor View we wrote about the Southfields housing stock attracting "down-sizers" from more expensive properties in higher priced areas. One should not forget that it also remains an area where "up-sizers" can afford to buy. This convergence is a recipe for a strong Autumn market.
- History has shown that in Emerging Prime areas, when the housing market becomes established, the flats follow. With respectable yields, and rents firm, the flats market should remain underpinned.

The election result has provided all of the ingredients for a strong and stable London housing market.

The Election Effect

Immediately after the surprise election result on 7th May we forecast that the outcome would produce all of the ingredients necessary to create a strong and stable London housing market.

Whilst post-election prices in some parts of the market are rising, data from the last 6 weeks indicates that in other segments, particularly for higher valued stock, it is too soon to detect any market movement.

Southfields Nominal Property Values

	Q2 2015	Q1 2015	Since Q2 2014
1 Bed Flats	5.00% ↗	6.67% ↗	0.00% →
2 Bed Flats	3.77% ↗	6.00% ↗	-2.65% ↘
3 Bed Houses	5.26% ↗	0.00% →	0.00% →
4 Bed Houses	4.76% ↗	5.00% ↗	2.33% ↗

Source: D&G proprietary data

Looking to the future, investors should consider the following:

- One of the new government priorities is to return its stake in Lloyds and RBS to the private sector. This will create a political landscape that will see an increase in lending, with potentially helpful consequences for the housing market.
- The early signs of change are evident in the mortgage market. Data from the Bank of England has shown that 5 year fixed rate mortgages (for 75% LTV) fell below 3% in Q2 2015. The recent upward trend in mortgage approvals, although way below historic levels, is also a positive sign.
- We have consistently argued that any fiscal tightening from the new government will keep base rates low.
- We are hearing that following the election, vendors have hardened their stance towards price reduction. In some instances this is understandable. In general, however, as the market strengthens, vendors looking to move up the property ladder should consider the risk of holding out for an aspirational sale price, whilst the purchase price of their new property increases at an incrementally higher rate.

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.

Q2 saw strong rental growth for houses.

Rental Growth & Yield

Q2 2015 performance

In Q2 2015 average rents across D&G Land rose by 1.6%. In Emerging Prime rental growth averaged +1.7%. This was higher than in Prime, which saw average growth of 1.5%.

Against this rather buoyant background, our data shows that in Q2 rental rates grew by 2.8% in Southfields. Our data also shows that the last 12 months in Southfields have seen a strong overall rental performance – particularly in the flats market.
The standout performer this quarter has been the house market. Although this is the start of the strong Summer rental season, there are a number of additional factors driving this jump in rental values:

- Stock levels have been lower than usual.
- More corporate tenants are relocating to Southfields.
- There has been a general improvement in the standard of houses for rent in the area – further increasing the attractiveness to potential tenants.

In contrast, the flats market has been more subdued. It is important to note, however, that rents have not fallen and better quality stock is achieving higher prices.

A strengthened sales market might dampen rental growth.

Outlook

Over the last 12 months in Southfields, the rental story has been about rental values benefiting from a slow down in the sales market - with our internal data suggesting that tenants are staying put for the moment.

As reported in the previous edition of The Investor View, a strengthened sales market will potentially lead to a slow down in rental growth. This may well happen in the Autumn.

Southfields Nominal Rental Growth

	Q2 2015	Q1 2015	Since Q2 2014
1 Bed Flats	1.62% ↗	1.31% ↗	4.67% ↗
2 Bed Flats	0.00% →	2.00% ↗	2.00% ↗
3 Bed Houses	4.00% ↗	0.00% →	5.05% ↗
4 Bed Houses	5.37% ↗	1.54% ↗	3.66% ↗

Source: D&G proprietary data

Current Rental Gross yields December 2014

1 Bed Flats	3.90% – 5.00%
2 Bed Flats	3.50% – 4.70%
3 Bed Houses	3.00% – 4.00%
4 Bed Houses	3.00% – 4.00%
10 Yr UK Gilt Yield	2.12%
FTSE All Sh Yield	3.36%
UK Base Rate	0.50%

Source: D&G proprietary data

Market context

The rental market: The gap is closing between Prime and Emerging Prime

At the start of 2015 Douglas & Gordon initiated a quarterly index, tracking capital values across Emerging Prime areas of London, particularly in relation to Prime London prices.

In the rental sector, the performance of Emerging Prime in relation to Prime tells an interesting story.

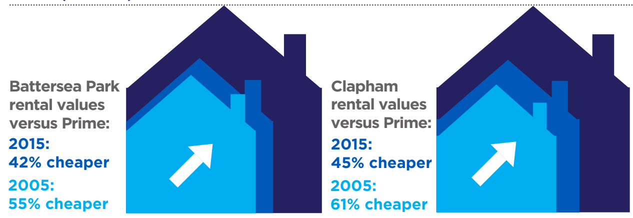
Over the last 10 years, rents in Prime have remained relatively static. By contrast, there has been considerable rental growth in Emerging Prime - consequently, the gap between the two markets is narrowing.

This movement is demonstrated in the charts using data from Battersea Park and Clapham.

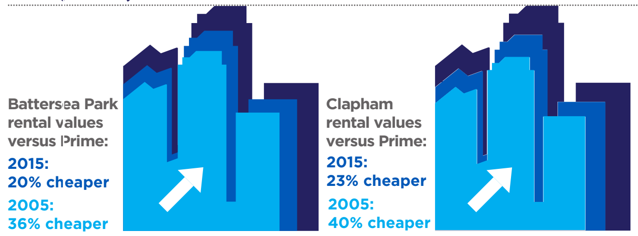
There are several factors behind this convergence:

- Demographics: There are almost 1m more people working in London than a decade ago. This has generated increased demand in the rental market.
- A changing corporate environment: Budgets have tightened since the financial crisis. This has led to corporate tenants seeking places to rent outside Prime London areas.
- Social Trends: Emerging Prime is becoming more fashionable, particularly with overseas renters.

Prime (Chelsea) rental values for 3 bed houses



Prime (Chelsea) rental values for 1 bed flats



Source: D&G proprietary data

Many investors are waking up to the fact that, with changing demographics, the quality of income streams in Emerging Prime are on par with Prime. Additionally, current yields in Emerging Prime are significantly higher than Prime.

It will be intriguing to see how this unfolds.

Southfields 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 2014

	2014	2 years	3 years
1 Bed Flats	-1%	14%	25%
2 Bed Flats	5%	20%	30%
3 Bed Houses	9%	28%	40%
4 Bed Houses	3%	25%	35%

Nominal Rental Income Growth to Dec 2014

	2014	2 years	3 years
1 Bed Flats	3%	7%	11%
2 Bed Flats	3%	0%	1%
3 Bed Houses	1%	3%	9%
4 Bed Houses	-3%	-3%	5%

Other Assets Capital Returns to Dec 2014

	2014	2 years	3 years
Nationwide HPI*	7%	16%	15%
Halifax HPI*	8%	16%	16%
FTSE100	-3%	11%	18%
RPI	1.6%	4.3%	7.6%

**House Price Index*

Southfields 2015 Our view

- **Capital values: Strong year ahead for sub £1m, above £1m slow start but picking up in H2 2015**
- **Rental values to plateau in real terms.**

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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