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The Investor View

Pimlico &
Westminster
Q2 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 Pimlico & Westminster area, please contact our office on Wilton Road. Contact details for this office can be found on the back page.

Property Values

In Q1 2015, capital values in Pimlico & Westminster remained static.

Q1 2015 performance

In the first quarter of 2015 capital values in Pimlico & Westminster were more or less unchanged from the close of 2014. The flats market was slightly weaker but the house market plateaued.

The wider picture across all Douglas & Gordon Emerging Prime offices was that prices rose on average by 1.1%, led mainly by smaller unit sizes. By contrast our Prime offices saw a small decline in capital values (-0.37%).

Q1 2015 - A market divided by price

In our Q1 Investor View, we argued that the change to the stamp duty regime in December's autumn statement (which reduced the tax burden on properties valued below £937,500) was a political green light for this segment of the London property market.

Although prices rose in many areas covered by our Emerging Prime offices, flat prices in Pimlico & Westminster remained subdued. One explanation for this is that the Pimlico & Westminster market did not experience the same weakness as many other markets in H2 2014.

By contrast, the autumn statement increased the amount of SDLT that purchasers would have to pay for properties over £1.1m - which very much impacted the house market in Pimlico & Westminster.

The larger house market (5 bed houses+) was the weaker performer in Q1. This was due to pre-election political uncertainty, particularly over the mansion tax, which some feared would put a ceiling on prices.

Looking forward - post the election

The election result has lifted the threat of a mansion tax, removing any ceiling on property prices over £2m.

Many investors/buyers have taken their eye off events unfolding across the globe.

Pimlico & Westminster Nominal Property Values

	Q1 2015	Q4 2014	Since Q1 2009
1 Bed Flats	0.00% →	0.00% →	100.00% ↗
2 Bed Flats	-2.78% ↘	0.00% →	98.86% ↗
3 Bed Flats	0.00% →	0.00% →	110.53% ↗
4 Bed Houses	0.00% →	0.00% →	83.33% ↗

Source: D&G proprietary data

Q1 2015 marked the 5th anniversary of interest rates remaining at 0.5%; and with inflation registering zero for the last two months, we continue to argue that monetary policy will remain accommodative for the foreseeable future.

Another consequence of all the election "chat" over the last six months has been that many buyers have taken their eye off events unfolding across the globe. The Greek debt saga remains unresolved, China is slowing, and there is rising geopolitical uncertainty caused, amongst other things, by the low oil price.

History would indicate that these events, alongside low interest rates, will provide a better long term benchmark for the future direction of London property prices.

We can expect a "market-driven" rally in H2 2015.

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.

Following a strong 2014, in Q1 2015 rental values in Pimlico & Westminster were modest.

Rental Growth & Yield

In Q1 2015, average rental values across D&G Land rose by 1%. This figure masks a contrasting market; in our Emerging Prime offices rental values grew on average by 1.9%, but rental values in our Prime offices declined by 1.6%.

Against this background Pimlico & Westminster saw modest rental growth of 1% in Q1 2015, although rental growth was very strong in 2014. This recent strength has cemented a pattern of rents in many Emerging Prime offices now standing substantially higher than pre-financial crisis levels on the eve of 2007.

What happened in Q1 2015

In Q1 2015, the major theme across Emerging Prime offices was that the rental market benefited from a slowdown in volumes in the sales market. This is a continuation of the performance in H2 2014 when potential buyers held off buying and remained in rental accommodation.

Another post financial crisis trend has seen corporate backed renters increasingly wanting to live in areas of the capital outside prime, where rental values are cheaper.

Recent analysis of our database has shown that our emerging prime areas are also gaining popularity with overseas tenants. In Q4 2013 overseas tenants accounted for 33% of all Douglas & Gordon's emerging prime tenants. The latest figures for Q1 2015 show that the number has increased to 39%.

Emerging prime areas are becoming increasingly popular with overseas tenants.

Outlook

With a pick up in the sales market, we expect rental growth to slow during the remaining part of 2015. We also argued at the start of the year that with concerns over the city and real wage growth, investors should moderate their expectations. This remains our stance.

Pimlico & Westminster Nominal Rental Growth

	Q1 2015	Q4 2014	Since Q1 2007
1 Bed Flats	2.44%	-2.38%	27.27%
2 Bed Flats	0.79%	-0.78%	42.22%
3 Bed Houses	1.31%	-1.29%	14.81%
4 Bed Houses	-0.38%	0.39%	48.00%

Source: D&G proprietary data

Current Rental Gross Yields May 2015

1 Bed Flats	3.00% - 3.50%
2 Bed Flats	2.80% - 4.00%
3 Bed Houses	2.00% - 3.20%
4 Bed Houses	2.00% - 3.20%
10 Yr UK Gilt Yield	1.90%
FTSE All Sh Yield	3.39%
UK Base Rate	0.50%

Source: D&G Proprietary data

The General Election result is a very bullish outcome for London real estate markets at all price levels.

**In the short term -
A 5 year surge in capital values**

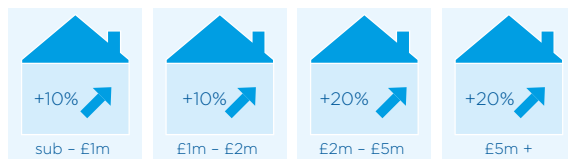
The election result will restore overseas investor confidence in the UK, and UK real estate assets, leading to a surge in capital values over the next five years.

This result, particularly the UKIP share of the vote, will help David Cameron in his negotiations with the EU over reform before a 2017 referendum. Importantly, we do not expect the prospect of an EU referendum to be a major dampener on asset values.

Following a 12 month period where policy-risk has subdued residential assets above £2m, we expect this part of the market to rally by up to 20% in the short term (next 12 months).

Over the next five years we think that capital values in the Prime London residential markets could as much as double.

D&G Land 12 month capital value forecasts



**In the long term -
The 10 year residential property
window is now open**

Crucially we believe that this result is also very bullish for the London residential property market in the medium and long term (the next 10 years).

This election result will force the Labour Party to confront existential questions about its future. Any likely federal settlement that is offered to Scotland and Wales by David Cameron will also force the Labour Party to work to attract English votes. As a result, we think it will have to re-position as a more 'New Labour', pro-market party.

We anticipate that there is likely to be a ten year cross-party consensus (as there was between 1997 and 2008) that seeks to encourage wealth creation, foreign inward investment, tight public spending and lower taxes.

This will keep UK monetary policy loose and provide a big green light for overseas investors to choose the UK in general, and UK real estate assets in particular. London is likely to be the main beneficiary of these inward investment flows.

An important point to note is that investors will be able to invest in the London residential property market with a ten year horizon.

We predict the following to unfold over the short and long term:

- | There will be significant inward investment into Prime London residential assets from parts of the world where major geo-political uncertainty prevails
- | UK based banks will be taxed less heavily than feared and will start to increase mortgage lending
- | With the threat of a Mansion Tax lifted, we believe that some sort of 'Commission' will be set up to look into residential taxation - from which we think higher Council Tax bands will emerge
- | No major house-building initiatives in the South East leading to the demand-supply imbalance remaining
- | Lower Gilt yields and Sterling

Implications for the London residential property market can be summarised as follows:

- | An immediate H2 2015 rally in all London real estate residential assets
- | The £2m+ market, especially in Prime, to rise 20% over the next 12 months - and to double within five years
- | Very modest rental rises as wage-inflation stays low and the sales market heats up

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