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Residential Property Group Newsletter 2016

A new year begins and we indulge in our annual ritual of forecasting the 12 months ahead. Predictions are only of use if the forecaster has a good track record of forecasting! So, as usual, we kick off reviewing how our predictions performed last year, before giving our forecasts for 2016.

Assessment of our 2015 predictions:

Our predictions in the past have been fairly good, so what about the predictions we made in January 2015 for the UK property market in 2015:

We are "cautiously optimistic" about the residential property market in 2015. It is difficult to be too excited for there are too many unknowns lurking on the horizon, and we can't help feeling marginally more subdued going into 2015 than we felt going into 2014. Correct

The market has strong, solid foundations, prices have increased slowly over 2014 and we continue to expect prices to rise over 2015 albeit at a slower rate.

As per previous years, we repeat and reiterate that; residential property investment is a long term investment over a 5+ year time horizon. Predictions over 12 months are provided for interest only, rather than any forecast of investment performance.

- **Capital values:** Direction: upwards, Magnitude: 4.5%.
  A national house price increase of 4.5%, or the equivalent of a real house price increase (after inflation of c1%) of 3.5%. Boring, I know, but there would seem too many headwinds to make the market, as a whole, move further up than this. About right, the consensus seems to be a 5% rise across the market.
- **Regional variations in property prices:** As always, the market is highly fragmented. We stick with our views of last year that the South East, East Midlands and East of England will outperform. Areas with strong economic activity and stronger job prospects will outperform and we are big believers in the East of England and Cambridge being the driver for increased activity. Spot on, areas of outperformance correct.
- **Rental growth:** Will be 2%, marginally above inflation, but part of a longer term upward trend. The demand from Generation Rent will continue to grow. Correct, if anything it was a bit stronger at c4%.
- **Transaction levels:** Will decrease marginally from 2014 levels. As house prices rise, wages are not rising proportionately as fast and housing therefore becomes more expensive. Combine this with the effects of a general election, a possible mansion tax and increased uncertainty and liquidity quickly evaporates from the market.(transaction levels in 2014 were 28% below the 25yr average prior to the credit crunch) Correct, still low levels of activity, this partly due to the unforeseen changes to stamp duty
- **Interest rates:** base rates will remain at 0.5% throughout 2015. There is a small chance of a 0.25% rise in the final quarter of 2015. This is a huge unknown, and will likely be affected by whatever form the next Government takes post-election. There will be constant "chatter" in the

press of rate rises throughout the year. Inflation, or deflation, is the factor to watch. Correct, that rates stayed unchanged, and that "chatter" was constant!

- **Mortgage availability**: Will be flat on 2014 levels. The longer term mortgage market has a far stronger base now; lending is prudent and executed on sensible metrics. Whilst affordability and availability is good, the "hoops to jump through" to attain a mortgage will prevent excessive lending. (MMR limits the number of borrowers and the amount they borrow) Broadly correct, we still await final figures for 2015.
- **House builders:** Share prices will fall c20% from their levels in December 2014. This will be driven by a slower market than 2014 and the problems with Government changes, policy changes and planning changes of different political parties. Wrong, we should stick to what we know best! House builders were among some of the strongest stock market performers, led by the Government's huge support of increasing the supply of housing. A favourite election subject!
- **New housing starts:** will be the same as, or small down on the 2014 numbers. However to put this in perspective, there were c112,000 new homes completed in year to March 2014 in England, this is still well below the 170,000 achieved in 2008 and hugely below the 240,000 needed to meet household growth. There was a small increase, again an improving picture courtesy of Government stimulus.
- **Prime Central London:** For the first time in 5 years the market will be subdued and we expect price rises in line with the national average ie. 4.5% over the year. Now a Global city it attracts wealth from around the world, but even the wealthy are concerned about the impact of changes to taxes and especially mansion taxes. Political uncertainty will further subdue the market. Correct that the market would be subdued compared to the past, and a brave call considering the performance over the preceding 5 years, but probably more like a 2% rise rather than 4.5%.
- **A couple of other brave predictions for 2015:** Greece will leave the Euro (wrong!), North Korea will increasingly worry the world (not drastically but the testing of an H-bomb last week added strength to this prediction), oil prices will hit a low of $30 (we should run a hedge fund this was a brave and good call), the Tories will form a majority government in May (again, not at all expected but we called it correctly), our stock pick for the year is NCC Group; a world leader in cyber security (with the increase of hacking scandals this was a good sector call, the stock rose 62%, a strong outperformance!) . Our recommended short is BP (oil price and exposure to Russia). (a 20% fall again outperforming) John F Kennedy to win the Derby (wrong, but gambling is bad for your health and wealth!).
- What we do predict is that predictions will not be as good as in 2014; there are just too many external factors that could come into play to affect the market. Not sure we got this right.
- **The above called the market correctly, as a whole we were possibly slightly cautious but there were a huge number of external factors that came together to create this effect. Importantly we got the direction and magnitude of movement of the wider market broadly correct. That sentiment would be positive and interest rates unchanged. We were also pleased with our predictions on oil, and our share predictions; but think we are best at what we know best; residential investment property!**

Our Recommendations for 2016:

Following a similar format to previous years, please find below our thoughts for the market in 2016.
We are "confidently optimistic" about the residential property market in 2016. Last year we were more cautious, now we are more confident.
Whilst returns may not be huge, it is a good, positive, stable market. We do not want a "run away" situation of boom&bust but a steady increase in capital values and a strong rental return.
There is real wage growth, good economic growth, low unemployment, low interest rates and cheap mortgage debt…….momentum is on the upside.

As per previous years, we repeat and reiterate that; residential property investment is a long term investment over a 5+ year time horizon. Predictions over 12 months are provided for interest only, rather than any forecast of investment performance.

- **Capital values:** Direction: upwards, Magnitude: 5%.
  A national house price increase of 5%, or the equivalent of a real house price increase (after inflation of c1%) of 4%. Similar to last year, and boring I know, but there is nothing wrong with a good steady long term positive return! This the type of market we want.
- **Long term capital appreciation:** As above, we need consider the long term, although this will take 5 years to judge the prediction we believe a 5 year capital return of 23% is easily do-able with a running net rental yield of c4-6% depending on location of property; an attractive blended return of capital appreciation and annual rental yield.
- **Regional variations in property prices:** The market is highly fragmented and it is imperative that residential property is purchased in the right location (location, location) and at the right price. We believe East Midlands and East of England will outperform. Areas with strong economic activity and strong job prospects will outperform and we are big believers in the East of England and Cambridge being the driver for increased activity.
- **Rental growth:** Will be 4%. A small increase on 2015 due to the new buy to let rules coming into play as of April 2016 (3% extra stamp duty) and therefore constrained supply of rental stock in the short term. The demand from Generation Rent will continue to grow and immigration, increased job mobility and a generation of younger workers priced out of home-ownership will all put further upward pressure on rental levels.
- **Transaction levels:** Will be static from 2015 levels (c1.2m versus 1.7m in 2007) though this will depend on the local market. One of the unintended consequences of stamp duty changes/increases will be a reluctance to move. Levels will drop in Prime Central London.
- **Interest rates:** base rates will remain at 0.5% throughout 2016. The longer this prediction remains as is, the higher the risk of getting it wrong; for one day rates will rise, we are sure of that! We would like to mention that if there is any increase in 2016 then it will be a rise of 0.25% in the final quarter of 2016. Low oil prices, low commodity prices and an economic recovery lacking real conviction will keep inflation under control and interest rates flat.
- **Mortgage availability**: Will be flat on 2015 levels. There may be a small uptick in first time buyer loans, but a proportionately larger downtick in buy to let lending. The mortgage market is in a much better condition than it has been for any time in the past 20 years; lending is prudent and executed on sensible metrics. Expect further legislation in the buy to let mortgage sector.
- **House builders:** Share prices will fall c20% from their levels in December 2015. We said this last year, and got it terribly wrong, so don't focus on this prediction too much! Yes they have Government support for more house building but there is only so long this bull market can last.
- **New housing starts:** will be up on 2015 levels. With Government support/stimulus and a low interest rate environment we expect further supply of new housing.
- **Prime Central London:** A small 3% rise for under £2m, a continued drop over £2m. More stamp duty is now paid on purchases over c£950k, add in a further 3% if it is a second home or buy to let, and stamp duty on £2m+ properties becomes very substantial. Furthermore, due to currency changes there will be a drop off in international demand. Clearly is a leading Global city now, in the past 5 years it has attracted considerable wealth from around the world, but this tap is turning off naturally and being further exacerbated by new taxes. As a footnote, we would add that many of the new build apartments sold to international investors are likely to drop in price by c10%.
- **Buy to let sector:** Higher stamp duty and higher taxes are set to plague the sector. However, this will not distract from the long term attractiveness of residential property as an investment. Rents may increase as there is a short term hit to supply.
- **A couple of other brave predictions for 2016:** North Korea will increasingly worry the world, oil prices will hit a low of $30 and remain below $50 for the whole of 2016, our stock picks for the year are Google/Alphabet and Bacanora Minerals, the FTSE will end 2016 lower than it starts 2016, Hilary Clinton will win the presidential election, Britain will vote to stay in the EU.

- **We predict that 2016 predictions will not be as good as 2015 predictions!** We called the market well in 2015 despite not knowing who would govern the UK nor indeed what their economic policies might be. We go into 2016 relatively clear in where we stand, but we are never sure what "unknown unknowns" might be sneaking up on us in 2016, and rest assured there will be plenty!

Given our predictions for 2016 above, residential property will be a steady performer. We aren't looking to shoot the lights out though, this is just the type of market that is ideal for long term residential investment.
More importantly is HOW will property compare RELATIVE to the other asset classes of gold, equities, bonds and commodities?
This is a huge unknown; there are a lot of economic forces at play; the winding down of QE programs, interest rate changes, political elections, volatility, unrest in the Middle East, low oil and commodity prices; even the venerable Warren Buffett's stock fell by 11% in 2015.
Interestingly, I read that the FTSE 100 index is still 10% below where it was on the last day of 1999 during which time the Nationwide house price index is 164% higher.
All we can say is that the historical attractions of "property" remain as strong today as of past years; less volatility, a tangible asset, a real asset with real tenants, an investment that is easily understood, and in an environment of limited supply and increasing demand. According to a recent survey 44% of people thought property was the best investment, pensions came a distant second at 25%.
In an increasingly unstable world, we believe the lower risk returns of residential property will prove attractive to many investors.

Where should one buy?

Whilst we predict national house price increases of 5% over 2016; there are opportunities within the diverse property market that will allow investors to make superior returns.
Please note we always recommend purchasing on a 5 year + investment horizon.

As many of you know, RPG cover the whole UK residential market, but we focus on the **East Midlands and East of England** where we manage c800 units, and also source a number of properties for our retained clients.

For 2016 we are sticking with our recommendations of 2015;
A: Peterborough/Northampton

Why?

- We are massive fans of the economic growth happening in the East of England and in particular Cambridge. Whilst the city of Cambridge itself is relatively expensive, we recommend surrounding cities which will benefit from the improving economy and jobs market in the wider area.
- Strong job prospects and good transport links
- Prices are still below the national average and often at or below £125,000. This is increasingly important given the higher levels of stamp duty; we expect the new announcements on buy to let and stamp duty to drive demand towards the bottom end of the ladder; ie. sub £200,000.
- Prices are only up c3% from their average levels in 2007; some 9 years ago
- These areas benefit from an active first time buyer market, where they can actually afford to buy
- The ripple effect of wealth flows out from London to these areas which are all within a 1hour commute of Prime Central London at a fraction of the price
- The blended returns of superior capital growth potential (5%+) accompanied by an attractive rental yield of c 6-7% make for an attractive total return of 11% +. (we would expect the total return in Prime Central London to be less than 5%). Longer term, we (and other industry professionals) believe a 5 year capital appreciation of c20-25% is achievable.

- Savills forecast a rise of 21% for these areas over the next 5 years; the highest of all areas in the UK.
- The recent changes to treatment of mortgage interest for buy to let investments will mean there is more focus on the higher yielding segments of the market, to ensure a net positive cashflow on a property investment.

B: City of Kingston upon Hull

Why?

- Regeneration; in 2003 Hull was voted the country's no 1 "crap" town in the Crap Town Book, but now voted city of culture for 2017! attractive rental yields; 8%
- Prices are still at low absolute prices; from £40,000 upwards for a two bed terraced house.
- High yields provide a "floor" preventing further downside to prices.
- With these higher yielding properties it is imperative that properties are managed carefully and professionally, many cowboys abound. We are pleased that we have our own property management team based in Hull with a 10 + years track record of property investment expertise.
- The blended return of some capital growth potential (4%+) accompanied by an attractive rental yield of c 7-9% make for an attractive total return of 10% +. (we would expect the total return in Prime Central London to be less than 5%).

RPG Property Finding Service:

We continuously review investment opportunities throughout the UK and we are not geographically constrained. Each opportunity is assessed on a project by project basis on its own merits. As always, due diligence of the unit(s) concerned is imperative.

The areas identified above we particularly like, but most importantly they meet the basic rules of a STABLE RECURRING BLENDED RETURN made up of capital appreciation and rental yield.

Capital values: In these areas are considerably lower than London and the South East. Prices are still near 2007 levels (this is nearly 10years ago now), and have only recently started to move upwards since 2014. There is NO bubble here.

Rental yields: Are typically 6% plus and underpinned by strong underlying tenant demand. These are real yields that net down after running costs to c6%. Yields of half this amount are typically available in London.

It is imperative that you select the right area, the right location, the right development, and the right unit(s) in which to invest. A poor purchasing strategy (or indeed exit strategy) can have drastic effects upon the total return.

It always amazes us that people use stockbrokers to buy shares and use estate agents to sell houses but often do not use property finders to buy investment property. Many investors are not able to do this in depth research, nor are they familiar with the local market. This is why we offer our property finding service.

We have been active in these regions since 2001, we know the local markets, we have the contacts, and we manage properties throughout these regions and we are therefore able to advise and assist our existing as well as new landlords.

It means you are being hand-held in what can be a complex purchase procedure, it means being confident in the decisions you have made to invest, and it means that we do not just source a property then run, but once sourced we will manage the property, and that we hope to forge a long term relationship with all our clients, old and new.

RPG can act as property finder for you the buyer (not an estate agent acting for the seller). We can let and manage the property for you (ensuring a seamless hassle free service), and we aim to considerably increase the chances of you attaining a higher total return for your property investment.

We wish our clients and friends a very prosperous 2016 **The Team at Residential Property Group Limited**