PROPERTY MARKET REVIEW AND PREDICTIONS FOR 2017

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A new year and apologies for the delay in the sending of this annual newsletter. Is it Brexit or is everyone busy and time just seems to be flying by?

As we indulge in our annual ritual of forecasting the 12 months ahead, we are reminded that predictions are only of use if the forecaster has a good track record of forecasting! So, as usual, we're going to kick things off by reviewing how our predictions performed last year, before giving our forecasts for 2017.

Assessment of our 2016 predictions:

Our predictions in the past have been accurate, so what about the predictions we made in January 2016 for the UK property market in 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. **Correct**
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. **Correct**

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. **About right, the consensus performance was probably 6%**
- **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 the location of the property; an attractive, blended return of capital appreciation and annual rental yield. **To be monitored, by 2020 we need 17% more upside, having done 6% in 2016**
- **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 the East Midlands and East of England will outperform other locations. Areas with strong economic activity and

strong job prospects will outperform and we are big believers that the East of England and Cambridge will be the driver for increased activity. **Spot on, East of England and Cambridgeshire lead, the rest follows**

- **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. **Very correct, Savills forecast further 19% rental growth over the next 5 years**
- **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. **Stats from HMRC show 2015 figures at 1.225m and 2016 at 1.231m; so spot on. Correct, re levels dropping in London causing listed estate agency share prices to plummet.**
- **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; 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. **Wrong; but who out there guessed that rates would fall! Brexit was not foreseen!**
- **Mortgage availability**: Will be flat vs. 2015 levels. There may be a small uptake in first time buyer loans, but a proportionately larger downturn in buy to let lending. The mortgage market is in a much better condition than it has been for a long time; lending is prudent and executed on sensible metrics. Expect further legislation in the buy to let mortgage sector. **Broadly correct, await final numbers**
- **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. **Barratt down 26%, Bovis down 18%, taylor Wimpey down 25%; broadly correct!**
- **New housing starts:** Will be up on 2015 levels. With Government support/stimulus and a low interest rate environment we expect further increases in the 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 London 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%. **Correct that lower priced property held firm, whilst higher priced properties fell, principally stamp duty related. Brexit caused the pound to weaken which has led to further strong international demand; no drop off.**

- **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. **Correct, investors still fundamentally understand property investment and its relative safety**
- **A couple of other brave predictions for 2016:** North Korea will increasingly worry the world **wrong or no more than usual,** oil prices will hit a low of \$30 **\$28 so not bad!** and remain below \$50 **\$56** for the whole of 2016, our stock picks for the year are Google/Alphabet **a miserly 2%** and Bacanora Minerals **flat and nothing like as good as last years pick; a 60% increase!** , the FTSE will end 2016 lower than it starts 2016 **Wrong**, Hilary Clinton will win the presidential election **How very wrong!,** Britain will vote to stay in the EU **disastrous prediction!.**
- **We predict that 2016 predictions will not be as good as 2015 predictions! Correct!** 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! **Very correct, and the two big unknown-unknowns were Brexit and Trump's election. I don't mind not predicting those outcomes; who did?**

We are pretty happy with the above, importantly, we seem to understand the UK residential market and predictions on this over the long term seem to have been good (or are we setting ourselves up for a big fall by saying that?!) Importantly we got the direction and magnitude of movement of the wider property market broadly correct.

<u>Our Recommendations for 2017:</u>

(Following a similar format to previous years, please find below our thoughts for the market in 2017.)

We remain <u>"confidently optimistic"</u> about the residential property market in 2017 unless some "shocker" occurs! Whilst returns may not be huge, it is a good, positive, stable market; just the sort of market people want exposure to.

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%.

A national house price increase of 6%, or the equivalent of a real house price increase (after inflation of c2%) of 4%. Like last year, and boring I know, but there is nothing wrong with a good steady long term positive return! This the just what we want.

- **Long term capital appreciation:** As above, although this will take another 4 years to really appreciate the accuracy of our prediction! Last year we forecast a 5-year capital return of 23%, we have done 6% in 2016, this leaves 17% to achieve by the end of 2020. Combine this with a running net rental yield of say 5% in the Midlands; this is 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. Same as in 2016, we believe the East Midlands and East of England will continue to outperform the North East, North West, Wales, and South West. The "East" is economically vibrant and will benefit further due to its proximity to London and the South East.
- **Rental growth:** Will be 4% again. There is constrained supply of rental stock, whilst demand continues to grow. Job mobility and a generation of younger workers priced out of home-ownership puts further pressure on rental levels over the longer term. Our lettings teams rarely have units on the market for long before they are snapped up.
- **Transaction levels:** Will be down a small amount from 2016; expect 1.1 million not 1.231 million or a 10% fall. Tinkering with stamp duty levels does not work; it will not affect the marker per se, but it will affect the revenue streams of estate agents!
- **Interest rates:** base rates are presently at 0.25%. We expect a small rise to 0.5% at the end of the year. The rise will be due to rising levels of inflation caused by sterling weakness. This prediction is becoming more and more difficult, suffice to say interest rates will not rise aggressively.
- **House builders:** after a poor 2016 we think share prices will be flat in 2017.
- **Prime Central London:** A difficult one. We think this will be flat for 2017. Properties under £2m may increase marginally by 2-3%, and Prime Properties above £5m may drop 5%. In between is anyone's guess and probably more dependent on where in London, what type of property, new build or traditional etc. Due to the weak pound, international buyers are still in the market, what will happen to the pound in 2017 we do not know, but London is far more affected by Brexit and sterling than the rest of the UK.
- **Buy to let sector:** Is alive and kicking despite the falling mortgage interest relief (which only affect investors with mortgages, which by the way are less than 50% of investors), and despite the increase in stamp duty for second homes (which can be amortised over 5+years).

- **A couple of other brave (or could they be stupid) predictions for 2017:** North Korea will increasingly worry the world (which we predicted in 2016 but I think Trump could reignite with ease), oil prices will trade between $40 and $70 throughout 2017, our stock picks for the year are long Countrywide plc, short Purplebricks, the FTSE will end 2017 lower than it started the year, Brexit negotiations will be generally positive, sterling will strengthen against the euro hitting E1.25 and pre Brexit levels. One of the world leaders will be assassinated.
- **We predict that 2017 predictions will not be our best!** We called the market well in 2015 despite not knowing who would govern the UK nor indeed what their economic policies might be. Our predictions were not too bad for 2016 considering Brexit and Trump. We think it might be a bit more stable in 2017, one would hope so, but be prepared for the "unknown unknowns".

Given our predictions for 2017 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 relative performance; HOW will property compare RELATIVE to the other asset classes of gold, equities, bonds and commodities?

Time will tell, and past performance is no prediction of the future, but the historical attractions of "property" remain as strong today as ever; lower 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.
No wonder pension investors think property is the best asset class.

In an increasingly unstable world, we believe the lower risk returns of residential property will prove attractive to many investors.

<u>Where should one buy?</u>

Whilst we predict national house price increases of 6% over 2017; 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 c 800 residential units, and where we are active in helping our investor clients source attractive investment properties to buy.

We particularly like this geographical market now.
Why? In a nutshell: strong economic activity, good employment prospects, good transport links, house prices below national average, still rising from a low base (prices are only up c10% from 10 years ago), an active first time buyer market, benefitting from the ripple effect of wealth flowing out

from London, areas which are within a 1hour commute of Prime Central London at a fraction of the price.

Expected Returns:
The blended returns of superior capital growth potential (6%+) accompanied by an attractive rental yield of c 6-7% make for an attractive total return of 12% +. Longer term, we (and other industry professionals) forecast 5-year capital appreciation of c20-25% and rental growth of similar amounts.
This makes the region one of the top forecast areas for capital appreciation in the UK.

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.

It is imperative that you select the right area, the right location, the right development, and the right unit(s) in which to invest in. 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 the in-depth research, nor are they familiar with the local market.

We have been actively finding properties for investors 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 clients 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 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 2017

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