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Residential Property Group: Newsletter 2018

As we indulge in our annual ritual of forecasting the next 12 months, we are reminded that predictions are only of use if we (the forecaster) have 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 2018.

Assessment of our 2017 predictions:

Our predictions in the past have been pretty accurate, so what about the predictions we made in January 2017 for the UK property market in 2017:

We remain "confidently optimistic" 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. Correct!

- **Capital values:** Direction: upwards, Magnitude: 4%. Not bad prediction, but on a national level probably more like 3% but 6%+ for the Midlands would be about right
  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 is 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. Correct, 6% 2016 and think we can say 5% in 2017; so 11% increase after 2 years, leaving 12% for the next 3 years…. Could prove correct yet!
- **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. Correct that East Midlands certainly outperformed London and the South East but the North East and North West markets seemed to perform similarly well.
- **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. Correct.
- **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! Correct, figures as of Nov 2017 (most recent available) show 1.1 million.
- **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. Correct, and pleased to get the timing of this correct!
- **House builders:** after a poor 2016 we think share prices will be flat in 2017. Wrong, housebuilders share prices outperformed the wider market by c30%, the "help to buy scheme", has been the "help the share price scheme"!

- **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. Wrong, the London market was down as a whole with the usual significant variations in locations, price brackets etc.
- **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). Correct, but I am possibly biased!
- **A couple of other brave (or could they be stupid** yes they were!) **predictions for 2017:** North Korea will increasingly worry the world (which we predicted in 2016 but I think Trump could reignite with ease) Quite pleased with that prediction!, oil prices will trade between $40 and $70 throughout 2017 correct, our stock picks for the year are long Countrywide plc, short Purplebricks terrible, worst prediction ever, Coutrywide down c30%, purplebricks up 160%, the FTSE will end 2017 lower than it started the year Wrong; started at 7200 and ended at 7600, Brexit negotiations will be generally positive Wrong!, sterling will strengthen against the euro hitting E1.25 and pre Brexit levels Wrong!. One of the world leaders will be assassinated. Wrong! Oh dear, I think I will stick to what I know best.
- **We predict that 2017 predictions will not be our best!** Some recompense for the above wrongs! 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".

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. With regards stock picks and the London market we were wrong; but we are not stock brokers nor do we have expertise of the London market. Our niche is the Midlands and especially East Midlands and it seems we know and understand our local market.

Our Predictions for 2018:

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.

It is the same story as 2017; we remain "confidently optimistic" about the residential property market in 2018 excepting any extra-ordinary events! Whilst returns may not be huge, it is a good, positive, stable market; just the sort of market people should want exposure to.

- **Capital values:** Direction: upwards, Magnitude: 3%.
  A national house price increase of 3%, or the equivalent of a real house price increase (after inflation of c3%) of 0%. This is down from 2017, and boring I know, but there is nothing wrong with a good steady long term positive return! This is the national figure, there will be large regional differences.
- **Long term capital appreciation:** This will take another 3 years to really appreciate the accuracy of our prediction! In 2016 we forecast a 5-year capital return of 23%, we did 6% in 2016, 5% in 2017, we expect 3% in 2018, leaving 14% to achieve in 2019 and 2020; perhaps a bit punchy but we stick with our prediction; we don't continuously adjust like others! Combine this with a running net rental yield of say 5% in the Midlands, and 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). In 2017 broadly speaking the North outperformed the South. In 2018 this trend will continue, but regions and cities will vary. We believe the East Midlands (we predict 6%) and east of England will certainly outperform London and the South East. Pockets of the North East and North West will perform similarly as strongly. The "East" is economically vibrant and will benefit further due to its proximity to London and the South East.
- **Rental growth:** Will be 3%, or in real terms flat. There is constrained supply of rental stock (becoming more constrained as there is less buy to let activity), whilst demand continues to grow, do they still call it "Generation Rent"?. Job mobility and a generation of younger workers priced out of home-ownership put further pressure on rental levels over the longer term. Speak to our lettings teams and we have very low void periods.

- **Transaction levels:** Will be down a small amount from 2017; expect 1 million not 1.1 million or a c10% fall; a slightly boring stat but it was 1.7m in 2007! Tinkering with stamp duty levels did not help, new buy to let lending and taxation rules do not help, Brexit and uncertainty does not help. This will not affect the market per se, but it does affect the revenue streams of estate agents!
- **Interest rates:** base rates are presently at 0.5%. We expect a small further rise to 0.75% or even 1% by the end of the year. The rise will be due to inflationary pressure and prudent management. Suffice to say interest rates will not rise aggressively; look at the 5 year swap rates or 5 year fixed mortgage rates at 2.5-3%.
- **House builders:** another fantastic year for housebuilders in 2017. After getting this really wrong in 2017, I should perhaps caveat this prediction, share prices for housebuilders will fall c10% in 2018.
- **Prime Central London:** A difficult one. We think this will be small down for 2018, say 4%. Properties under £1m will be more in demand from investors, and from the perspective of a wider buyer base. There will be differences depending on location, type of property, new build or traditional etc. Due to the weak pound, international buyers are still in the market but London is far more affected by Brexit and sterling than the rest of the UK. We do not think there will be massive job losses, and this "pause" in the market is a sensible re-adjustment for a market that badly needs a breather.
- **Buy to let sector:** OK; today as a buy to let investor (compared to 2 years ago) you have a 3% extra stamp duty charge, phased withdrawal of mortgage interest relief, a tougher market to attain a buy to let mortgage, a higher capital gains tax on second homes; George Osborne did what was only correct with hindsight and killed the golden goose. BUT, it is still an extremely attractive asset class, even after these changes. Residential investment property is a real, tangible investment that people understand. A lack of credible, understandable alternative asset classes, an investment that will slowly and surely rise over the longer term. I may sound like a broken record but show me an investment that I would better understand with better justified reasons for growth. And if all goes horribly wrong then I can always live in the place!
- **A couple of other predictions for 2018:** Given poor success on this part in 2017, this prediction is for entertainment purposes only, although we were pleased last year to predict in 2017 that North Korea will increasingly worry the world! Oil prices will trade between $50 and $70 throughout 2018, our stock pick for the year is Bacanora Minerals (130p and first tipped at 70p in Jan 2016), our short is Purplebricks (with a health/wealth warning), the FTSE 100 will end 2018 lower than it started the year, Brexit sentiment will become generally positive, sterling will strengthen against the euro to E1.2. Theresa May will remain Prime Minister. Germany will win the football world cup. And I might as well stick with this wrong 2017 prediction; that one of the world leaders will be assassinated.
- **We predict that 2018 predictions will be OK only!** 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. Our predictions above in 2017 were generally good for property and weak on other subjects! We expect more of the same in 2018! Stick to what we know best is the adage.

Residential Property Investment in 2018:

Given our predictions for 2018 above, residential property will be a steady, stable 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. Past performance is no prediction of the future, but the historical attractions of "residential property" remain as strong today as ever;

- lower volatility than other asset classes
- a tangible asset, a real asset with real tenants, and most importantly an investment that people understand
- a macro environment of limited, constrained supply and increasing demand from both house buyers and tenants
- a low interest rate environment with the ability to attain cheap fixed rate debt
- a relatively stable economy, with some small wage growth

It is no wonder that pension investors think residential property is the best asset class. I think importantly, it is the fact that it is a relatively easy investment to understand. It is credible. If one is fortunate enough to inherit or win the lottery and have £200,000 to spend; what do you do with it? Which market do you understand, what is your risk profile? I think many turn to buy to let residential investment.

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 only 3% in 2018; as mentioned above there will be large regional differences. Please note we always recommend purchasing on a 5 year + investment horizon. As many of you know, we cover the whole UK residential market, but we focus on the **East Midlands and East of England** where we manage c 1000 residential units, and where we are active in helping our investor clients source attractive investment properties to buy.

As in the past couple of years, we particularly like this geographical market at the moment (and yes, we would say so if we thought there were better opportunities elsewhere!).

Why? In a nutshell: relatively strong economic activity, good employment prospects, good transport links, house prices below national average, and still rising from a low base (prices are only up c15% 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 annual return of 12% +. Longer term, we (and other industry professionals with far greater research than us) forecast 5 year capital appreciation of c15-20% combined with rental growth of similar amounts. This makes the **East Midlands** region one of the top forecast areas for capital appreciation in the UK.

How should one buy?

It is all well and good us predicting 6% capital appreciation in the East Midlands, but there will be opportunities for 20%+ returns and no doubt others that will make the equivalent of 20% + losses. There are 4 key components of residential property investment;

A: Buy well: you must get proper advice and use the expertise of someone like us who work in the market 24/7. 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. Residential investment is typically a significant amount of money (hundreds of thousands of pounds) and it is important you spend it with the best possible advice. Yes, there are fees to property finders, but at c1% and amortised over the 5-10 year life of the investment it is a small price to pay for good advice.

B: Manage tightly and control costs: It is imperative that your asset is well looked after. The wrong manager, the wrong tenant, the wrong contractor can all greatly affect the net rental income of the property and thereby the total return on the investment. We manage and let properties in Hull, Leeds, Nottingham, Rutland, Leicestershire, Lincolnshire and Northamptonshire. Furthermore, we have the skills to manage properties throughout the UK and we can gladly recommend others where applicable.

C: Financing: Monitor the performance of the asset over the longer term. Consider leverage and money is cheap at the moment. Build a portfolio of properties if possible to diversify risk. All important considerations.

D: Sell Well: It is important you receive the very best price for the asset you are selling. Not only should you appoint a good agent but you need ensure the property is presented as well as possible. Might it be better to sell the property tenanted, could a redecoration improve returns, could a refurbishment improve returns etc. Through our local branches we offer estate agency services. We differentiate ourselves from other estate agents in many ways (we hope!) but not only in customer service; we have access to a large database of active regular buyers, but also a very large database of active investors who are continuously seeking new units to purchase.

If you can buy well, manage tightly, finance the investment as best possible, and sell well then you will achieve the very best returns; a blended return of capital appreciation and rental yield.

To do all this it is imperative you seek the right advice, and we would be delighted to advise you. A poor purchasing strategy (or indeed exit strategy) can have drastic effects upon the total return.

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. You must choose the right area, the right location, the right development, and the right unit(s) in which to invest in

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.

Our property services include property finding, lettings and management and estate agency. Please see links for further details:

www.osprey-property.co.uk
www.residentialgroup.co.uk

We wish our clients and friends a very prosperous 2018

The Team Residential Property Group Limited