Residential Property Group Ltd, 1b Uppingham Gate, Ayston Road,
Uppingham, Rutland, LE15 9NY
Tel. 01572 824980 **Fax.** 01572 829973

Residential Property Group Newsletter 2012

It is that time of year again, when we assess the predictions we made last year for 2011 and give our predictions and recommendations for 2012.

Assessment of our 2011 predictions:

Our predictions for 2009 were very good, 2010 predictions were OK, so what about the predictions we made in January 2011 for the UK property market in 2011:

- Unemployment will rise, especially in those areas most exposed to public sector cuts, notably the North of England. There will be no driver to push property prices up in these regions. Correct.
- Interest rates will increase to 0.75% from 0.5% by the end of 2011 to counteract inflation. Furthermore interest rates will rise to 3% plus by 2014. Wrong! Base rates remained unchanged at 0.5%, but the libor rate and cost of borrowing has risen, with libor now around 1% Vs 0.5% for base rate.
- "new housing starts" will be even less than in 2010, hitting an all time low. The reason for this being the withdrawal of the "Home Buy Direct" shared equity scheme, and the continued constrained mortgage market. Correct. 106,000 houses were built in England in the 12months to September 2011 — less than half the number needed and down by 37.5% on the pre-recession total.
- Property prices will be flat for the year as measured by the national surveys. There will be large variations throughout different regions of the UK and between different asset types eg. Country home or inner city flats. Correctish, Residential property prices across the UK fell between 1% and 3.5% depending on which survey one uses, broadly similar to the 2010 performance. There were large variations in performance with most notably the performance of Prime Central London.
- Mortgage availability will remain constrained, and despite its relative affordability will mean that there are few buyers, especially first time buyers. Correct. Net mortgage lending will be an estimated £9 billion this year — during the bull market it was that much each month.
- Liquidity and transaction levels will remain low; there is no short term catalyst to cause this to change in 2011. Correct. Transactions for all homes, newly built and old, are running at half their peak level. Savills calculates that 856000 homes will change hands in 2011, 828000 lower than the 10yr average of 1.7m.

All in all these predictions weren't bad, not that they were very exciting but neither was the underlying property market. We probably expected a stronger economy and we did not foresee the Euro-crisis. Otherwise our general "call" of a less exciting, boring residential market was correct.
It has now been over 4 years since the property market crash of 2007 and this period of consolidation does no harm for whilst inflation is strong, the real price of property continues to fall.

Our Predictions for 2012:

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:** National prices will fall circa 2% over the year, or in real terms (after inflation of 3%), a 5% fall. There is just no catalyst for prices to rise (as a whole). Low interest rates are propping up prices to a large extent, there are no drivers for significant house price growth or significant house price falls.
- **Regional variations in property prices:** The market is not homogeneous but made up of fragmented micro markets that each perform differently. There will be large variations throughout different regions of the UK and between different asset types. We expect London, the South East, and East of England to perform best, and the North and North West to be the weakest.
- **Rental growth:** Will continue to be strong. Driven by scarcity of mortgage funds for frustrated first time buyers and an acute shortage of homes to let. Rents are likely to rise by 4% over the year, or 20% over the next 5 years.
- **Transaction levels:** Will remain low, due to the fact that UK GDP growth in the UK next year will be lower than previously hoped and unemployment will be higher.
- **Interest rates:** base rate will remain at 0.5%, libor rate will remain at around 1% but peak at up to 2% on an evaporation of interbank lending in Europe. The low levels of 2011 for 5 year fixed rates which bottomed at circa 3.3%, will not be seen again this year.
- **Mortgage availability**: will continue to remain constrained, and despite its relative affordability will mean that there are few buyers, especially first time buyers.
- **House builders:** We expect a significant amount of their sales will come from the Governments "first buy" initiative (the successor to Labour's "Homebuy Direct"). It will prove to a very important selling tool for the house builders.
- **New housing starts:** will increase marginally on the record lows of 2011. The modest increase will be on the back of the announcements in the November 2011 housing review.
- **Level of repossessions**: Will remain low, as a result of the low interest rate environment.
- **Prime central London:** The strength of our legal system, schools and universities, and the enduring appeal of the cultural and historical capital, means that London will continue to remain attractive for further international buyers. The flight to safety of global capital from other regions of the world facing economic or political upheaval will continue. The Prime central market will remain resilient and appreciate by 5% over the year.
- **Unemployment:** will continue to rise, especially in those areas most exposed to public sector cuts, notably the North of England. We can expect social upheaval and more strikes.
- **Private rental sector:** This sector will become even more important as more people are forced to rent rather than buy homes. The number of people renting in this sector has increased 55% over the past 6 years. In 10years time we expect more people to be renting than owning homes.
- **A couple of other thoughts;** the retail sector will discount hugely in the new year with some outstanding bargains, the Eurozone will break up, and the Olympics will be viewed as a huge success.

Our Recommendations for 2012:

On the surface the predictions above would seem rather negative, and one may query why one wants an asset allocation to residential property. However, what are the alternatives?
Gold; one has arguably missed out on the strongest run.
Equities; are more volatile and can possibly fall dramatically from present levels, especially if the Eurozone situation gets worse.
Government Bonds: yield less than inflation and less than equities.
Cash: returns are negligible, and is ones money actually safe in a bank account?

We would argue that there is a lack of attractive alternative assets and therefore residential property does look attractive in the bigger picture.

Capital values: as a whole, may fall next year, but there will be regional variations, and most importantly there will be "buying opportunities".
We expect certain geographic areas to outperform other areas. It is important to select the right area, the right location, the right development, and the right unit.

Rental yields: vary hugely throughout the UK. We see gross yields of between 12% and 3% depending on the quality of stock and its location. We have always believed that rental yields are exceptionally important and gross rental yields of 8%+, netting down (after running costs) to c6%, remain an attractive income stream.

Rental growth: We expect rental growth to continue for the right stock, and underlying tenant demand will underpin rental levels and lead to a small increase in the rental yield achievable.

The macro view:
Residential property has outperformed commercial property and equities over the long term.
There is a long term imbalance between the demand for, and the supply of housing in the UK.
The constrained mortgage market means fewer buyers, more renters, and therefore more rental demand.

Conclusion:
We have always focussed primarily on rental yield and secondly on capital appreciation. It is rental income that pays a landlord's mortgage or a landlord's income, whilst capital gains are important over the long run.
The ability to purchase stock opportunistically and achieve an 8%+ yield we believe represents a compelling long term investment opportunity compared to many other asset classes.

So WHERE should one buy?

Our focus and expertise is England, excluding London.

It is easy to be distracted by the short term performance of the London property market. However, the areas that experienced the strongest price growth in the "noughties" began the decade with lower than average house prices, which provided the platform for bigger price gains. Average prices in Yorkshire & Humber soared 130% from £55,000 to £128,000, whilst prices in London rose only 80% to £255,000.

Similar to last year, we continue to recommend purchasing on a 5yr investment horizon in the following areas;

Birmingham, Leicester and Peterborough.

Why?

Exposure to areas of stronger economic growth with lower public sector employment.
Exposure to areas where people can afford larger equity/cash deposits that are needed by buyers, ie. higher earning areas.
Absolute Prices are around the national average price level in these areas.
Prices are still some 30 to 50% less than their peak levels in 2007.
There are opportunities to purchase properties at distressed levels.
There is a lack of competition from other professional cash buyers in these areas, in comparison to London.
Rental Yields attainable in these areas are above the national average. A target gross yield of 8% is achievable.
London will have above average capital appreciation over the long term, but the total return from investing in these areas (capital appreciation AND rental yield) will be commensurate with London.

How?

As explained above it is imperative that one buys well.
Property purchases need to be extremely well researched. The wrong unit in the wrong location can result in dramatic capital depreciation.
Property rentals need to be extremely tightly managed. Any loss of rental income or leakage in running costs dramatically affects the net rental yield.

RPG is a property services company.
We act as property finder for you the buyer (not an estate agent for the seller)
We act as property manager for you (ensuring a seamless hassle free service)
By using our services we considerably increase the chances of attaining a higher total return for your property investment.
For those who would prefer indirect exposure to this asset class, through a fund or pooled vehicle, then please contact us.

Conclusion:

Whilst on the surface the market as a whole may seem dull, there are good reasons to buy, and good opportunities to buy, especially on a long term investment horizon.

The lack of attractive alternative assets for investment, makes the investment rationale even more compelling.

We wish our clients and friends a very prosperous 2012
The Team at Residential Property Group Limited