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Residential Property Group Newsletter 2013

It is that time of year again, when we assess the predictions we made last year for 2012 and give our predictions and recommendations for 2013.

Assessment of our 2012 predictions:

Our predictions for 2009 were very good, 2010 predictions were OK, 2011 were fair, so what about the predictions we made in January 2012 for the UK property market in 2012:

- **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. Correct, a remarkably stable market given the poor domestic and overseas economic climate.
- **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. Correct.
- **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. Correct, depending on which benchmark is used we believe it was c3%.
- **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. Correct.
- **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. Correct, but we were overly negative on libor rates they did not approach 2% on the back of Euro woes, and 5 year fixed rates were back down to these low levels.
- **Mortgage availability**: Will continue to remain constrained, and despite its relative affordability will mean that there are few buyers, especially first time buyers. Correct, there was talk but little action.
- **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. Correct.
- **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. Correct, but levels really are modest, remember that back in the 1930's when the population was 2/3rds the size it is now, we built an average of 300,000 homes a year from 1932 to 1939. Last year we built just over 100,000.
- **Level of repossessions**: Will remain low, as a result of the low interest rate environment. Correct.

- **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. Correct that London would outperform, if anything the rise in Prime Central London market was nearer 10%.
- **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. Correct, but overly negative and there was no social upheaval.
- **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 10 years time we expect more people to be renting than owning homes. Correct.
- **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. The retail sector has continued to suffer, the Eurozone did NOT break up, and the Olympics were a huge success. We are property experts, not European Economists, perhaps we should stick to what we know best!

All in all we think these predictions were pretty good. We importantly got the price rise correct, the interest rate levels and the fact that London would outperform the national market.
The predictions weren't the most exciting but neither is the underlying property market. The return to a more solid, stable, less volatile market is no bad thing however.

It has now been over 5 years since the property market crash of 2007 and this period of consolidation does no harm for whilst inflation is relatively strong, the real price of property continues to fall. By the end of September 2012 the average UK house price was still 11% below its peaks level in 2007, equivalent to a fall of 24% in real, inflation adjusted returns.

Our Predictions for 2013:

We cannot help feeling more positive about the residential market. Strangely upbeat, mildly and quietly confident, cautiously optimistic; call it what you will, but there is a glimmer of good news and a belief that the residential property market over 2013 will be a positive experience.

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:** Boringly we stick with the figure we went for last year; that national prices will fall circa 2% over the year, or in real terms (after inflation of 3%), a 5% fall. We expect ongoing inertia with no significant drivers either for house price falls or house price rises at a national level. We expect prices in 2014 to increase moderately.
- **Regional variations in property prices:** As always, the market is highly fragmented. We expect the South East and East of England to outperform, the North to underperform, the north/south divide will thus grow not shrink.
- **Rental growth:** Will be flat. Rents have risen over the past 24months and will plateau this year. Longer term we do believe rents will continue to rise further.

- **Transaction levels:** Will increase marginally from 2012 assisted by the Government funding for lending scheme and the increasing availability of mortgages. However, the average house costs over 5 times the average wage so there will be no dramatic increase.
- **Interest rates:** base rate will remain at 0.5% throughout 2013. Libor rate will remain at around 1%.
- **Mortgage availability**: Will continue to remain constrained, but will improve from 2012 assisted by the funding for lending scheme. Affordability is not the constraint, but the amount of deposit needed by the average buyer to purchase a property.
- **House builders:** Had a good 2012, land bought in the market dip and revision of valuations downwards meant they reported strong profits for the calendar year 2012. We expect this to continue, and they will continue to be able to sell units with the assistance of the Governments "first buy" initiative.
- **New housing starts:** Will be marginally higher than 2012. There is a long term imbalance between the demand for and the supply of housing in the UK and this will remain the case.
- **First time buyers:** The real drivers of the market will increase. There were 216000 first time buyers in 2012; the most since 2007 and up 12% on 2011, expect this to increase further.
- **Level of repossessions**: Will remain low, as a result of the low interest rate environment.
- **Prime central London:** Had another strong year in 2012 driven by the flight of capital to the safe haven of London property. Whilst there is turmoil elsewhere in the world, funds will continue to flow into the London market. The profile of London has been further strengthened on the back of the success of the Olympic Games and the Jubilee celebrations. The Prime central market will remain resilient but not strengthen; we expect a flat market in 2013.
- **Private rental sector:** This sector will continue to grow in importance. By 2020 we expect more people to be renting than owning homes.
- **A couple of other thoughts for 2013: the US economy will strengthen, the Euro woes will continue to be a theme throughout the year and William and Kate will produce a male heir to the throne called George.**

Our Recommendations for 2013:

Given our predictions for 2013 above, it would not seem the residential market is going to be a particularly strong performer. As a "whole" this will be the case, but there are many anomalies and opportunities within the market that will allow investors to make superior returns.

There is also a lack of attractive alternative assets. Whilst the housing market as a whole may be subdued in 2013, as per our predictions, what are investor's views on the equity market, gold or commodities? We believe investors are more cautious now, and a flat housing market with its lower volatility and long term growth potential may seem appealing compared to these other asset classes (remember that residential property has outperformed commercial property and equities over the long term).
As for cash, we have all learnt by now, that holding cash over the long term produces negative real returns.

Where should one buy?

As many of you know, we focus on the whole UK residential market, but we are particularly active in the Midlands and the East of England, and in 2012 and going forward into 2013 we continue to see increasing opportunities to purchase good value stock throughout these markets.

We also highlight the city of Kingston upon Hull, East Yorkshire. A strange choice to some but we have on the ground" expertise here, and with a good, trusted property manager, one can attain attractive rental yields, whilst prices have fallen to levels we believe over the longer term will offer attractive returns.

We recommend purchasing on a 5yr investment horizon in the following areas, Cambridge, Peterborough, Leicester and Kingston-upon-Hull but not exclusively.

Within all areas of the UK there will be attractive opportunities that we will assess. Each will be assessed on a project by project basis, and an attractively priced opportunity in the North East of England may perform just as well over a 5 year period as long as the right property is purchased at the right price. As always, due diligence of the unit(s) concerned is imperative.

Capital values: Are considerably lower in all these areas than in London and have fallen c50% from their 2007 highs. We feel that investors may be wary about investing into the London market, having experienced strong capital appreciation over the past 5 years, we do not think there is a bubble in this market, but the upside is limited, and rental yields are negligible.
In these areas we can purchase units often below the stamp duty threshold of £125,000 and in the Hull market at prices circa £50,000. Therefore, investments can be made with a lower capital investment, and often without mortgage funding. Similarly, the underlying first time buyer market is active as first time buyers are able raise the smaller amounts needed for deposits.
These areas are relatively immune to further price falls; the economies in Peterborough and Leicester are performing well and prices have fallen over the past 5 years, meaning there is relatively limited downside to prices. Whilst Hull is a bit of an anomaly, and the economy is not so strong, this is already reflected in house prices.
London generated equity will flow out in a ripple effect into the East of England and other key commuter locations like Leicester and Peterborough.

Rental yields: In our recommended markets above, yields are typically 6% plus and rents are underpinned by strong underlying tenant demand. We have always believed that rental yields are an exceptionally important part of total return and gross rental yields of 8%+, netting down (after running costs) to c6%, remain an attractive income stream. In Hull we are able to achieve even higher gross rental yields given the relatively low capital values and last year it had one of the highest rental growth rates at 7%. Please note this compares to c3% net yield in London. Yields look attractive at these levels and will put a floor under residential values.

Total returns: There are TWO key parts to the total return from residential property investment; capital appreciation AND rental yield. 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 market in London may (as per our predictions) be flat this year rather than down 2% for the national market, but the total return including the rental yield will actually be better in these target areas.

Buying Opportunities: 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. In the current market, it is the purchasing side of the equation that we particularly focus on. There are opportunities to purchase mispriced properties at levels which are less than market value. These markets are not "hot" (like London) and there is a lack of competition from other professional buyers in these areas. This makes for more opportunities.

How to buy?

It is essential that investors seek expertise when looking to make a residential investment. People use stockbrokers to buy shares, people use estate agents to sell houses, so similarly people should use property finders to buy investment property. We are property finders and act for the buyer.

We have been active in this market since 2001, we know the market, we have the contacts, and we manage 95% of the units that we source for our clients. What does this mean? 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.

Conclusion:

A reminder of why to buy residential property:

There are 1.9m Britons with direct investments in property, and there are very few alternative assets that are genuinely "as safe as houses". Any asset with a net yield of 4%+ and the prospect of longer term capital growth looks compelling and is increasingly popular amongst those saving for their retirement.

The key features of residential investment;

Undersupplied market with strong growth prospects
History of real annual house price growth
High rates of occupancy
Low rates of depreciation versus commercial property
Different returns profiles can match individual investor's requirements for income versus capital growth
A low correlation with UK equities so a great diversifier for an investment portfolio.
Nascent investment from institutional investors into the sector, set to grow strongly over the future.

Whilst on the surface the market as a whole may seem relatively subdued, there are good reasons to buy, and good opportunities to buy, especially on a long term investment horizon. Property must be purchased well, and managed well.

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.

We wish our clients and friends a very prosperous 2013

The Team at Residential Property Group Limited