

Balham Battersea Battersea Park Chelsea Clapham East Putney Fulham Gloucester Road
Hammersmith & Shepherd's Bush Kensington **Notting Hill** Pimlico & Westminster South Kensington Southfields West Putney

The Investor View

Notting Hill
Q2 2015



Douglas
& Gordon

Good to know.

Introduction

Anyone who owns a property in London is a property investor. Our lives and plans often depend on the performance of what is likely to be the largest asset we own. So perhaps it will be helpful to take more of an investor's view of the market.

To produce this report we worked closely with D&G Asset Management, a company we co-founded in 2005. They deploy money into London residential property all the time, so they are constantly analysing different areas and the assets within those areas, seeking to maximise returns.

As well as publicly available sources, we have used the proprietary data that we have been capturing since 1996 to help us make decisions and provide advice and guidance to our clients.

D&GAM has helped us focus on the data that counts and we think the results make fascinating reading.

If you would like to learn more about the Notting Hill area, please contact our office on Westbourne Grove. Contact details for this office can be found on the back page.

Property Values

In Q1 2015, the Notting Hill sales market was our best performing Prime area.

Q1 2015 performance

In the first quarter of 2015 Notting Hill produced the best capital returns of all our Prime offices. The flats market rose by 2.4% and smaller houses were firm. In Q1 2015 the main theme across D&G Land, however, was a divergence of performance between Douglas & Gordon Prime offices, where prices have been on average slightly weaker (-0.37%), and our Emerging Prime offices where prices have been marginally stronger (+1.1%).

Q1 2015 – A market divided by price

In our Q1 Investor View, we argued that the change to the stamp duty regime in December's autumn statement (which reduced the tax burden on properties valued below £937,500) was a political green light for this segment of the London property market.

Although there is not a lot of stock in Notting Hill valued below this level, our data shows that this was the hottest part of the market.

The most interesting movement in Q1 has been that buyers have come back to the market for properties around the £2m mark – a clear vote of confidence that any proposed mansion tax threat would not have created a “ceiling” on values going forward.

Economic headwinds remained focused on the larger house market. The higher the price, the stronger the force. This was caused by a lack of visibility of proposed taxation of bands over £3m and the fear that the “progressive” nature of the mansion tax would have led to large incremental rises above the £5m mark.

Looking forward – post the election

The election result has lifted the threat of a mansion tax, removing any ceiling on property prices over £2m.

Many investors/buyers have taken their eye off events unfolding across the globe.

Notting Hill Nominal Property Values

	Q1 2015	Q4 2014	Since Q1 2009
1 Bed Flats	1.63%	0.00%	97.29%
2 Bed Flats	3.25%	0.00%	83.33%
3 Bed Houses	2.99%	-3.60%	84.74%
4 Bed Houses	0.00%	0.00%	92.62%

Source: D&G proprietary data

Q1 2015 marked the 5th anniversary of interest rates remaining at 0.5%; and with inflation registering zero for the last two months – we continue to argue that monetary policy will remain accommodative for the foreseeable future.

Another consequence of all the election “chat” over the last six months has been that many buyers have taken their eye off events unfolding across the globe. The Greek debt saga remains unresolved, China is slowing, and there is rising geopolitical uncertainty caused, amongst other things, by the low oil price.

History would indicate that these events, alongside low interest rates, will provide a better long-term benchmark/proxy for the future direction of London property prices.

We expect a “market-driven” rally for properties in H2 2015.

How an investor looks at the market

Residential property investors use two key measures: the capital value of the property and its net rental yield.

You can make money from an increase in capital value and earn additional income by renting out a property you own. The net yield is the annual rent, less expenses, divided by the property's capital value.

Both are important and are influenced by many factors including: supply of new properties,

infrastructure projects, demographics of the area, the economy (in particular, interest and tax rates) and the wider geopolitical picture.

The interplay of these factors is what determines investment returns and what makes property investment decisions so interesting. We hope this report provides some help as you assess your options.

For the second consecutive quarter, rental values in Notting Hill were subdued.

Rental Growth & Yield

In Q1 2015, average rental values across D&G Land rose by 1%. This figure masks a contrasting market; in our Emerging Prime offices rental values grew on average by 1.9%, but rental values in our Prime offices declined by 1.6%.

Against this background average rental values in Notting Hill declined by 2.9%. This was the second quarter in a row that Notting Hill has had the greatest decline in rental values in D&G Land.

What happened in Q1 2015

The major theme across our Prime offices in recent years has been that rents have become more volatile. They have failed to show any meaningful underlying increases over the last 5 years. Investors should note that inflation has increased by 17% over the same period.

There are two stand out reasons for this. First, there is a post financial crisis trend whereby corporate backed renters increasingly wanting to live in areas of the capital outside prime, where rental values are cheaper.

Secondly, recent analysis of our database has shown that our emerging prime areas are also gaining popularity with overseas tenants. In Q4

2013, overseas tenants accounted for 33% of all Douglas & Gordon's emerging prime tenants. The latest figures for Q1 2015 show that the number has increased to 39%.

Although rental values in prime still command a premium, landlords in Notting Hill should take note of this trend and maintain their properties to a high standard in order to achieve these values.

Landlords need to maintain their properties to a high standard in order to achieve premium prices.

Outlook

In Notting Hill we are moving into the busiest time of the year when our applicant levels pick up.

We advised investors at the start of the year to expect modest rental growth in 2015. In light of the poor Q1 performance there is room for small rental increases going forward.

Notting Hill Nominal Rental Growth

	Q1 2015	Q4 2014	Since Q1 2010
1 Bed Flats	0.00% →	-5.00% ↘	5.56% ↗
2 Bed Flats	-3.36% ↘	-8.46% ↘	4.55% ↗
3 Bed Houses	-5.00% ↘	-9.09% ↘	-5.00% ↘
4 Bed Houses	-3.33% ↘	-9.09% ↘	-17.14% ↘

Source: D&G proprietary data

Current Rental Gross Yields May 2015

1 Bed Flats	2.50% - 3.70%
2 Bed Flats	2.10% - 3.50%
3 Bed Houses	2.20% - 3.20%
4 Bed Houses	2.20% - 3.20%
10 Yr UK Gilt Yield	1.90%
FTSE All Sh Yield	3.20%
UK Base Rate	0.50%

Source: D&G Proprietary data

The General Election result is a very bullish outcome for London real estate markets at all price levels.

**In the short term -
A 5 year surge in capital values**

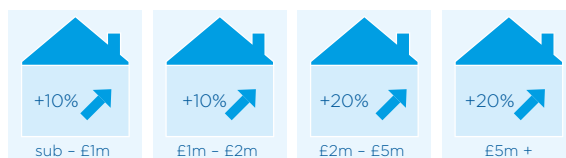
The election result will restore overseas investor confidence in the UK, and UK real estate assets, leading to a surge in capital values over the next five years.

This result, particularly the UKIP share of the vote, will help David Cameron in his negotiations with the EU over reform before a 2017 referendum. Importantly, we do not expect the prospect of an EU referendum to be a major dampener on asset values.

Following a 12 month period where policy-risk has subdued residential assets above £2m, we expect this part of the market to rally by up to 20% in the short term (next 12 months).

Over the next five years we think that capital values in the Prime London residential markets could as much as double.

D&G Land 12 month capital value forecasts



**In the long term -
The 10 year residential property
window is now open**

Crucially we believe that this result is also very bullish for the London residential property market in the medium and long term (the next 10 years).

This election result will force the Labour Party to confront existential questions about its future. Any likely federal settlement that is offered to Scotland and Wales by David Cameron will also force the Labour Party to work to attract English votes. As a result, we think it will have to re-position as a more 'New Labour', pro-market party.

We anticipate that there is likely to be a ten year cross-party consensus (as there was between 1997 and 2008) that seeks to encourage wealth creation, foreign inward investment, tight public spending and lower taxes.

This will keep UK monetary policy loose and provide a big green light for overseas investors to choose the UK in general, and UK real estate assets in particular. London is likely to be the main beneficiary of these inward investment flows.

An important point to note is that investors will be able to invest in the London residential property market with a ten year horizon.

We predict the following to unfold over the short and long term:

- | There will be significant inward investment into Prime London residential assets from parts of the world where major geo-political uncertainty prevails
- | UK based banks will be taxed less heavily than feared and will start to increase mortgage lending
- | With the threat of a Mansion Tax lifted, we believe that some sort of 'Commission' will be set up to look into residential taxation - from which we think higher Council Tax bands will emerge
- | No major house-building initiatives in the South East leading to the demand-supply imbalance remaining
- | Lower Gilt yields and Sterling

Implications for the London residential property market can be summarised as follows:

- | An immediate H2 2015 rally in all London real estate residential assets
- | The £2m+ market, especially in Prime, to rise 20% over the next 12 months - and to double within five years
- | Very modest rental rises as wage-inflation stays low and the sales market heats up

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