Article

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Jeremy Leach – Managing Director
Managing Partners Limited

UK Property Market

During times of global recession there is one asset class that remains the most invasive and emotive for the British Investor – property.

The reason for this for this really is quite obvious; an enormous percentage of the British population own their own homes, which are typically the largest investment they will ever make and the fortunes of the United Kingdom property market will determine the wealth of the nation and any change to its value can have a deeply profound impact on the sentiment of each and every home owner.

Unlike many asset classes however, there is general acceptance that even when property prices are going down, it is only a matter of time before the market returns value as all home owners harbour a desire for property market to rise and therefore when a recessionary trend comes to an end, the emergence of the property market can happen with considerable impact.

The property market in the United Kingdom also has a natural floor because whilst demand for property starts to slow down during a housing recession, it never stops completely because there is always a demand for property. This is a particularly significant factor for the housing market in the South East of England where there has been a continued shortage of domestic housing since the Second World War.

Continued economic development and increasing density of population due to economic migration have continued to hamper the government's plans to maintain pace by providing sufficient housing to satisfy demand in the South East, which has been a constant battle against ecology because of the limitation of suitable land sites for development. This challenge, even in today's market is well behind housing demand and the irony is that the current housing recession is likely to increase the size of the problem as the larger house builders are simply not in a position embark on new development projects because of the weakness of their own balance sheets and the lack of liquidity in the market place.

In contrast to the South East there are other areas of the United Kingdom, where populations are declining because of the lack of local employment opportunities and the outlook in these areas is going to look quite bleak for some time to come. In order to understand the reasoning behind this statement we firstly need to understand and identify why property prices in less affluent parts of the United Kingdom started to rise so dramatically in the first place and without going into deep economic theories the simple answer is that the broader housing market is and has always been heavily influenced by London and the South East.

Quite some time ago we reached a point where property prices in the South East had reached a level where rental yields became extraordinarily low and property investors could no longer justify committing capital to the region because they had no longer had the ability to service the interest payment on any debt element, nor the inclination to invest in an asset that had a very low investment return. In simple terms, house prices become too toppy!

As a result of this phenomenon and continued appetite for property investment, the window of opportunity broadened and areas of the North of England were analysed with a great deal more scrutiny to find better value. Properties in places such as Hull, Leeds and Bradford to name a few, were tested by property speculators where Victorian houses could be purchased at one time for as little as £25,000 and generate significant rental returns.

As always however, the upside potential for such properties is more limited and the cost of maintenance is significantly higher as the price of a new window for example remains the same irrespective of whether a house is worth £25,000 or £250,000. Never the less we have seen a staggering rise in house prices in parts of the north of England, Scotland and Northern Ireland that are well beyond the reach of wealthy cities and have defied all economic growth expectations.

What we can learn from this, is that in a market of decline there will clearly be certain parts of the United Kingdom where property prices will be hit harder and will suffer for a lot longer than others because prices simply got way too high and the local housing demand is too low to restore investor confidence in the short term.

During 2008 we have seen a steady decline in the value of property prices and the 20% correction that I predicted earlier in the year does not appear to be too far off the mark. Clearly some areas such as inner London have remained robust whilst areas of the North East will have experienced exaggerated losses as property values continue to gravitate back to realistic levels.

Whilst the market is presently enduring a well overdue correction in value, the core fundamentals of property investment have not changed and the secret to achieving the best long term success with the property market is to identify where the best value lies.

So who is taking advantage of the property market today, where are they investing their money, what property represents the best value for the future and how can investors benefit?

A new wave of property investors are now starting to emerge as pockets of the United Kingdom now represent good value money these areas are typically those that in areas of economic development, have density of population, a shortage of available housing and equally have the opportunity to deliver a magical balance of long term capital growth in property values, coupled by high rental yields.

The types of property that are least affected by housing slumps tend to be bungalows because typically they are purchased by more elderly people who are less affected by housing trends and are not inclined to consider a house move in the short term. They do not therefore represent marvellous value in the current climate because their values have remained more robust. Equally, new build properties are notoriously overpriced and in the case of apartments the management fees are often extremely high making them equally less attractive unless purchased at particularly keen prices.

So the sweet spot in the current housing market is the older, Victorian two or three bed roomed house in a reasonable urban position, based in an area of the South East offering a healthy rental yield and reasonable upside potential for value. One shining example of premium property value can be seen in the Portsmouth area where there is a significant availability of this style of housing at what has to be argued to be excellent value.

Firstly, Portsmouth is well inside the golden catchment of the South East, it is within commutable distance to London and is the most densely populated city in the United Kingdom outside London. Unlike other areas of the South East, property prices have been relatively stable in Portsmouth and whilst they got fairly dizzy eighteen months ago, the market has already gone through a correction phase and property is now available with rental yields of up to 10% per annum being a strong indicator that property now represents excellent value in the area and whilst it is possible for a further correction to occur, it is unlikely to go much further as value, in the long term, is largely supported by the income potential of an asset and 10% is extraordinarily high.

As usual, the best time to invest in property is when sentiment is at its lowest ebb and few would argue against the statement that we are in that position right now. Many of those that are old enough to recall previous housing recessions would freely admit that had they been brave enough or had the capital to invest in property then, they would have been wealthier today as a result and the same principles are manifesting yet again.

Sadly, for many the dilemma is not a lack of inclination to invest in property but limited resources to do so. Banks are typically hawkish about lending money at present and the cost of borrowing is prohibitive and difficult to obtain and because we are in the midst of an economic recession then many inventors have less liquidity also.

For those that wish to participate in the emerging property market and do not have the resources or inclination to embark on building their own property portfolio there are still very some attractive property funds. Regrettably however, most of the larger property funds will have trouble for some time as they will continue to suffer from the impact of having built large portfolios of property at or before the peak of the market. Many are now equally compromised as their liquidity is being squeezed by a flow of redemptions as investors wish to reduce their exposure.

The area of the market to watch most carefully therefore is the newer vulture-style property funds from boutique investment houses that have emerged during 2008. They will have no legacy portfolio to battle with and no liquidity constraints. Their goal will be a straight forward one; to acquire property in key areas of the United Kingdom where best value can be achieved and to continue to buy through the curve into late

2009 when the property market is expected to stabilise. Until then the newer funds, if well managed will be able to deliver superior income yields from property rental and at the point when the market stabilises they will have an enviable portfolio of property that will start to escalate in value at a significant pace.

As always, the message with property is not to leave it too late to capitalise on the trend. Property always has and always will be a core asset class for the sterling investor and the key is not whether to invest in property it is more a case of identifying the best way to do it.