

# Inside Access

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# Reasons for Optimism in a Flat Market



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Disruption in the UK economy continues to deflate consumer and business confidence. Renewed Eurozone sovereign debt issues and weak US economic figures have now been compounded by new challenges on the domestic front, not least by the August riots, a 15 percent average drop in global equity markets and very weak growth indicators. There is now a real possibility of another period of economic contraction not just in the UK but across our key trading partners.

Despite this greying backdrop, Hamptons International transaction levels held up well over the summer months. We have seen continued growth in demand, with the volume of exchanges up four percent between August and September. Applicant numbers

are now up marginally on the previous year and by 50 percent over August 2008 levels.

Overseas investment demand had a knee-jerk response to the drop in equity markets and the August riots, which were portrayed very negatively across global media outlets. The impact was therefore short-lived. The transaction fall-through rate increased marginally over historic norms and while the business saw a shortfall in revenue terms, there has been an immediate return to trend activity levels. We will be closely monitoring autumn figures, but do not anticipate any lasting impact on the housing market from these events.

Against this largely uncertain backdrop, development activity and land transactions were steady over the summer months across the South of England. However, the resilience of London and its fundamentals as an investment location have not been altered; for many, investment in London property is akin to gold as a safe haven in this period of uncertainty.

# Getting it Right in a Changing Market



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We are undoubtedly not out of the woods yet. House sales volumes remain severely below peak levels. However, for good quality development stock, there is still a healthy market.

With the valuation process now proving to be a great leveller, we are still in a halcyon period whereby new development product is being sold at reduced premiums compared with the height of the market. In some areas, new stock can be purchased for values at or near parity with the second hand market.

The key to successfully selling in the current market is to know your audience, providing not merely a succession of flashy extras but recognising what will genuinely appeal to the target market in question.

At the top end of the market it is widely known that lateral living, premium specifications and luxury add ons are a must, coupled with a high level of services and amenities. Internal space planning is also a key success factor; premium specifications will not make up for a lack of attention in this area.

However, at the entry level of the market it is not quite so straightforward. Whilst specification and service are universally important across all sectors of the market, at lower price points the focus should be on practical solutions rather than optional extras. This is especially true at the first time buyer end of the market, where practical financial assistance will be far more of a sales driver than free specification extras.

No matter what end of the market we are working on, one essential element is future proofing. As development consultants, we often find ourselves advising on development specifications far in advance of practical completions. As such, a specification that is *de rigueur* today may well be old hat in two years time. Innovation does not necessarily need to be limited to the apartments themselves. Moreover, an effective use of amenity and communal areas can be a huge driver of values and saleability if done correctly.

In a market where appraisal margins are getting ever tighter, innovation does not need to be expensive. Whilst the market is providing little assistance, forward thinking and intelligent design will make a significant difference.



# Residential Investment Grows



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The London residential investment market has seen a significant amount of activity in the last quarter.

London and Stamford, a UK-REIT, have been hitting the headlines with two new forward purchases totalling £73.5 million. The company is capitalising on rising residential rents as first time buyers are prevented from entering the market due to higher mortgage deposits than before the recession. The new purchases are in addition to blocks already purchased in Battersea and Highbury. The aim is to build a portfolio of £300 million in residential property.

Elsewhere in London, Delancey and Qatari Diar have bought the balance of the units in the Athletes Village in Stratford. Nearly all of the 1,439 residences have been earmarked as rental accommodation, creating the first UK private sector residential fund of over 1,000 homes to be owned and directly managed as an investment.

Equity funds such as Area Property Partners are increasingly acquisitive. Having placed upwards of £100 million on the balance sheet of Central London developer Mount Anvil, they have (via their Jupiter investment vehicle) taken control of high end developer Minerva who currently are selling The Lancasters, overlooking Hyde Park.

Residential is an increasingly attractive asset class to professional investors and institutions and will soon be considered a mainstream asset class alongside commercial investment stock. Hamptons International's investment team have experienced the pick up in the market with over £100 million off-plan stock under offer to private investors in the last quarter alone, with more new investor clients knocking on our door.

Housebuilders are bridging the gap between affordable housing products and mainstream private residential by using the Government's Firstbuy schemes for instance. First time buyers have the opportunity to take an interest free loan on 20 percent of the property value, which could mean in some instances, the property is more affordable than shared ownership products as there is no rent on the un-owned equity.

Hamptons' own Nanofunds vehicle is going from strength to strength with investors seeing the benefits of a fund which buys land with a planning consent and with risks (e.g. construction) managed out by a dedicated development manager.

And finally, government initiatives like PRSI should only encourage the investment market to grow further, although this may be limited to the more secure markets such as Central London.





# Is VPV Always Greater than MV?



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**H**ave long-term low prevailing interest rates facilitated a shift in the way that residential investment portfolios are valued by investors?

In the Sixth Edition of ‘Valuation: Principles into Practice’ the view of Eric Shapiro is that “the maximum value which can be placed on a property let on an assured shorthold tenancy should be 90 percent to 95 percent of its vacant possession value”. However it goes on to say that “If it is the buyer’s intention to continue letting the property, 100 percent of the VP value will be achievable”. Residential investment portfolios are evidently being bought for continued letting so why do valuers, myself included, feel it appropriate to apply a discount from aggregate vacant possession value?

Where a managed portfolio of say 14 units in a five year old block let to professional covenants is sold, at the current time an investor might not consider paying 100 percent of aggregate MV a bad deal. After all, there will be no initial void periods and given the low prevailing interest rates and potential for capital growth, on the surface it appears like a reasonable investment.

We recently valued such a portfolio in a decent London location (Zone 2). The gross rental income showed a yield across the portfolio of 4.8 percent against the aggregate Market Value of the units, which even if you allow a gross to net of 25 percent gives a net yield of 3.6 percent. This return is better than one would currently find in all but the most high interest savings account and also gives the possibility of capital growth. To discount the aggregate Market Value of the units by, say, 10 percent to allow for the ongoing tenancies and bulk nature of the purchase gives a gross yield on the passing rent of over five percent. If an investor is willing to purchase the 14 units at a gross yield of below 4.8 percent, why does the capital value not rise commensurately?

Unlike commercial property, standard residential property is not normally valued on a yield basis. However, in the US residential investment portfolios are regularly traded and valued for purchase on a yield basis. After all, it is simply an investment medium that provides for ease of comparison against other investment opportunities. If investors look at residential property in this way, there is no reason why the valuation approach can’t be adjusted accordingly.

# The Straight Facts in the Development Land Debate



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**H**ousing development naysayers use phrases like ‘Concreting the Countryside’ and ‘Developing the Green Belt’ to galvanize support against development. In reality, less than eight percent of England is classified as developed land. Further, between 2005-2009 the average greenfield land take for residential property in England was 1,218 hectares, equating to 0.01 percent of all land.

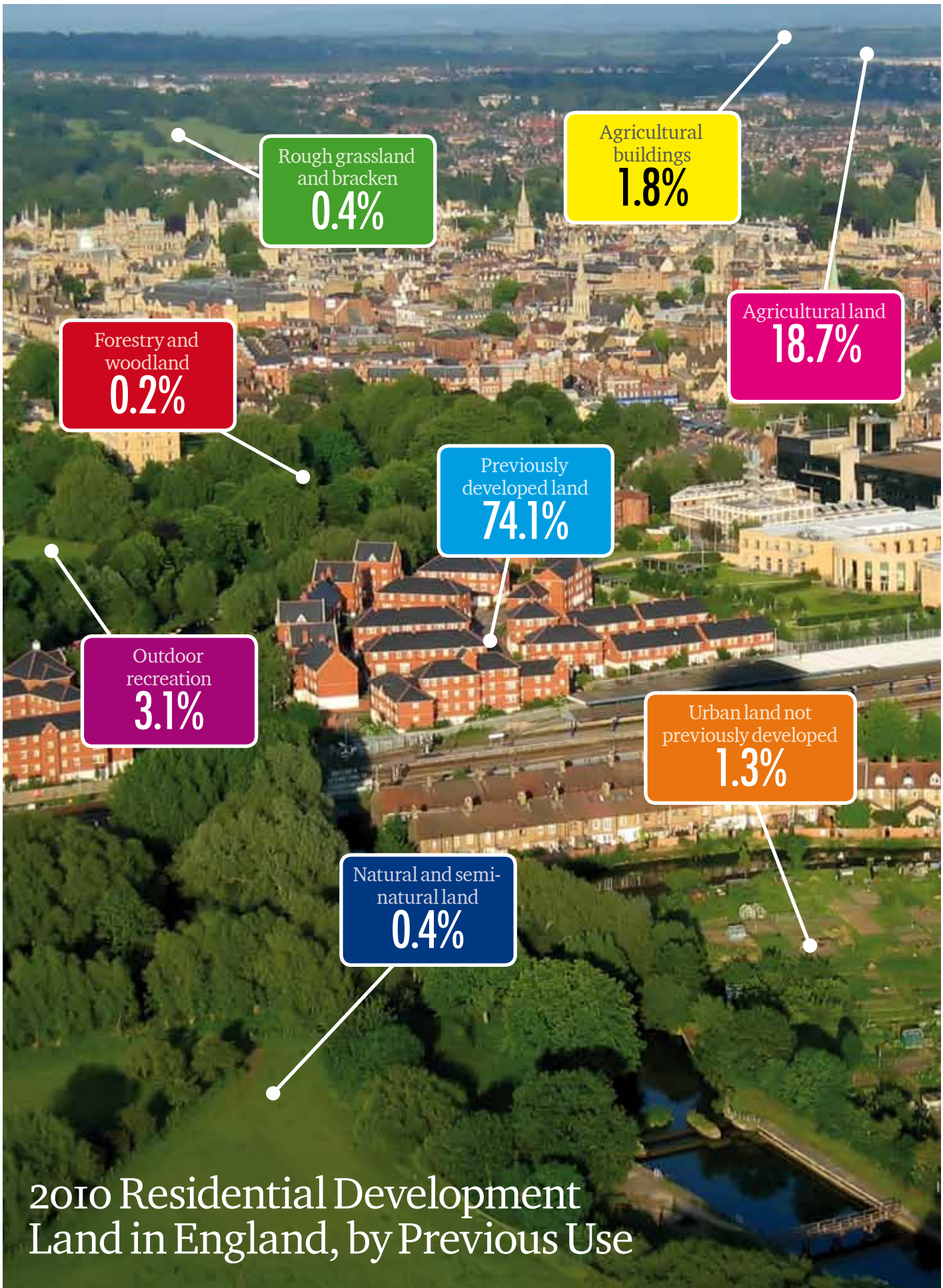
Last year 32,000 units of new housing were built on greenfield land in England, 26 percent of the current provision and the vast majority of which is on agricultural land. Contrary to much of the public debate on this subject, a tiny fraction of greenfield development is comprised of land in what would be described as being in a natural state. This equates to around 36 hectares of land per annum. In short, greenfield development is an important part of the development land

mix, but falls well short of the volumes being suggested in the current public debate.

The renewed flashpoint in the debate about where development should occur surrounds an overriding principle within the recently published National Planning Policy Framework (NPPF). It encourages a presumption in favour of development where the principles of sustainable development have been upheld. This is being wrongly interpreted by some as an endorsement of unchecked development.

This new document retains the essence of the existing planning system, but simplifies what previously became a very prescriptive and unwieldy set of documents. The important point here is that the guidelines and thrust of the existing planning system have been broadly retained, but interpretation of which developments are appropriate is for local people to decide.

The debate needs to move on from the old, entrenched perspectives if we are going to reach an outcome that has a chance of delivering the volume of new housing this country desperately needs.



## 2010 Residential Development Land in England, by Previous Use

Source: National Statistics, 2010 estimate

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