EnterpriseUK
The Financial Ecosystem

INVESTING INTO Residential Property

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I. OVERVIEW OF UK RESIDENTIAL PROPERTY AS AN ASSET CLASS

Real House Prices and Affordability of Property in the UK Supply and Demand Metrics

Investments into real estate can offer partial protection against inflation, strong and stable income streams and diversification to an investment portfolio. The UK property market has risen strongly over the past 20 years. Land Registry figures for England and Wales show that house prices tripled in the 20 years between 1995 and 2015. Growth was almost continuous during the period, save for a two- year period of decline around 2008 as a result of the banking crisis.

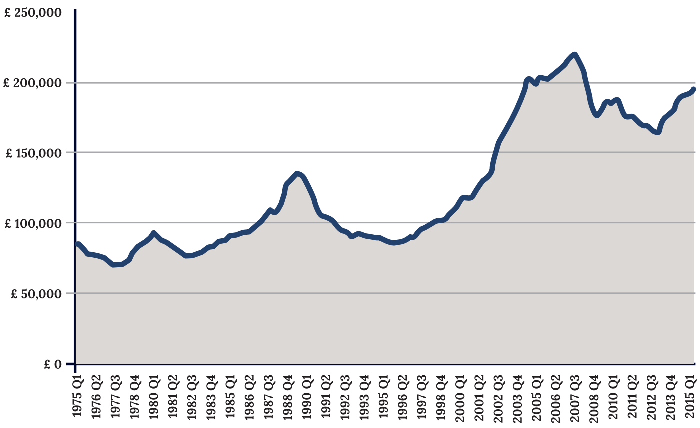

Chart 1. Real house prices in the UK in the last 40 years (adjusted for RPI inflation)

Source: Nationwide, O2

However, the affordability of property had deteriorated sharply over this period (measured by mortgage payments as a percentage of take home pay). Even in the most affordable regions of England and Wales buyers now have to spend around six times their income, whilst in hotspots such as London the average property now costs around 12 times income levels. In 1995 homebuyers would on average have only had to spend between 3.2 times and 4.4 times their salary on a house, depending on where they lived.

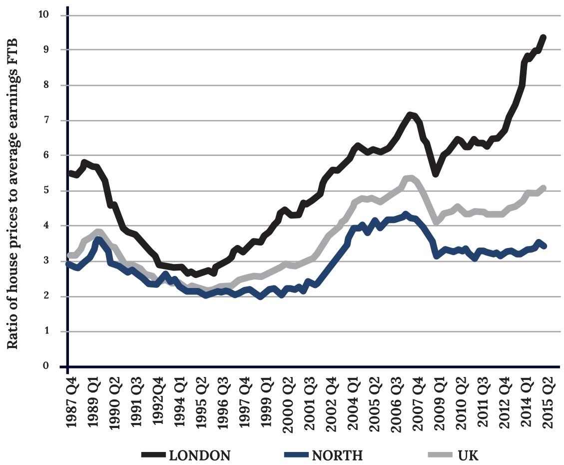

Chart 2. House prices to Average Earnings (FTB)

Source: Nationwide, O2

As a result of this, the accessibility to property, either as a prime residence or as an investment vehicle, has changed dramatically. In 1991, more 25-to-34-year-olds owned a house than not. Less than 25 years later, the rate of home ownership in this age group has fallen to 35.8% - as houses become more expensive, would-be buyers have to wait longer to save up the money required for a deposit on a property.

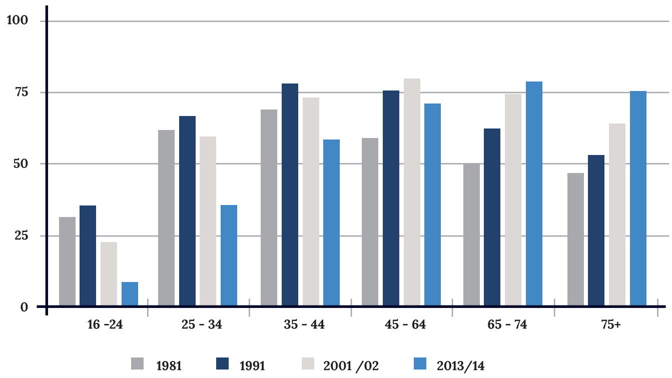

Chart 3. Percentage of each age group that are homeowners in England, 1981 - 2014
Source: English Housing Survey

Conversely, home ownership has been rising steadily among those aged 65 or more. In 1981, half of the 65-74 age groups were home owners. By 2013/14 that figure was 78.6%. The average age of first time buyers has now risen to 30 in the UK and 32 in London.

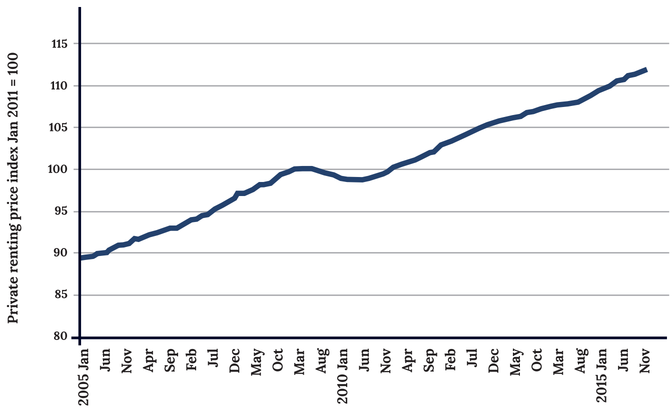

Chart 4. Renting Index - England
Source: English ONS

Supply and Demand Metrics

Demand for property has started to heavily outstrip supply. A decline in local authority building has led to a rise in the number of people forced to rent using the private sector. More than 20% of people aged between 36 and 40 lived in private rented accommodation in 2014, compared with 12.6% in 2008. While in 1986, 27% of people in the UK lived in a council home, that figure had tumbled to 9% by 2014.

Effects of Brexit

Unless there is a sharp decline in UK property values, the plight of younger people and their inability to get on to the property ladder is unlikely to change. Real wages in the UK have fallen 10.4% in the years following the financial crisis, a decline matched in the advanced Western economies only by Greece. The days of 120% mortgages being available have long since gone, and in the time it takes for a young person to now save enough for a deposit, prices have often risen so significantly that they are out of reach. However, the amount that renters can afford to pay as a percentage of their disposable income is already alarmingly high so any further increases in UK property values will result in a reduction in yield for landlords and this seems likely to temper any further sharp valuation increases.

The ten months following Brexit have significantly impacted property prices. The strong fall in the value of the pound has made it much more attractive for overseas investors to buy into UK property. However, there is nervousness amongst them about what the future will hold for the UK, once article 50 is triggered.

Property prices in the UK capital fell for a fifth month in August, the worst streak since 2009, amid concern that the referendum result will hurt the economy. Demand from landlords has fallen after the stamp duty tax for investors was increased by 3% this year. The pipeline of sales in London at the end of the third quarter was 26% lower than a year earlier. Landlord demand has fallen 60% in the UK capital year-on-year, according to data compiled by some property brokers.

It is illogical to assume that UK house prices can continue on a never ending upward spiral – wage growth simply cannot support maintaining existing yields – and our conclusion is that the UK housing market seems “toppy”. Clearly even getting access to the market is becoming ever more difficult and UK property is now largely a domain exclusively for the older generation. Given that organisations such as Credit Suisse have suggested that a balanced investment portfolio should hold 5-30% “hard assets” such as property, should we be looking further afield for more affordable alternatives which offer better value for money and significantly higher capital growth potential?

II. OUTLOOK OF THE OVERSEAS PROPERTY MARKET

More than Just a Holiday Home?

Many affluent Brits now own a second home overseas. These typically are holiday apartments close to their favourite beach in places like Spain and Portugal, or rural retreats, often bought as long term development projects, in places like France and Italy. There are seemingly some amazing bargains to be found, whether it be distressed holiday apartments or rustic stone houses which have fallen into disrepair. Whilst these types of properties can, on the face of it - and certainly relative to UK prices - seem amazingly cheap to purchase, are they really a good medium to long term investment?

The main issue with buying one of these properties in mainland Europe is that there are not the same drivers (demand) in place as we find here in the UK. In France for example it is possible to buy a stone house with land for as little as €50,000, but once the necessary and time consuming repairs have been completed the price can easily rise to several hundred thousand Euros. In many cases the resale value of these properties is then much lower than the finished costs because the only people wanting to buy these type of properties are often overseas buyers. Properties are hugely over-priced even though they may seem “cheap” compared to a like-for-like property in the UK.

Is there even a strong domestic market to quickly sell one of these properties? We suggest not - unless it is “priced to sell”! The younger generation seem to be seeking properties with much cheaper running costs – they are not interested in stone houses which are expensive to heat, hence the increase in “pavilion” style houses being built. There is also much more supply than demand for the old rustic properties due to the large number of expats, who bought their dream homes over the past 20 years, now needing to return to live in the UK. Older Brits living off their pensions in places like France are suffering, not least because the pensions are often index linked and they have seen a significant reduction in their monthly disposable (€) income post Brexit.

Trends have also changed and often their siblings do not share the idyllic dream of spending a large part of their holidays in a remote French or Italian village. It can often take years to sell a property at the full asking price and the market is extremely distressed. It is not uncommon to see houses listed for sale at €200,000 which subsequently have to be sold at a quarter of this if the owner is desperate to return to the UK.

Overview of EU Residential Property Market

Rents in many parts of Europe are also much more closely controlled by the governments than they are here in the UK. Tenants enjoy much stronger protection and it is very difficult to remove them (assuming they have always paid their rent) than it is here – hardly ideal if circumstances change and a quick sale is necessary. In places like Germany, it is difficult for a landlord to even raise rents and so it is not uncommon for tenants to stay (trapped) in the same property for 20-30 years, because they are paying a rent which was fixed in the 1980s or 1990s and they cannot afford to move and then have to pay current market rates.

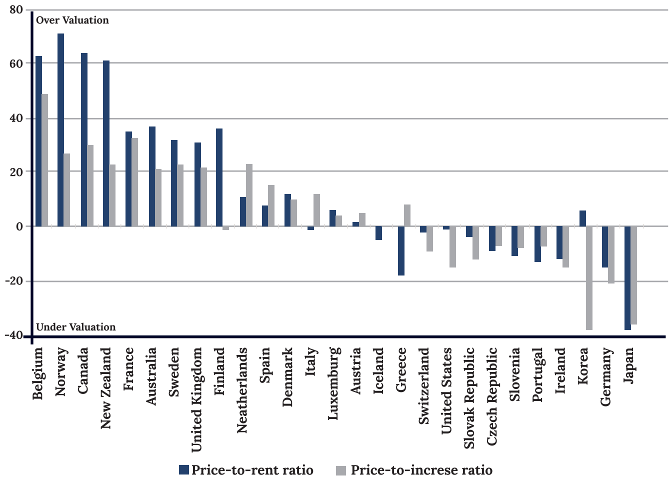

Chart 5. House Prices across OECD Countries
Source: OECD House Price Database

Immediately post Brexit, the sudden drop in value of sterling meant that the asking prices for many European properties were suddenly 15% more expensive than before. There has been a sharp downward adjustment in asking prices to ensure that they remain attractive to UK buyers. This can be easily confirmed by referring to the prices of houses on sites such as RightMove, where thousands of houses are now 30% lower than when first advertised. Because of this many of these properties have failed miserably to provide any sort of currency hedge to their owners.

Chart 6. The change in the GBP /EUR Exchange rate since Brexit
Source: Yahoo Finance Uk

]The uncertainty around the future of the Eurozone has made it incredibly risky to invest in a jurisdiction outside the very strong group of Northern European member states. If the Eurozone were to break up, and the weaker Southern members reverted back to their “old” currencies, it is likely that these currencies would devalue considerably against the German Mark, Sterling, and those of other countries with strong GDP. Sharp drops in asset values, including real estate would follow.

So, should we only look at real estate opportunities in nearby places we have visited for years on vacation or are there other more exotic global property hotspots offering much higher investment returns?

Top 3 Global Property Hotspots

Many Brits who have been made redundant over the past decade have used their redundancy payments to relocate overseas. They have reconciled themselves to the fact that unless they own the roof over their heads and are largely mortgage free, the redundancy money would soon run out through paying ever increasing rent. They have relocated through necessity rather than choice and for many, buying an apartment for a few thousand pounds in an emerging area which is starting to attract mainstream tourism makes strong fiscal sense. Whereas a decade ago it was possible to buy an apartment somewhere like Goa for less than £20,000 the increase in tourism and high demand for cheap accommodation has led to prices soaring.

Many parts of Asia have also seen an explosive growth in real estate prices. They are now visited by a growing number of tourists attracted by the cheap cost of living and an improvement in hotels and facilities. It is now impossible to build or buy for the pennies of yester-year so many investors have sadly missed the boat. Those who had the foresight to predict the increase in development and visitor numbers have made a tidy profit. So where else in the world are we likely to see explosive growth in real estate, and what sort of opportunities are on offer?

1. **The Caribbean Islands:** Mention the Caribbean and we think of amazing coral reefs, crystal clear waters, calypso music, beautiful sunsets and the fabulous all year-round climate which has made the islands a Mecca for a rising number of tourists. The tourism industry is quickly gearing up for them. Many arrive on cruise ships but there are a number of high-end hotels being developed across the region. Property prices on some of the islands have gone through the roof, with water front properties in places like the Bahamas and Turks and Caicos having enjoyed a 1000% increase in price over the past decade. English is the spoken language and the fact that many are British Overseas Territories lends a home-from-home feeling which has Brits flocking back year after year. For those with a budget in excess of $1,000,000 it is still possible to buy a small beachfront villa on one of the developed islands, but prices are at a premium – especially

considering that these types of properties were available for $100,000 a decade ago at the development stage. As visitor numbers increase, a growing number of smaller islands are now being developed, offering the savvy investor the opportunity to pick up turn-key properties as well as invest into off-plan opportunities. Water frontages are a must as are strong transport links and if possible choose a location which has a golf course nearby. If you are prepared to invest with a view to development this can often yield the highest returns and demand/rental yields are very attractive.

2. **Hong Kong:** Hong Kong's best known luxury residential enclaves are all on Hong Kong Island, within easy reach of international schools, clubs and the city's main business districts. It is in these areas where prices have risen most rapidly over the past three years. In the eastern New Territories, however, in Sai Kung and Clearwater Bay, a lifestyle of sailing clubs, beaches and hiking offers a great quality of life at a fraction of the cost of the more traditional areas. Prices of luxury accommodation in these areas have risen by 65% since 2008, compared with a staggering 80% on the Island. Houses with gardens and views typically average around £1,100/sq. ft. compared with £2,500/sq. ft. in Southside district on the Island. The discount is sufficiently steep to allow more room for growth over the coming years, particularly as access improves, but you do need a tidy sum to get involved and it is tough to do so at the early development stage.

3. **Latin America:** Previously sound economic development has significantly moderated in countries such as Colombia, Chile, Mexico, and Peru, where there might be some recovery during the course of 2017, but it seems almost certain to be on only a slow upward trajectory. Nevertheless, Forbes magazine identifies Latin America as the next prime hotspot for property investors, particularly in Chile, Mexico and Brazil. Transport links are very good but other issues apart from the language barrier are local currency fluctuations and a potentially volatile political outlook. The lack of transparency in these areas is also an issue and many investors prefer to deal with more established development companies in the West and with lawyers who speak their language and can provide them with the assurances they need around title of ownership. It is often more difficult to use assets purchased in jurisdictions such as these as leverage, but if the currency works in your favour and they become more widely visited by mainstream tourists, the inevitable price rises would follow.

Different Ways to Buy

There are of course several companies offering investments into overseas projects which are all at different stages of development.

Stage 3 • These are "turn-key" properties which are fully developed and ready to move into and the most hassle-free but offer the weakest returns for investors. Often the property will have already have passed through several links of the chain. It would have first been sold as a freehold plot of land (stage 1) before infrastructure was built around it (stage 2), and then the land footprint developed to house the property (stage 3). Of course, it is then ready to move into or can be rented out as a managed unit, but the main equity increases have already been realised and stage 3 investments typically offer a much lower yield than stage 1 or 2.

Stage 2 • Opportunities are generally those where the investor purchases a plot of land which has been sold earlier and may have been held passively for 2-3 years awaiting development of the main infrastructure around it. The investor will then generally work with a reputable company who will help him source funding to develop the plot. This can be generally done quite quickly and the finished property is then at Turn-key stage within 12-18 months. Whilst purchasing a plot for imminent development can still provide the owner with a relatively high equity gain on his investment, he will have the build financing costs to pay for 12-18 months before he is able to see income streams from his investment, although global interest rates are so low currently that the cost of this may not be too significant.

Stage 1 • Opportunities are those which involve buying plots of land at pre-development (off plan) stage. These transactions offer the investor the highest returns because generally the purchase must be funded in cash and there may be a 2-3 year wait before the surrounding infrastructure is developed and the plot is ready for stage 2 development. Often the plots are deeply discounted and many developers offer a buy-back option or offer other exit strategies to the owners who decide to dispose of the asset prior to development. As the infrastructure is developed, the plot of land often rises significantly in value and stage 1 developments generally offer investors the highest equity gains available.

III. CHOOSING THE RIGHT INVESTMENT PARTNER

There are a wide range of companies offering property investments and great care needs to be taken before you part with your hard-earned cash. Always look for an investment partner who:

- Has an established and verifiable track record of successfully completing projects in the geographical area
- Has positive reviews from previous customers
- Works within a strong framework of trusted and reliable professional construction partners
- Is represented by a reputable network of lawyers, accountants and other professional partners who can assure valid title of ownership and safe stewardship of your funds
- Offers you notarised translations of all documentation in English
- Comprehensively explains all of the costs, benefits and risks associated with a transaction
- Can meet the repayment of any capital obligations at an agreed time
- Is completely transparent
- You trust and are comfortable working with

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These investors often will use an IFA or professional wealth advisors, particularly for the design and implementation of their core investments and these core investments will typically be in the traditional asset classes, whether invested directly or through managed funds.
However, if they are savvy and can manage a part of their portfolio themselves, they may want access to innovative opportunities that are often in asset classes that are not systematically or even typically researched or offered by conventional routes.
These alternatives very often have zero correlation to publicly traded investments.
We conduct primary due diligence on the investment concepts we feature so investors can have access to key facts. This usually provides investors with enough information to make up their minds if the proposition is sufficiently interesting for them to carry out the additional research and due diligence they would need to know if the investment is appropriate for their portfolio and whether to make an investment.
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Alternative investments are only appropriate for investors who are able and willing to accept the higher risk associated with such investments. It is generally recommended that such investments are made part of a broadly diversified portfolio. Professional advice is recommended before making any investment decisions.

AmazonaGroup

Small things make a big difference.

We support NGO´s that focus on preserving the Amazon and supporting the local people who protect and nurture this beautiful land.

We commit 1% of our revenue to environmental causes close to our heart.

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