prime central london property time to invest?

Interview with Stephen Yorke, CEO and Partner of D&G Asset Management

Q: Does D&GAM invest in all types of property?
A: No. We are specialists and believe strongly that the only way to make consistently good investment decisions is to stick to what you know and be disciplined. The biggest mistakes in property investing tend to be made when you are tempted into an area, geographic and/or conceptual, that others know better than you.

Q: So what is your area of expertise?
A: We look only at Prime Central London residential real estate. That means our investment focus is exclusively on a defined geographic area. Within that area we will consider most things – short leases, flats, houses. The investment strategy is not rocket science – it is to identify quality and buy well.

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Q: Why property and why Central London?
A: Short questions but they will require longish answers I am afraid! Firstly, before any investor decides to invest in anything he must have a view as to what is happening in the world. That will determine his asset allocation. My view is, again, not original nor overly-clever. The biggest cause of low, and falling, yields on most assets is the disinflation caused by the rapid growth in the economies of China and India.
As those economies grow, and grow mainly through exports, they keep downward pressure on goods in the developed world. That keeps a lid on domestic inflation. Secondly, a large percentage of the trade surpluses of China and India (and other low cost exporters) is invested in the government bonds of the developing world, principally, US Treasuries. That keeps a lid on long term interest rates and the rates UK mortgage payers pay on their 2/3/5 year fixed rate mortgages. So, to my mind the future direction of UK interest and mortgage rates is more likely to be determined by what happens in China and India than anything else. If you believe, as I do, that this is not a one-off event but a major shift in the economic architecture of the world then this will be a factor in where you invest, and how.

Q: OK, but still not clear how we get from China to Cadogan Square?
A: In a nutshell, I believe that, as long as there are still over 270 million rural unemployed in China then the authorities there will continue to invest in growth and job-creation. The Chinese Government are capitalists who do not require a return on capital (which probably explains why the Chinese stock market has performed so badly recently). Provided the Chinese continue to export goods cheaply to the rest of the world and as long as developed world companies continue to outsource there the following is likely, to my mind: continuing low real interest rates, the owners of capital getting richer as profits continue to rise, and money chasing quality assets.

Q: Quality assets – so that is where Central London property comes in?
A: Yes. The net result of all of the above to my mind is firstly, that the rich of the world will continue to get richer, in absolute and relative terms. Secondly, I want to own things that the Chinese, or Indians, cannot make or copy. Thirdly, the emergence of two huge economies in such a relatively short time offers massive opportunities to the providers of capital and the financial engineers who come with it (bankers, lawyers, accountants). And the global centre for these types of skills is here in London. So that is why I think that the very best real estate assets in the top global financial capital, London, will be highly sought-after for the foreseeable future.

Q: You don't think Central London is expensive at the moment?
A: No. Firstly, for as long as I have been looking at Central London property people have always said it is expensive. So are diamonds and they always will be. That is not the point. The right question, I think, is "Is central London expensive relative to other comparable assets?". A good way to look at this is through yield. Last year 2005, according to the Savills statistics, Prime Central London yielded 4.8% and grew 4.4%. That is a total return of 9.2% in what most consider an average year. This compares very favourably to 5.7% which was the average return on a Hedge Fund in the same year, according to Hedge Fund research, Chicago.

Q: But where are yields heading do you think?
A: Before I answer that lets just compare the yields on Prime Central London property with other blue chip assets. 4.8% for Prime Central London compared to 3.3% for FTSE Financials, 1.72% for the Dow Jones Industrials, 2% for the Dax, 4% and 3.7% for the 10 and 30 year Gilts respectively. Looked at from New York, Tokyo or Europe a gross yield of 4.8% plus the reasonable expectation of steady capital gain should be attractive. Lets say you own a house in Chelsea worth £1.2 million and it currently yields 4.8% in rent, that is £57,600 p/a. If that yield was to track the levels of the other assets mentioned, as historically it has tended to do, it would mean either price falls and steady rents or price gains and steady rents or rent rises and steady prices.
We believe that for the reasons set out in our research that the most likely outcome is steady price increases and small rent rises. For an asset of £1.2 million to go from yielding 4.8% to 4.22%, or 4% or 3.5% would suggest capital increases of 14% to £1.36 million, 20% to £1.43 million or 26% to £1.5 million respectively. I don't know which number it will settle at but I do think that, in a world where yields on assets are set to remain low and are possibly falling further, a combination of decent yield, steady capital growth and low volatility will be attractive to investors here and from abroad. As for market timing, we have had three years of very anaemic growth (about 10%) in Central London and I just wonder if, after two to three very strong years of returns in the commercial sector, some smart fellas might start to switch from commercial into Prime Central London residential.

There is only one Unit Trust Fund that specialises in Prime Central London. It is accessible with £25,000 but only available to eligible investors.

Q: So you are another who thinks this will be the year Central London out-performs other areas of the UK property market?
A: As I said earlier I have no idea what will, or might, happen elsewhere in the UK. We only look at Prime Central London but for a number of reasons I do think this will be a year of strong capital growth for the best real estate here. We undertook some research, along with a Professor of Statistics from New York University and Hedge Fund manager, and deconstructed Prime Central London as an asset class comparing it to other asset classes like the FTSE All-Share, FTSE Financials, Gilts over a 26 year period going back to 1979.

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Q: Sounds a bit nerdy – what were the headlines?
A: Fair do's – I like the statistics and the background because I think it helps to show that Prime Central London is a property micro-climate and has a long track-record of behaving in a certain way but the headlines were :

- Prime Central London has produced a better mean return with less volatility than either FTSE-All Share or cash on deposit since 1979
- There is a very close relationship between the performance of global financial equities and Prime Central London after a year to 24 months
- Over the last three years the FTSE Financials have been strong
- UK house prices have gone up 169% and yet Prime Central London has gone up only 10%
- If the historic pattern resumes then we should start to see Prime Central London prices move this year

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Q: Hasn't that move in prices already started?
A: Yes, I think the end of last year started to see a move upwards and, with the continuing supply problem, which is a story for another day, that trend is set to continue.

Q: Ok – so again I come back to my earlier question what do those of us who would like more exposure to Prime Central London property do if either we don't have a couple of million pounds to throw around and/or we don't have the time to find the good properties?
A: Gordon Brown got a lot of stick for doing a U-Turn on residential property and SIPPS but I think he did the right thing. It makes much better sense for an investor or a pension trustee to invest in a Property Fund rather than a single property. Via a Fund an investor can limit his investment, benefit from the diversity of the portfolio, benefit from the economies of scale on fees and, most important with any property investment, let the guys who spend all day every day looking at property make the investment decision. If an investor wants to get more exposure to Prime Central London property and he doesn't want to do it himself and/or does'nt want to commit £500,000 to it then I suggest he finds a specialist Fund that invests in that area.

Q: Any idea as to who?
A: Modesty, and the regulators, forbid me from saying. There is only one Unit Trust Fund that specialises in Prime Central London. It is accessible with £25,000 but it is only available to eligible investors.
For further information please call 02079634622 or go to info@dngam.co.uk