Property in London: Is it a safe asset?

Base rate hikes and a strong pound will dent prices, says **Yogi Dewan**

THE EASY money in property markets was made a long time ago. That said, real estate remains the ultimate safe haven for many investors, as they consider it to be a better alternative to investing in global equities, government bonds or other assets like gold.

PRICE PRESSURE

And London house prices have had a very strong run over the last two years. In the 12 months to the second quarter of 2014, for example, prices in the capital rose by 25.8 per cent according to Nationwide. But based on more recent house price data, we think property now looks fully valued. We expect house prices to slowly decline (but not crash) over the next 12 months. The decline has already started in the London prime market, and it is just a matter of time before price declines spill out into the rest of London and then England.

UK rate hikes will likely be the primary catalyst for this, with many City analysts expecting a rise in interest rates as early as November 2014. Interest rate futures, meanwhile, are pricing in a first UK rate hike by the first quarter of 2015. A rate rise will impact on mortgage repayments for domestic buyers, and will affect the strength of the pound for international purchasers. Neither will be good news for UK house prices in the short term.

The strength of sterling has substantially impacted on international demand. Despite the pound's recent pull-back, it is still roughly 12 per cent overvalued against the dollar and 15 per cent against the euro, on a purchasing power parity basis.

The inverse correlation between a strong pound and the prevalence of international buyers has always had an adverse impact on demand, particularly at the high end of the housing market. And international demand, which is influenced by currency levels, always has a direct impact on buyer sentiment across the board.

POLITICAL RISKS

There are other factors investors and house owners should consider. In the run-up to next year's general election, taxation and regulation will be firmly on the agenda. In this area, the biggest risk to house prices is the so-called mansion tax, although we think this is unlikely to materialise. While politically popular, it will be almost impossible to implement. Council tax reform, perhaps adding additional bands to the top end of the market, may be a better solution. More stringent mortgage regulation or any further measures associated with bank bonuses, however, will certainly impact on domestic demand.

As the UK economy strengthens, domestic demand should be able to offset a decline in international buyers. UK economic data has been slowly improving. Demand from our European trading partners has been picking up. Corporate earnings and unemployment have been slowly improving, and there has been less drag from fiscal austerity. Banks are slowly starting to lend again.

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STEADY GAINS

So despite moderating in the coming year, in the longer term, the outlook for London property prices remains reasonably positive. We will still have a housing supply shortage, population growth (through immigration), and an improving domestic economy. This will likely offset any decline in international buyers, who are worried about short-term taxation risks and a strong pound.

Prices are likely to decline in the near future, but we expect a slow rise (including rental yields) in the long term. For many investors, property is still the ultimate safe haven. But expectations of price appreciation need to be moderated.

Yogi Dewan is chief executive at Hassium Asset Management.

Safe as houses? Plush London pads might not be the best home for your money