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London buyers find streets paved with gold

By Tanya Powley

Properties in the London districts of West Hampstead, Paddington and Chiswick have seen the biggest growth in rental yields in the capital over the past six months, offering promising returns for buy-to-let investors looking for a growing income stream.

Strong tenant demand from young professionals has seen an increase in returns for investors with properties in these letting "hot spots", as rents have risen faster than capital values, according to research from property consultants Jones Lang LaSalle.

While average yields in the capital rose by 20 basis points over the past six months, properties in Paddington saw the biggest increase, with yields rising by 71.6 basis points. The next biggest risers were Acton and West Hampstead, which saw a growth in yields of 64.3 basis points and 53.7 basis points, respectively.

This comes as rental prices across London have continued to surge, driven by a shortage of good quality rental stock and growing demand from first-time buyers who are unable to get on to the property ladder because of stricter mortgage lending criteria.

According to Jones Lang LaSalle's quarterly review of London's residential housing market, the average rental price across
the capital has moved
from £37.87 per square foot per year to £40.20 – an increase of 6.1 per cent
in the six months to the
end of this year's first quarter.

In comparison, the average sale price across London has risen from £718 per square foot to £734 – a pick- up of just 2.2 per cent.

"The very interesting story we're seeing right now is that rental growth is escalating much faster than capital growth," says Rob Bruce of Jones Lang LaSalle.

This surge in rental growth has seen average gross yields in London increase from 5.27 per cent to 5.47 per cent. The highest yields in the capital can be found in the south-east: 7.68 per cent in Forest Hill, followed by 7.38 per cent in Upper Norwood.

However, experts say investors need to carefully consider the locations of their investments and not be led by high yields alone. The risk of void periods is likely to be greater in certain locations, therefore the strength of tenant demand is crucial when selecting an area to invest in a buy-to-let property.

James Moss of Curzon Investment Property points out that Paddington, West Hampstead and Chiswick have always been good quality rental areas. Gross yields in West Hampstead are currently around 4.86 per cent, while areas around Chiswick can achieve a 5.01 per cent yield.

Dominic Agace, chief executive officer of Winkworth, the estate agents, says it has seen a big increase in tenant demand for areas such as Kensal Rise, Islington, Chiswick and Shepherds Bush from young professionals looking for locations with good transport links.

He says Kensal Rise has seen the largest rental growth, with rents rising 20 per cent over the past six months, followed by Islington with a 15 per cent increase.

In some locations around London, the competition for good quality rental homes has led to a rise in tenants looking to secure longer lets of up to three years. According to LudlowThompson, the London-based estate agent, 71 per cent of lets it has agreed so far this year have been for two years or more, while 44 per cent have been for three years or more.

"The most sought-after properties, typically attractive two-bedroom properties with good commuter links, are being snapped up for periods of two or more years at an unprecedented pace," says Stephen Ludlow, director at the estate agency.

He explains that these types of deal can often help secure a tenancy as landlords like the security of a long let because they reduce void periods and alleviate the uncertainty of changing tenants.

The locations where this is happening the most include Clapham, Notting Hill, "Little Portugal" in Vauxhall, Canary

Wharf and Greenwich.

However, not all these areas are seeing a growth in yields for property investors. Jones Lang LaSalle's research found that the greatest yield compression in London occurred in Greenwich – a fall of 49.0 basis points – Hammersmith, Vauxhall and Clapham. The average yield in Greenwich is now 4.43 per cent and 4.18 per cent in Hammersmith.

However, Moss admits that although rents are going up in these locations, capital values are going up even faster.

"What is now happening is that these areas are being recognised as the good locations that they are and in many cases full 'gentrification' is underway," he explains.

He points out that Greenwich now has excellent transport links to Canary Wharf and the City, leading more young professionals to buy there.

Moss says wealthy property investors and international buyers are still focusing on prime central London locations such as Knightsbridge and the best parts of Kensington and Chelsea.

Prime locations such as these provide investors with lower yields – around 3 to 4 per cent – but have the potential for bigger capital growth.

"With these investment buyers, the emphasis is not on income, it is on having a safe asset base with the emphasis on long-term capital appreciation," Moss explains.

However, Moss says he would not be surprised
to see a gradual divergence by some clients into areas such as Vauxhall, Stockwell and Kennington, where unit costs are lower and the potential for faster capital appreciation can be found.

"While rents continue to increase, this also creates a further hedge in these 'newer' locations. In essence, what we are seeing here is a classic ripple effect, just like in Notting Hill 15 years ago," says Moss.

According to Lucy Morton, head of lettings at WA Ellis, a prime central London estate agency, Knightsbridge and Belgravia remain the foremost "hot spots" for tenant demand among the wealthy, along with Kensington, Notting Hill and Chelsea.

"Marylebone is now the new Notting Hill with its trendy 'village' shops, atmosphere and excellent transport links. In particular, the young professional tenants are flocking here," she adds.