research

from Hurford Salvi Carr

MIDTOWN, CITY AND DOCKLANDS

RESIDENTIAL REVIEW 2015

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In the past decade the proportion of London households in the private rental sector rose from 14% to 30%.

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HURFORD SALVI CARR

Market Overview

ANTICIPATED SLOWDOWN CONFIRMED

There is unequivocal evidence that the London residential market slowed down in 2015, even as the UK economy proved one of the strongest in the developed world. As we expected, the slowdown in transactions, which began in mid 2014, turned out to be something more fundamental than pre-election nerves. Indeed for some, fears of a bubble in the prime housing markets refuse to be quelled with UBS still ranking London number one in its 'Real Estate Bubble Index'.

Our view is more sanguine. Some price adjustment is almost inevitable after a prolonged period of strong growth, primarily because vendors become hooked on over-ambitious asking prices but we expect a stable market, with reduced demand counter-balanced by lack of supply. In our markets, owners are rarely forced sellers and if prices are under pressure, owners tend to hold on to their assets until the market recovers.

This is particularly true of investors who continue to receive rental income while they wait for capital growth to resume. In fact, most investors in Central London tend to retain their hard-won stake in the London housing market for the long term.

HOLLOWAY ROAD N7 - SELECTION OF 2 BEDS, LET DEC 2015 FROM £460-£550 PW

The Chancellor's announcement in November's Autumn Statement will only reinforce this tendency to hold long term, as from April 2016, the cost of acquiring any more investments will be subject to an extra 3% of SDLT, charged for 'additional homes'. Better then, to hold on to existing investments than to trade in and out, especially in a low growth market when there is little scope to off-set against Capital Gains tax (CGT), in the short term.

Conditions had become less attractive to new investors in 2015, since yields dipped well below 4% with no immediate prospect of significant capital growth. This has been the most difficult sales market since 2008. The added cost of buying property imposed by the reform of Stamp Duty in December 2014, was already a significant factor in dampening demand in 2015 and now there is an additional 3% from April 2016. Put simply, this will extend the time an owner would need between buying and selling to recoup initial costs of purchase. So, anyone whose financial calculations rely on short term capital growth will be deterred from buying in Central London.

For instance, a professional posted to a job in London for say, two years, might have considered buying a second home for the duration of their posting and then selling it on but in the current market renting a property is probably the more cost effective option, unless the posting is extended beyond 5 years.

According to the Organisation for Economic Co-operation and Development (OECD), the UK now raises a larger proportion of its total tax revenue from property than any other of the 34 OECD nations. The OECD calculates the tax to GDP ratio for each country and, while the UK is ranked 18th overall, it is first for its property taxes with 12% of all tax revenue earned from property.

The Bank of England has made no secret of its desire to cool the buy to let market because of the risk it poses to the economy if interest rates rise. It does not however, wish to discourage the evolution of an institutional private rental sector and in the Autumn Statement owners with a portfolio of more than 15 properties were exempted from the SDLT surcharge.

Private renting continues to expand as a form of tenure across London. In the decade to 2014, the proportion of London households in the private rental sector rose from 14% to 30%, according to the English Housing Survey. Over the same period, owner occupation fell from 56.5% to 49.5% of households in London and the proportion of owners relying on mortgage finance declined from 39% to 27%, as cash purchases became more commonplace.

With a population that is projected to grow by 1.4 million in the next 15 years, it seems clear that the private rental sector has a growing role to play in housing London's increasingly footloose and cosmopolitan residents, especially as average sale prices are beyond the means of so many.

For a growing number of Londoners, owning a home is not a realistic option. Affordability has become an issue for large swathes of the population. The London Help to Buy announced in the Autumn Statement, which offers an interest free loan on 40% of the purchase price to buyers of homes up to £600,000 once they have saved a 5% deposit, will help those who are in a position to raise debt for the balance.

This well-paid cohort of private renters is the primary target market for most institutional PRS investors and it is interesting to reflect on whether the government's enthusiasm to create a nation of homeowners will undermine the rationale for Institutional PRS investment. It could also inadvertently push prices up to the £600,000 threshold.

Although there was a continuous flow of new homes delivered throughout the past five years in Central London, it has focussed almost exclusively on an affluent target market above £1,000 per sq ft, where developers are able to generate higher returns.

London remains attractive to investors and, despite some short term resistance to the additional up-front costs, we are confident that money will continue to flow into London as long as it represents a secure home for capital and there is no alternative investment class offering a better return.

Economic Overview

UK ECONOMY SOLID IN THE FACE OF GLOBAL WEAKNESS

2015 marked another year with no change in interest rates. December was the 81st consecutive month in which rates were held at 0.5% and forecasts of the next rate rise were pushed out to mid 2016 and beyond.

There were plenty of positive indicators for the UK economy – rising wages, increased consumer spending, expanding employment, strong service sector growth, even manufacturing output strengthened over the summer months, while exports, which had been dented by a strengthening pound, recovered in Q3 2015. However, despite all the encouraging economic data from the UK, instability in other parts of the globe and threats from emerging economies and China in particular, were enough to persuade the Governor of the Bank of England that the time was not yet right to raise interest rates.

On the back of cheap energy, supported by low oil prices, inflation remained doggedly low throughout the year, at times dipping below zero. Until that changes, interest rates are likely to remain very low too, which means that rising wages are driving growth in real income levels. As spending power increases, price growth will follow and with it the return of inflationary pressures in the economy.

> “Central London residential has moved into a phase of low activity, low growth.”

Autumn Statement 2015

London Help to Buy
From April 2016 a prospective buyer with a 5% deposit can borrow 40% of the purchase price of a home up to £600,000, and the loan will be interest-free for 5 years.

Shared ownership Help to Buy
From April 2016 the limit on household income to qualify for shared ownership help to buy will be raised to £90,000 in London (£80,000 elsewhere in the UK).

Stamp Duty Land Tax (SDLT) on Additional Homes
An extra 3% will be added to Stamp Duty for homes described as 'additional', which includes second homes and investments.

It is worth noting that SDLT on purchase can be offset against CGT on sale.

Additional SDLT payable from 2016:

Purchase price	Additional 3% SDLT
£500,000	£15,000
£750,000	£22,500
£1,000,000	£30,000
£2,000,000	£60,000
£5,000,000	£150,000

The Chancellor is not the only one pleased with the performance of the UK economy. The IMF said in October that "Britain's economy is still solid in the face of global weakness". It forecast that the UK economy would grow by 2.5% in 2015, (it grew at an annual rate of 2.25% in the first half of 2015), settling to 2.2% in 2016. In the view on the IMF, the Bank of England could consider raising interest rates before long.

On the 17th December, the American Central Bank raised interest rates by a quarter of a percent to 0.5%. The move was welcomed by savers and clears the path for a similar increase in Britain in 2016.

Low interest rates are a boon to residential markets. The combination of low borrowing costs and policy designed to help first time buyers, has inevitably led to house price growth which has spread beyond London and the south east in 2015, with many UK regions recording annual growth of 5% or more this year.

The terror attack on Paris in November shocked the world. London, like other world cities, was put on high alert. An escalation of this kind of violence probably poses a greater threat to London's economy than any other single factor.

The prospect of what has become known as 'Brexit', following an EU referendum, has slipped from the headlines but it too has the potential to destabilise the economy and dampen growth in the first half of 2016.

As the year ended the fall in global oil prices was an area of concern to the financial markets but was a welcome relief to UK consumers at the petrol pumps.

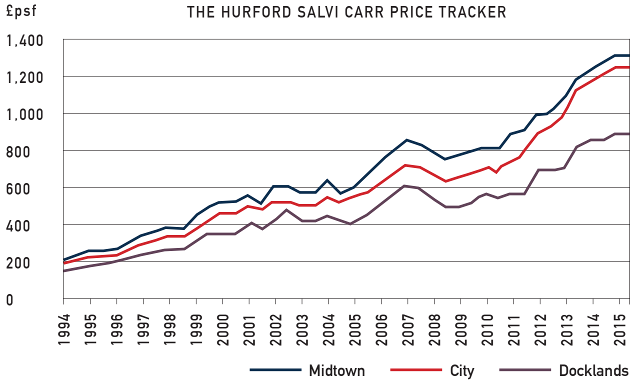
Sales Market

TWO TIER MARKET ESTABLISHED

The average price of a one-bed apartment in Midtown, City and Docklands rose by 5.8% in 2015, reaching £550,000, (See table 1). There was virtually no growth at all in the second half of the year. For properties over £1.5 million, prices were, at best, static throughout the year against a backdrop of dramatically reduced sales volumes. Despite the strength of the UK economy, it is clear that, after six strong years during which capital values gained around 80%, Central London residential has moved into a phase of low activity, low growth.

FIGURE 1

THE HURFORD SALVI CARR PRICE TRACKER



Source: Hurford Salvi Carr *Data based on the value of a 500 sq ft one bed apartment in the re-sale market*

The sales market exhibited the first signs of a slowdown back in May 2014. Explanations for the slowdown included an increased tax burden on overseas buyers via Capital Gains Tax and changes to the rules for properties owned within companies, as well as a looming General Election and threat of a mansion tax at the beginning of 2015. By the end of 2015 the election had passed smoothly, the threat of a mansion tax had receded and yet the residential market in Central London remains languid, burdened by high purchase taxes.

The strongest price growth across City Midtown and Docklands was in Docklands, where a one bed flat gained over 7% in value, reaching an average of £450,000. At that level, the price of a home in Docklands remains at a substantial discount to prices in Midtown where the equivalent high specification, one-bed flat would cost £650,000 - 45% more than in Docklands. In fact for the price of a one bed flat in either Midtown or City, a purchaser could have two bedrooms in Docklands (see table 2).

In the current market, there are many examples of owners being misguided in their expectations on price. Often encouraged by the new homes premiums quoted by house-builders and developers for high quality new apartments, owners test the price of older stock with premiums of 10% or even 20% above prevailing rates. Faced with unrealistic asking prices, the response from some buyers has been to seek off-market opportunities. The upshot is that price corrections above £1.5 million became commonplace in 2015, not because prices fell, but because the asking prices were never realistic.

Agents too, have been party to overpricing and encouraging the practice of 'testing the market'. There has been a 30% increase in the number of branches of agents operating across Midtown, City and Docklands since early 2013, and the fierce competition for a limited supply of stock has been one reason that asking prices have often been set above current market values.

There is a growing tendency amongst purchasers to compare valuations in terms of £ per sq ft. Investors are particularly keen on this basis of comparison but it is far from being a precise indicator of sale value.

Homes are not valued on a £ per sq ft basis by the profession. Each property is individual. The language of £ per sq ft has been established in the new homes market as a proxy for end value in development appraisals or to calculate an average price across a whole building.

Indeed using £ per sq ft is a blunt instrument that fails to take account of attributes that have an enormous impact on capital value such as views, outside space, condition, quality of block, lease length and service charges. Analysing prices by £ per sq ft can leave potential buyers disappointed as owners rely on market comparables, not £ per sq ft, to set their asking price and competing buyers are handed an opportunity to step in and meet the vendors' expectations.

HIGH HOLBORN WC1 - 3 BED APARTMENT, SOLD SEPT 2015 £1,425,000

In Central London a distinct division opened up with prices for one-bedroom apartments holding their own in 2015, while prices for larger and more expensive properties were under pressure. There was a short-lived flurry of activity in the immediate aftermath of the election but it did not develop into a sustained recovery and as the year progressed, price reductions became more commonplace. It is inevitable after a prolonged period of strong growth that vendors begin to over-estimate the value of their real estate.

STAMP DUTY SLOWS MARKET

There is no doubt that the introduction of a 12% rate of Stamp Duty at the end of 2014, for purchases over £1.5 million, was a major factor in keeping a lid on activity in the prime residential markets. The tipping point fell at around £1 million. As is well known, properties selling for less than £937,500 benefitted from a reduced stamp duty bill, while those above that level were hit by higher taxes and transactions dropped.

The headline in the London Evening Standard on 13th October read 'Buyers go on 'Tax Strike' in protest at Osborne's Stamp Duty Shake Up'. A slowdown in the London's housing market was probably the government's desired outcome.

TABLE 1
PRICES AND ANNUAL GROWTH FOR ONE BEDROOM APARTMENTS IN THE RESALE MARKET AT YEAR END : AVERAGE FOR MIDTOWN, CITY AND DOCKLANDS

Year	Annual Price Change %	Market Value £	Annual Change in Value £
1998	N/A	150,000	N/A
1999	26%	189,000	39,000
2000	11%	210,000	21,000
2001	10%	230,000	20,000
2002	13%	260,000	30,000
2003	-8%	245,000	-15,000
2004	0%	246,000	1,000
2005	10%	270,000	24,000
2006	26%	340,000	70,000
2007	9%	371,000	31,000
2008	-15%	318,000	-53,000
2009	8%	338,000	20,000
2010	4%	351,000	13,000
2011	10%	386,000	35,000
2012	5%	405,000	19,000
2013	20%	486,000	81,000
2014	8%	520,000	34,000
2015	5.8%	550,000	30,000

Source: Hurford Salvi Carr

For the year to end of September 2015, the total revenue earned from Stamp Duty on house sales in Greater London was £1.59 billion. Under the old system, the equivalent sales would have earned the government £1.54 billion.

The big difference of course, is in where the burden of taxation falls. Under the old system, properties sold for under £1 million accounted for 56% of SDLT revenue compared with 45% under the new system, while buyers paying over £2 million now account for 32% compared with 24% previously.

New data released by HMRC at the end of Q3 2015, found that in 2003/4 sales of London homes contributed 28.4% of all SDLT receipts across England. This rose in every year to 2013/4 by when it accounted for 44.5%. Provisional data for 2014/5 suggest that London's contribution will have fallen to 42.7% while receipts across England were 16% higher. This reflects a slowdown in sales across London in 2015.

It is not only buyers who have retreated from the market in Central London, owners too are reluctant to put properties up for sale and supply constraint is part of the story. In our experience, only those with compelling reasons to move considered either buying or selling in 2015, others sat tight.

At the end of the year, transaction volumes remain low, demand is still weak and prices now appear out of touch with the budgets of even our most reliable and cash-rich second-home and investment buyers. From April 2016, those investment buyers will also face higher purchasing costs.

TABLE 2
LONG RUN PRICE CHANGES FOR A ONE BEDROOM APARTMENT IN THE RESALE MARKET

Submarket	1994 - 2015	2000 - 2015	2007 - 2015	2008 - 2015
Midtown	574%	156%	54%	70%
City	603%	183%	74%	92%
Docklands	577%	159%	49%	73%

Source: Hurford Salvi Carr

However, it is worth noting that Stamp Duty incurred on purchase costs can be offset against any CGT liability arising from a subsequent sale.

The majority of investors lost their appetite for Central London residential as the potential for capital growth diminished and gross yields of less than 4% proved not enough compensation. For investors relying on mortgage debt, the Chancellor's announcement in July 2015, that higher rate taxpayers would no longer be able to offset their mortgage interest payments against taxable income from rents, was another blow. In the same announcement, all investors lost the right to claim a 'wear and tear allowance' as a taxable expense (see box on Page 6). There were also lost benefits on inheritance tax for properties held in off-shore trusts or owned by non-doms.

Nevertheless, investors, like owner-occupiers, have benefitted from a long steady run of rising price in Central London. Since we first began monitoring the market in 1994, values have risen almost six-fold. Even in the six years following the credit crisis in 2008, the price of a one-bedroom apartment in Central London has risen by 70% in Midtown, 73% in Docklands and by 92% in the City (see table 2).

Central London has always been too expensive for first time buyers but restricted mortgage finance meant that first time

SPITALFIELDS E1 - TWO BED APARTMENT, SOLD DEC 2015 £799,000 buyers were also struggling to get on the housing ladder anywhere in the capital so there was little motivation for private sector house-builders to get building on any scale. In London, average prices reached 12 times average wages (24 times in Westminster) and research from the GLA estimated that London needed at least 49,000 new homes a year to house its burgeoning population but was managing to build less than 20,000.

In Central London there is plenty of high-end new build underway. Here it is not supply per se that is the issue but affordability. The market is delivering stock priced at over £1million, which is exclusively aimed at wealthy buyers with access to large amounts of capital. We have noticed an emerging trend for people to maintain a city lifestyle by renting in London while investing in a property elsewhere.

Housing stayed firmly at the top of the political agenda throughout 2015, well beyond pre-election posturing. It figured large in both the contest for a new labour leader and in the selection of candidates to run as London mayor in May 2016. All parties seemed to agree on the need to meet two, sometimes contradictory aims – to suppress price growth and contain activity in the prime London markets, while fuelling demand from first time buyers elsewhere.

Affordability of London homes has become a contentious issue. According to the Council of Mortgage Lenders, the average household income of a London First Time Buyer is £55,687 pa. The average deposit is 19% and the average loan £213,750, meaning that 'a prospective buyer on median London earnings would have to save their entire pre-tax earnings for over two and a half years to raise the deposit on an average London home.' An ambition to buy in a prime London borough is out of reach for all but the most affluent or heavily subsidised households.

TABLE 3
PRICES AND ANNUAL GROWTH IN THE RESALE MARKET AT YEAR END

Submarket		2013 £	2014 £	2015 £	Change 2015
Midtown	1 Bed	580,000	620,000	650,000	4.8%
Midtown	2 Bed	950,000	960,000	1,000,000	4.2%
City	1 Bed	550,000	595,000	630,000	5.9%
City	2 Bed	800,000	810,000	840,000	3.7%
Docklands	1 Bed	400,000	420,000	450,000	7.1%
Docklands	2 Bed	580,000	600,000	625,000	4.2%

Source: Hurford Salvi Carr — 1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths

Jeremy Corbyn's popular appeal in the campaign to lead the labour party was yet another drag on sales activity, amid fears that he would stoke more negative sentiment about investors, overseas buyers and affordability. At times it seemed that his rise to prominence grabbed more headlines than the general election, it certainly provoked more passion amongst the general public. That seemed to account for September's apathy in the Central London residential market. His victory in September ensured that fierce debate about how to tackle the housing crisis would not wane. In the event, it was a Conservative chancellor who has announced yet more punitive tax for investors in his Autumn Statement.

PINNACLE E14 - 3 BED APARTMENT, SOLD JULY 2015 £1,050,000

Both Jeremy Corbyn and the mayoral candidate, Sadiq Kahn, have suggested that 50% of the dwellings in new residential developments should be 'affordable'. The average in much of Central London in recent years has been closer to 20%. For instance, in the core boroughs of prime central London - Kensington and Chelsea, Westminster, Hammersmith and Fulham, and Camden, the average over the past 3 years has been 19.3% compared with 38.5% in the period 2006-2008.

In his party conference speech on October 7th, David Cameron announced a plan to help turn 'generation rent' into 'generation buy'. His big new idea was to allow developers to meet their affordable housing obligations through the provision of 'starter homes' for first time buyers under the age of 40. These starter homes, must be offered at a maximum of 80% of open market value, with a ceiling price of £450,000. Buyers may not sell at full market value within the first five years of ownership. The price ceiling is set too low for this new scheme to have much bearing in our markets.

The Prime Minister also made clear his position on money laundering. In a speech in Singapore in July, he vowed that corrupt offshore companies using the UK property market to launder 'dirty money' would be unmasked. In future, details of properties owned by foreign companies will be published in the pursuit of greater transparency.

ISLINGTON N1 - FREEHOLD HOUSE, SOLD SEPT 2015 £1,899,000

Housing and Planning Bill

The government announced a number of measures designed to expedite the delivery of new homes in October, contained within a new Housing and Planning Bill that will go through parliament over the next few months.

Permitted development rights:
The office to residential 'permitted development rights', which had been due to end in May 2016, will be made permanent. This means that prior approval can be assumed for converting office buildings into new homes.

The rights will also be extended to allow demolition. This means that prior approval can be assumed to demolish office buildings and replace them with new residential buildings.

Areas that currently have an exemption, including London's Central Activity Zone (CAZ), will be able to preserve those rights as long as they successfully apply for an Article 4 direction before May 2019. If not, they too will lose it. An Article 4 direction removes permitted development rights, meaning that a developer needs to apply for planning consent. The CAZ comprises The City of London, most of Westminster, parts of Kensington and Chelsea, the South Bank, Tech City and Canary Wharf.

Starter Homes:
The Bill will introduce a duty to promote the supply of 'starter homes' through the planning process.

A starter home is defined as a 'new dwelling, available to purchase by first time buyers under the age of 40, with the price set at least 20% below market value'.

All proposals above a threshold size must contain a proportion of these starter homes.

Local Plans:
The Secretary of State will have greater powers to direct a local authority to prepare or revise a local plan.
If a local authority fails to implement an up to date plan for new homes by 2017, the government will work with local people to deliver one.

Planning Permission in Principle:
The Bill provides for identified brownfield sites to be given an 'in-principle' permission for new homes. The sites can be identified in a development or neighbourhood plan or in a register of brownfield land.

In principle consent could also be granted on a small site in response to an application for less than 10 homes.

Summer Budget : Tax Changes for Investors

In his summer budget, the Chancellor announced significant changes to tax liabilities for landlords.
From April 2016, landlords will no longer be able to claim a wear and tear allowance, although they will still be able to off-set the costs of any repairs or maintenance as long as they can provide receipts.

From April 2017, the tax relief on mortgage interest payments will change. Landlords (except landlords of furnished holiday lettings) will no longer be able to deduct finance costs to work out their net income. Instead they will receive a basic rate reduction from their income tax liability.

Finance costs are defined as mortgage interest, fees incurred when taking out or repaying mortgages or loans and interest on loans for furnishings.

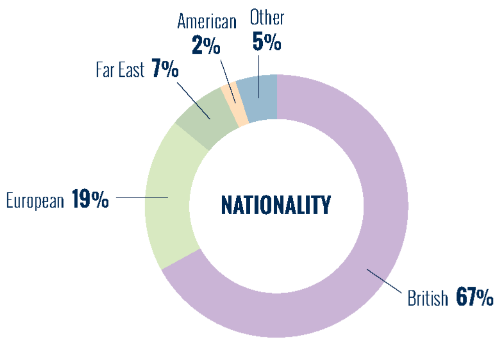
The new system will be phased in on the following timescale:

2017-2018 deduction from property income will be restricted to 75% of finance costs, the remaining 25% will be available as a basic rate tax reduction
2018-2019 50% finance costs deduction and 50% as a basic rate tax reduction
2019-2020 25% finance costs deduction and 75% as a basic rate tax reduction
2020-2021 all financing costs will be given as a basic rate tax reduction.

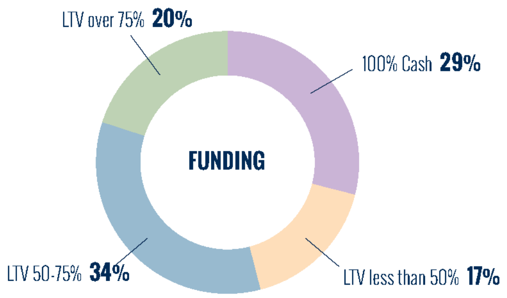
2015 BUYER PROFILES

Once again, British buyers made up more than two thirds of all purchasers in our markets. Their share rose to this level from 54% in mid 2013 and has stabilised. Asian buyers now make up only around 7% of all purchasers, whereas back in early 2013, they accounted for 25% of the market. There are no significant differences between our markets in the national origin of buyers.

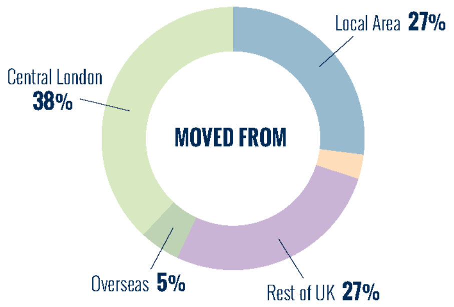
There are indications that Asian buyers in particular have a sense that UK tax policies are being specifically designed to discourage overseas buyers from the market. This, combined with a concern that there may be more such policies in the pipeline, flat prices and low rental returns, is suppressing demand.



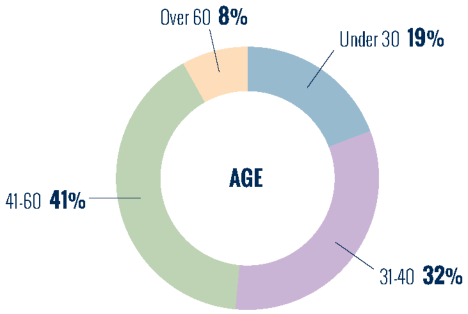
The proportion of buyers relying entirely on capital resources to fund their home purchase has fallen from 46% in 2014, to 29% this year. It has not been this low since 2012. The biggest shift has been to buyers borrowing more than half the value of the property – this group made up 41% in 2014 and 54% in 2015.



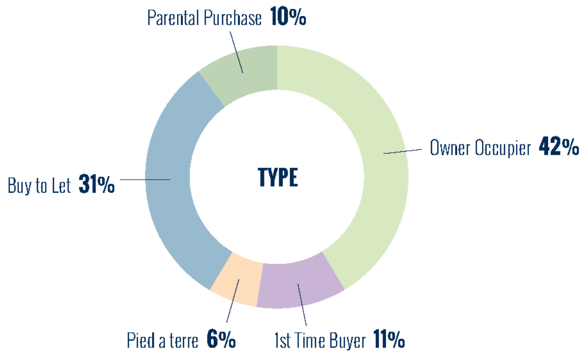
Despite the well-publicised new stricter lending rules, buyers in our markets did not encounter too much difficulty in securing loans. In fact bank valuations to support lending are generally in line with sale prices agreed. Cheap finance became far more widely available to equity-rich buyers over the last year and this is likely to have driven the increase in mortgage debt amongst affluent purchasers. Banks have competed aggressively with each other offering low interest rates, modest arrangement fees and promises of faster offers. Mortgages of £1 million or more are now mainstream for high street as well as private banks.



The age profile of buyers in our markets has been fairly consistent over the past three years with the over 40s being the most likely buyers. This year however, there has been a marked increase in younger buyers below 30 from 12% in 2014 to 19% in 2015. It is hard to work out what has changed here. It is not a first time buyer market and mortgage finance has not become easier. It may be that parents are supporting these purchases and as price growth has subsided, these more cautious buyers have taken the opportunity to buy. The fact that the proportion of buyers identified as 'parents buying for their children' (and in an older age group) has risen from 8% to 11% supports the notion that the increase in young buyers could also be underwritten by parental capital.



35% of purchases in 2015 were buy to let investments. That is a return to the levels recorded in 2012 and 2013 and reverses the dip to 28% in 2014. The proportion of buyers identifying as first time buyers shot up to 11% this year - more than twice the level of the two preceding years but in line with the increase in younger buyers and parental-support.



London Mayoral Elections 2016 : Housing Policies

The election of the Mayor of London, who will follow in the footsteps of Boris Johnson, will take place on 5th May 2016. The conservatives have chosen Zac Goldsmith as its candidate while Labour has chosen Sadiq Khan. Runners from other parties include Sian Berry (Green), Caroline Pidgeon (Lib Dem) and Peter Whittle (UKIP):

With some months to go, new policy ideas may well emerge, but they agree on some matters. Both agree on the need to build new homes and would work to bring publically-owned brownfield land to market and set up some form of investment fund to finance new construction; both recognise a need to control excesses in the rental market though they differ in their willingness to intervene; both want to give Londoners more access to new developments.

This is how the two main candidates policy aspirations stood at the end of 2015:

Zac Goldsmith

- Target of 50,000 homes pa for London (no announcement on percentage to be affordable)
- Set up a Pan-London investment fund for domestic and overseas investors to finance new homes.
- Focus on releasing publically-owned brownfield land
- Bring empty homes to the market
- Operate a London-first bias for new developments
- Get community consent to build homes appropriate to an area
- Create more certainty over rent increases and aim for longer-term tenancies
- Ensure rogue landlords are brought to justice
- Develop London's 3,500 estates into low-rise, high density developments
- Ring fence right to buy receipts raised in London to building housing in the capital

Sadiq Khan

- Block planning consent for schemes with 'poor doors'
- Reverse affordable rent homes back to social rent
- Set up a New Homes Team within GLA to act as a developer of homes for social rent, London Living Rent and first time buyers, Homes for Londoners
- 50% affordable housing target for any new development
- Grant planning powers to prevent 'buy to leave'
- Create 'London Home Bonds' and pension fund investments from unspent cash in the London Affordable Homes Programme
- Bring forward publically owned brownfield land
- Introduce Living Rent, linked to third of average incomes
- Set up a London wide not-for-profit lettings agency
- Campaign for power to limit rent rises

Lettings Market

RENTAL SECTOR GROWING STEADILY

Brand new build apartments would, in a normal market, command a rental premium over their second-hand equivalents, as tenants fall for the appeal of being the first occupants. However, when the majority of apartments have been sold to investors, the completion of a new block can mean a glut of identical rental flats competing with each other and suppressing achievable rents.

Renting a place to live in London is not a new phenomenon. London has a long-standing and mature rental market that has met the needs of generations of young professionals in their early-career years, as well as life-long rental households. The defining factor of today's rental market in London is that it is expanding, that young professionals are renting for longer, in better quality accommodation and that there is a growing array of facilities, amenities and conveniences on offer, for those with big enough budgets. There is also a gradual acceptance that renting has shifted from being predominantly a 'phase' before owning, to become a 'lifestyle choice' for those who wish, or need, to use capital and income in other ways.

FOLGATE STREET E1 - TWO BED APARTMENT, LET DEC 2015 £550 PW

There is an on-going debate as to whether it is out of choice or necessity that young professionals are renting for more years. The incentives announced in the Autumn Statement to boost homeownership (discussed in the sales section) will undoubtedly enable more people to get a foot on the property ladder outside of central London, while the disincentives to investors (SDLT surcharge) will discourage some potential investors from buying to let.

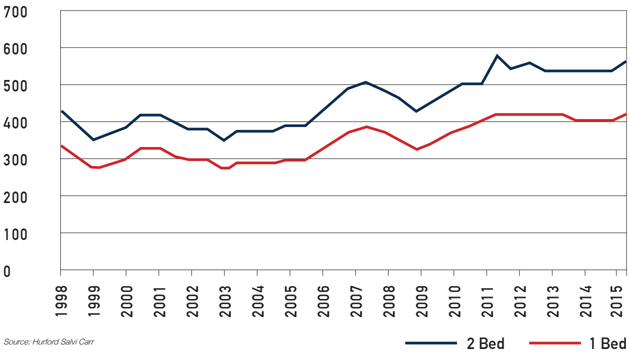
TABLE 4
WEEKLY RENTS FOR ONE AND TWO BEDROOM APARTMENTS
IN MIDTOWN, CITY AND DOCKLANDS AT YEAR END

Submarket		2012 £	2013 £	2014 £	2015 £	% Change 2014 / 2015
Midtown	1 Bed	425	425	425	440	3.5
Midtown	2 Bed	620	650	625	640	2.4
City	1 Bed	450	425	425	440	3.5
City	2 Bed	630	575	550	580	5.5
Docklands	1 Bed	340	350	360	370	2.8
Docklands	2 Bed	425	425	430	450	4.7

Source: Hurford Salvi Carr

1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths

FIGURE 2
WEEKLY RENTS FOR ONE AND TWO BEDROOM APARTMENTS
MIDTOWN, CITY AND DOCKLANDS



Source: Hurford Salvi Carr

In our view however none of these measures will turn the tide of demand for living in the centre of the city. More and more people are willing to pay premium rents to live in modern blocks with a high standard of amenity and convenience. As much as 75% of all new homes completed in central London may be sold to investors and find their way into the rental market. Investors are a significant force in the suburban markets too ensuring a continual flow of new stock.

Of course, affordability is a factor in the choice to rent. A recent report from Centre for London found that a household with the average income for London would need to save their entire pre-tax earnings for two and a half years in order to raise the average first time buyer deposit. While London Help to Buy will shift this equation for some, the hurdle remains high to become a property owner in the capital.

As we explained earlier in this report, it is not only first time buyers who are making the choice to rent. Well paid workers on short term postings may also find it more cost effective to rent. Until now, most of the growth in supply has come from individual or relatively small scale private landlords but if the large professional landlords become established, the offer for renters will become ever more persuasive. The Chancellor is clearly keen to encourage this market as indicated by the exemption from the SDLT surcharge for landlords with a portfolio of more than 15 properties.

LIMEHOUSE MARINA E14 - TWO BED APARTMENT, LET NOV 2015 £625 PW

Over the past decade, private rental has overtaken social rental as the second most popular form of tenure in London, rising from 14% of all households in 2003/4 to 30% a decade later. Given the combination of high sale prices in London and the flow of new rental property to the market, we expect this proportion to continue rising. As discussed earlier, many prospective buyers are effectively excluded from the sale market by the hurdle of saving for a deposit, irrespective of borrowing power, which fuels demand for rental while, at the same time, investors take the opportunity to buy up the new stock and meet that growing demand with new stock.

The clear evidence of strong demand has encouraged institutional private rental investors many of whom who are now keen to establish portfolios in London and, in the absence of standing investments to buy, are seeking out opportunities to build new rental stock – a phenomenon known as Build to Rent. Institutional and branded private rental providers with experience in the US and Europe can bring expertise to the UK and once they identify opportunities, we could see our markets changing very fast.

The relationship will be a different one. Despite the perception in some quarters that private landlords are ruthless predators exploiting powerless tenants, our experience is of a positive symbiotic relationship between supplier and consumer. Most landlords would welcome longer tenancies and are less keen to extract rental increases than to maintain an uninterrupted income stream to cover the costs of maintenance, finance and service charges. A reliable and conscientious tenant will be valued and respected.

TABLE 5

ANNUAL RENT PAYABLE AND RENT PER SQ FT FOR ONE AND TWO BEDROOM APARTMENTS : 2015

Submarket		Total Rent Payable Per Annum £	Rent Per Sq Ft £
Midtown	1 Bed	22,100	46
Midtown	2 Bed	32,280	44
City	1 Bed	22,800	46
City	2 Bed	30,160	40
Docklands	1 Bed	19,240	38
Docklands	2 Bed	23,400	31

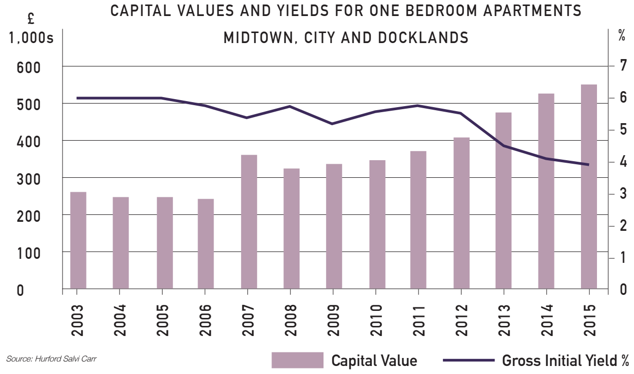
Source: Hurford Salvi Carr

1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths

Rents rose in 2015, for the first time since 2011. They grew by an average of 3% which fell short of our prediction of 5%. Neither did it apply across all of the market - it did not extend to properties at the upper end, nor to new developments where multiple units were released to the letting market in parallel. Indeed, the number of enquiries for larger properties, with asking rents of more than £1,000 per week, fell. An increase in rents across our mainstream market however, was welcome news for landlords who had accepted no growth for four years (see figure 3).

FIGURE 3

CAPITAL VALUES AND YIELDS FOR ONE BEDROOM APARTMENTS MIDTOWN, CITY AND DOCKLANDS



Source: Hurford Salvi Carr

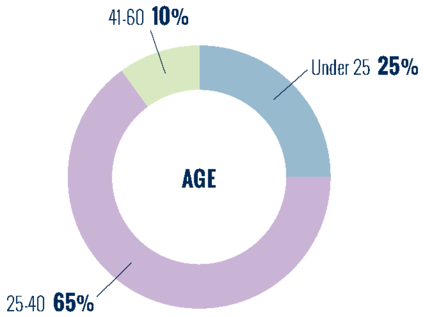
Interestingly, two bed apartments gained more value more than one beds in both City and Docklands, whereas in Midtown, where base prices are higher, growth in the rents for one bed apartments was stronger (see table 4).

The income return that an investor can expect to earn from a residential investment has been adversely affected by a mix of new regulations and the changes to taxation introduced in mid 2015. For instance, there are new obligations to fit smoke detectors and to test for legionella, as well as more stringent requirements to check prospective tenants' passports and visas to establish that they are entitled to rent. The changes to tax relief on buy to let mortgages and loss of the 'wear and tear' allowance, chip away at the net yield.

WHITECROSS STREET EC1 - 9 NEW APARTMENTS, LET OCT 2015 £480 - £775 PW

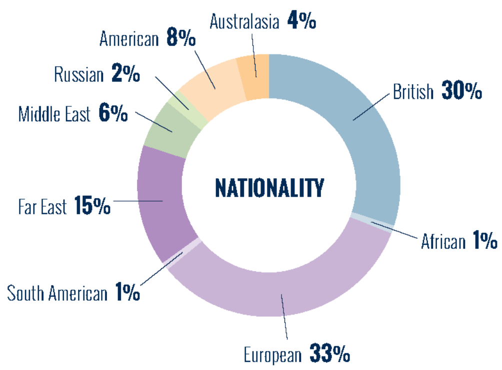
2015 TENANT PROFILES

The majority of people renting properties through our offices are aged between 25 and 40 years old and 90% are aged below 40. There is some variation between offices. Midtown for instance, has a higher than average proportion (47%) of under 25s, reflecting a high concentration of students renting in Bloomsbury and Midtown and also of over 60s.



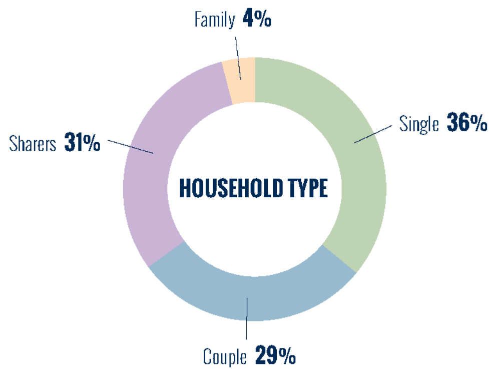
Overseas nationals make up 70% of renters in our markets, with Europeans the dominant group, accounting for 33% - these proportion are both line with the 2014 shares.

Docklands is the most British of our markets for renters – here they accounted for 48% of tenants compared with just 17% in Midtown. The bias towards overseas nationals in Midtown reflects the higher budgets generally available to overseas students than domestic ones. 21% of renters in Midtown were from the Far East compared with 14% overall and just 8% in Docklands.



US nationals were most likely to be in the City or Docklands where they made up 13% and 8% respectively. In other markets their presence was negligible.

The household composition for renters in our markets was fairly evenly split between sharers, couples and singles. Families made up only 4% of renters in our areas, reflecting high entry levels for 3 and 4 bed properties. This dataset is new this year but this balance probably reflects the norm in our markets. The City has a higher proportion of singles (43%), while Midtown had a bias towards sharers.



There are distinct geographical differences in occupation type. 40% of all tenants leasing homes through our City office were employed in the financial sector and a further 13% in the law and 15% in TMT. In Midtown, students dominate the rental market, accounting for half of all tenants there. Finance is also an important employer in Docklands although the spread is wider here, with public sector and hospitality becoming more significant.

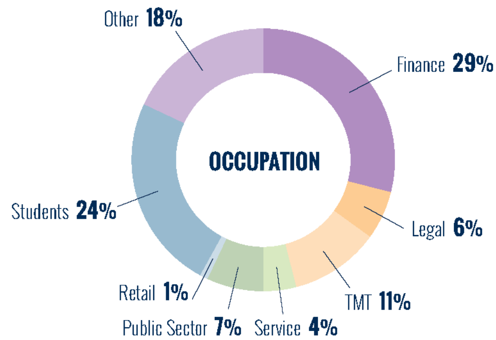


TABLE 6

INCOME, VALUES AND INITIAL YIELDS FOR ONE BEDROOM APARTMENTS

AVERAGE OF MIDTOWN, CITY AND DOCKLANDS 2002 TO MID 2015

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Gross Annual Income £	15,600	14,820	14,820	15,340	18,200	20,020	18,200	17,680	19,760	21,840	21,840	21.840	21,060	21,580
Capital Value £	260,000	245,000	246,000	270,000	340,000	371,000	318,000	338,000	352,000	386,000	405,000	486,000	520,000	550,000
Gross Initial Yield %	6.0	6.0	6.0	5.7	5.4	5.4	5.7	5.2	5.6	5.7	5.4	4.5	4.1	3.9

Source: Hurford Salvi Carr

1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths

Market Prospects

STILL WATERS AHEAD

Central London is increasingly like housing markets in Central and Northern Europe where sale prices are stable and renting is the dominant tenure. As new studio apartments approach £500,000 across Midtown, City and Docklands we do not envisage any significant price growth over the next 2-3 years as long as the UK remains a low inflation environment. Generation Rent will face years saving for a deposit before being able to buy a home in Midtown, City and Docklands.

London is unlikely to fall into line with government policy on homeownership. It does not have the land available to expand supply to a level with any prospect of satisfying demand. The bar for entry level properties is too high for most buyers and we foresee a future where families who wish to stay in Central London raise children in rented homes. Home ownership in Central London will remain beyond the reach of first time buyers even after government incentives and buying at a later age will become the new norm.

We expect the proportion of London's population in private rental homes to rise towards 40% over the next 10 years. Most new homes in the planning pipeline or under construction including the growing number of Build to Let developments, will add to the supply of high quality rental accommodation.

Buyers will remain scarce throughout 2016 for properties over £1.5 million as SDLT continues to weigh on the market. The additional 3% after April 2016 will only add to the lethargy.

We do not expect capital growth in 2016 across Midtown, City and Docklands, although we expect a short term increase in transactions in Q1 as investors seek to complete purchases before additional SDLT is introduced in April 2016.

Traditional Tory voters may well exert growing pressure on the Chancellor to review taxation policy for higher value properties and to revise downwards the top rate of 12% (for first homes over £1.5 million). At the same time we expect more parents to look at ways to release equity form their homes to assist children entering the property market.

With a strong economy and growing employment, London will remain attractive as a long term investment, even if the short term prospects are flat. We do not see the additional SDLT adversely impacting greatly on the number of second home or pied a terre owners in London. The same cannot be said for buy to let investors who will be less inclined to accept high purchase costs and lower returns. Overseas buyers particularly in the Far East will also regard the increased SDLT and other tax burdens announced by the UK Government as targeting them directly and could look to other parts of the world for their property investments. This will cause developers difficulties when they look to sell off-plan overseas.

The greatest threat to the market is from geopolitical uncertainty as the UK joins the air strikes on Syria and the western world is still reeling from the Paris attacks. Concerns over the global impact of economic slowdown in China and the fall in oil prices might reduce profits in the financial sector but it reinforces the arguments to bring money to more stable markets, like the UK.

There is home-grown uncertainty ahead in 2016: an EU referendum and a London mayoral election. After 8 years in office, whichever of the two main condidates succeeds Boris Johnson, he will present a more serious face to the world. Also any decision to leave the EU would inevitably cause economic instability with some businesses relocating and all adjusting to very different operating conditions.

Interest rates may finally rise in 2016 after an exceptionally long delay. Although the rises have been anticipated for some time, they will dampen any prospect of price growth.

In a backlash against internet marketing, we expect a greater level of discrete marketing – where serious sellers will engage with agents for off-market selling, in order not to alert neighbours of their intentions. There is a sense that there has been over-exposure on the internet and - rather like the resistance to agents' boards in the past – vendors are choosing not to go online.

Given the number of development completions that will inevitably find their way into the rental market in 2016, it is difficult to foresee any rationale for rental growth and so we expect rents to remain stable but with increased choice for tenants. Since we are not expecting any price change either that will leave yields unchanged in the year ahead for first time in five years.

So, with little prospect of capital or rental growth, the additional tax burden on landlords will mean it will be a fairly unrewarding year for investors – despite long term prospects. For the time being, landlords have become the target of government plans to raise additional tax revenue and, with interest rate rises in prospect, landlords are considered to be a risk to economic stability.

New council tax bands would be a logical move in the government's drive for additional tax revenue especially as it could be targeted at more affluent segments of the population.

Despite the negative sentiment that has gathered against using homes as a form of investment, it is a deeply engrained practice in the UK and, much of government policy is specifically designed to encourage the next generation to become homeowners to safeguard their future. In the end, it seems likely that most people will continue to see property as a safe home for capital and that in itself makes property an attractive long term investment proposition.

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