research

from Hurford Salvi Carr

MIDTOWN, CITY AND DOCKLANDS

RESIDENTIAL 1ST HALF 2016

“

Owners are turning to

the rental market rather than try

to sell in a buyers’ market.

”

HURFORD SALVI CARR

Market Overview

PRICES FALL FOR FIRST TIME SINCE 2008

David Cameron announced on February 20th that he had set the date for a referendum on Britain's continuing membership of the EU. Between that day and June 23rd, the housing market was overshadowed by the looming prospect of what became known as a 'Brexit'.

For most of the first half of 2016 it was very unclear which way the vote would go and the housing market, already dragged down by a succession of punitive tax changes, virtually ground to a halt in some parts of Central London. Major figures from business and politics lined up on both sides of the argument. Boris Johnson lent a major boost to the Leave campaign.

By the time June 23rd came around, there was a widespread feeling in London that the Remain campaign had edged to a narrow victory. The nation awoke to news of a Leave majority on June 24th shortly followed by the resignation of the Prime Minister, sending stock and currency markets across the world into disarray.

As long as the market was mired in uncertainty, it was virtually impossible to gauge the true impact of all the other factors bearing on the market. The one exception was the 3% SDLT surcharge levied on additional homes from April 1st – there was no doubting its profound short term impact on sales with investment sales continuing ahead of the deadline before falling sharply immediately afterwards. Make no mistake the first half of 2016 was the most difficult for central London's housing market since 2008 when the world was gripped by the financial crisis.

Overseas investors lay low in H1 2016. They may not bounce back in H2. Returns on Central London residential investment are less attractive now than they have been for several years. Capital values have risen much faster than rental values since 2009, which has eroded yields but supported total returns. Now capital growth has slowed, with no immediate prospect of recovery, purchase costs have risen and investment in London residential looks far from exciting. Investors seeking a secure place for their money can still rely on central London but there may be other locations around the world that offer more tempting returns. Britain's lukewarm attitude to foreign investment does not help.

Developers continued to deliver a steady flow of new stock to the market at larger development sites - as schemes completed. However owners of existing homes were less motivated to bring properties to the market, preferring to retain their assets in London until there are clear signs of a stronger market.

By mid year there was evidence of housebuilders and developers offering incentives and discounts to attract buyers while existing owners rejected serious offers that fell short of their price expectations and withdrew properties from sale rather than relinquish a prized London asset at a discounted price. The 'new homes premium' shrank as a result and sales volumes fell across all market sectors .

Prices held up at the 'more affordable' end of the market which, across our areas is anything up to £1 million. The value of a one bed apartment crept up by around 3% to £565,000 before the SDLT deadline, whereas the price of anything over £1 million was either static or dipped. Properties between £2 and £3 million lost around 5% in the first six months of the year and properties over £3 million lost 10%.

This is the first drop in pricing that we have reported since 2008 and was not solely down to the prospect of Brexit. The UK's taxation policy played a large part in the decline in demand in the first half of 2016 and that is not going to change in the near future.

VIEW FROM BARBICAN TOWER, EC2 - 3 BED APARTMENT - SOLD MARCH 2016 £2,250,000

Affordability is now in sharp focus and the economic and political uncertainty following the referendum result clearly does not help to restore confidence. Pricing will come under pressure and more owners will turn to the rental market rather than try to sell in a buyers' market.

The supply of rental stock was plentiful in H1 2016 and rents fell marginally as tenants took advantage of increased choice. Supply has been replenished by development completions flowing into the rental sector and owners who become 'accidental landlords', preferring to hold onto properties and rent them out rather than sell at prices that will not meet their expectations.

Rental values were static or fell in the first six months of 2016 and in fact have changed little since 2011. Returns on rental investments are inversely proportional to size with studios and one bed apartments usually producing the most attractive yields.

Domestic fiscal policy will pale into insignificance for a while as the market adjusts to a future outside the EU. While there is fairly universal agreement about short term uncertainty – at least until there will be a new Prime Minister - opinions are divided about what this means for residential property. The fundamental drivers of demand remain – births, deaths, marriages and divorces and there are new opportunities for the brave hearted created by a fall in the value of sterling.

The more pessimistic however, point to the accumulation of reasons that demand had already fallen in spite of the referendum, as returns from property had been undermined by increased taxation. Few argue that there will be more realism amongst sellers in the next 6 months and perhaps the real hope is that a government seeking to stimulate the economy will consider lifting some of the tax burden and reduce Stamp Duty rates for buyers.

Economic Overview

BREXIT FALLOUT

The UK's recovery remains fragile and was overshadowed through most of H1 2016 by the prospect of the EU referendum - which caused widespread concern. At the end of May, the OECD suggested that the UK would suffer a 'large negative shock' if it left the EU and that GDP could be 3% below where it would otherwise be by 2020 and 5% below by 2030. The FTSE 100 lost £20 billion in 2 days to June 1st, reflecting a poor output figures from China and falling commodity prices, which depressed prices for mining stocks, as well as continuing geo-political unrest. The UK's dominant service sector faltered in June along with a similar slowdown in construction with only manufacturing bucking the trend ahead of the EU referendum.

CHANCERY LANE WC2 - 5 FLATS - CORPORATE LET MAY 2016

The reaction of the markets on June 24th supported the worst of those fears but even by the end of day one the FTSE had recovered much of its early day losses. The Governor of the Bank of England sought to calm nerves by explaining that it had a contingency plan in place, that capital requirements for banks were now ten times higher than before the 2008 financial crisis and that banks had been 'stress-tested' against scenarios 'more severe than the country currently faces' meaning that they are well placed to continue lending.

The Bank had also made provision for an additional £250 billion should it be required. The following week, the markets swung, punishing housebuilders and banks more than other sectors as they cast around for a level that accurately reflected confidence and prospective returns. By 6th July Standard Life, Aviva, M&G and Henderson had suspended trading of their property funds as investors looked to withdraw cash in the wake of Brexit.

It was widely expected that the Bank of England would slash interest rates in July to 0.25% after data showed the UK economy ground to a near- halt at the end of the second quarter, even before the decision to leave the European Union was made. Sterling fell to a 31 year low against the US dollar to $1.29 on signs that interest rates cuts could be imminent.

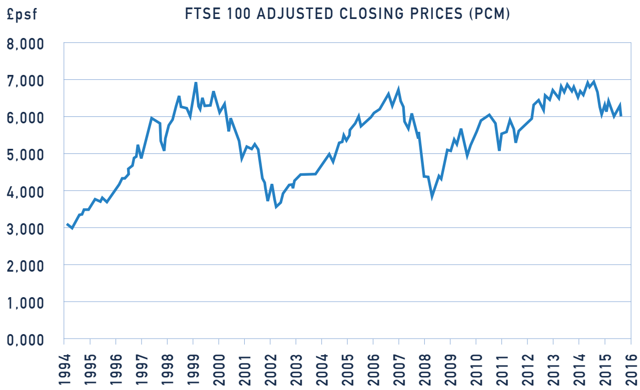
It is inevitable that there will be considerable political and administrative time and resource allocated to negotiating or renegotiating terms of trade deals and reassuring the sizeable share of the UK population who voted to Remain that their futures will be secure, that the UK still welcomes immigrants and that the economy is resilient. Politicians on both sides will also need to calm conflicts in their own ranks.

Employment is a key indicator for housing demand and employment trends in the financial and business services sector is particularly significant in Central London. In April, the CEBR expressed concerns about the prospects for the financial sector having seen that the number of new stock market listings was low this year (according to the PWC monitor), the FTSE had not performed well and productivity remained poor. The sector was told to brace itself for job losses and disappointing bonuses. "The City seems to be in real economic trouble," according to Douglas McWilliams, president of the Centre for Economics and Business Research (CEBR).

Some job losses seem inevitable in the banking and finance sector as the City sheds its role as Europe's leading financial centre though most commentators are confident of its continuing place as a global centre. CityUK, the group that represents the financial sector, was guarded in its initial reaction on June 24th. Its chief executive said "It is vital that action is taken to reinforce the global competitiveness of the UK as a place in which and from which to do business. This will help to mitigate the risk of prolonged uncertainty while a new relationship with the EU is negotiated."

FIGURE 1

FTSE 100 ADJUSTED CLOSING PRICES (PCM)



London's other great growth story – its tech sector - will inevitably be courted by rival cities. Berlin is probably the prime competitor and it already has a vibrant sector of its own on which to build. However, no other city in Europe has the combination of financial expertise and tech skills in one place and that could secure London's long-term place as the primary focus of the tech sector in Europe, if not in the EU.

Sales Market

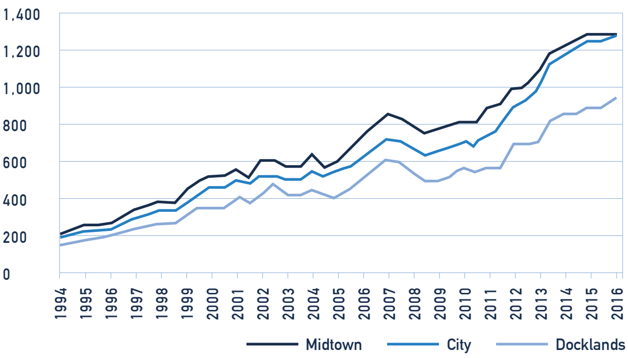
TRANSACTION NUMBERS FALL

Despite the indisputable slowdown in London's residential sales market in 2016, the average price of a one bed apartment surprisingly edged up by a further 3% in the first six months, adding £15,000 to the value and taking the average price to around £565,000 across the Midtown, City and Docklands.

Price rises were however confined to certain limited segments of the market. One bed apartments have proved more resilient than those with two or more bedrooms but there was no growth in Midtown, even for one beds and Docklands had more impetus than either the City or Midtown (see figure 2 and table 2). In terms of £ per sq ft, a one bedroom apartment in Midtown is now just under £1,300 and only marginally lower in the City. Docklands still trades at a significant discount at £930 per sq ft.

FIGURE 2

PRICE TRACKER - ONE BEDROOM APARTMENT



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

There is no doubt at all in our minds that the jump in buying costs that followed the changes to Stamp Duty in December 2014, has been a enormous drag on parts of the market and the impact has been most sorely felt in the demand for high value properties – which took a disproportionate share of the additional costs.

SHOREDITCH E2 - 1 BED APARTMENT - SOLD JUNE 2016 £650,000

For properties priced at over the magic £937,500, many buyers now hope for a concession on the asking price to offset their additional purchasing costs. The majority of vendors however, held firm on their prices in H1 2016.

Below £937,500, the market was more resilient but even here price growth slowed in Q2. In fact prices in our markets have now reached a point at which there is a resistance at all levels.

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	6%	550,000	30,000
H1 2016	3%	565,000	15,000

Source: Hurford Salvi Carr

Table 1 shows the annual rates of price growth for a one bed apartment in the resale market, the pattern is far from smooth. The highest rates of growth were achieved at 7-year intervals, in 1999, 2006, and 2013. While that may be a neat coincidence, it is our view that a similar rate of increase is unlikely to recur before 2020. The two periods of price falls followed external shocks to market that undermined the demand for residential property. In 2003, our markets were affected by the aftermath of the dotcom crash and in 2008 by the turmoil in the financial markets. The decision to leave the EU could create a similar shock to demand and we along with housebuilders and other agents lost sales and renegotiated prices following the referendum result.

Escalating prices coupled with high transaction costs have also reduced demand from potential buyers who only intend to be resident in the UK for a 2 to 3 year period. They are better housed in the rental market where transaction costs are low and they can benefit from block services without being liable for annual service charges. In a static market there is no fear of missing out on a capital gain.

Growth was not universal and, while the demand for one bed apartments has proved more resilient, the market for two beds is now considerably weaker. In fact, Docklands and East London was the only part of our markets where the price of a two bed apartment gained any significant value in H1 2016, with a rise of 4% in six months. That takes the average two bed apartment in Docklands and East London to around £650,000 – the same as a one bed in the City and Midtown. It is that price comparison that probably explains the stronger growth in Docklands and East London.

BLOOMSBURY WC1 - ONE BED APARTMENT - SOLD JANUARY 2016 £755,000

The cost of acquiring a home in Docklands and East London remains at a significant discount to our other markets (of over 30%) and this price advantage has helped to boost its appeal as the market slows and concerns over affordability increase.

After a long tradition of being dismissed as the least desirable area of the capital, East London is finally becoming a destination of choice. It has gained enormously in popularity and the price differential is narrowing between here and the more established parts of the capital. That is part of a long-term process and will override market cycles in the mainstream market.

TABLE 2

PRICES & PRICE CHANGES FOR 1 & 2 BED APARTMENTS IN THE RESALE MARKET

		2014 £	2015 £	MID 2016 £	Change H1 2016
Midtown	1 Bed	620,000	650,000	650,000	0%
	2 Bed	960,000	1,000,000	1,000,000	0%
City	1 Bed	595,000	630,000	650,000	3%
	2 Bed	810,000	840,000	850,000	1%
Docklands	1 Bed	420,000	450,000	475,000	6%
	2 Bed	600,000	625,000	650,000	4%

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

A buyer will get far more space and amenity for their money in Docklands and East London and the quality of many (though not all) new developments is high. Young professionals employed in the financial sector at Canary Wharf, Shoreditch and the City, are more able to access a stylish modern apartment with a view here than in any other part of London. The opening of the Elizabeth Line (formerly known as Crossrail) in 2018, will greatly improve connectivity and is already attracting buyers speculating on future values. There are Elizabeth Line stations due to open at Whitechapel and Canary Wharf.

The expansion of employment in the tech sector has undoubtedly been a key driver of demand for residential property in East London. Between 1997/8 and 2014/15, the number of 'digital' businesses in London rose from 33,200 to over 91,000 and 226,000 jobs were created in the sector (Max Nathan, 'London's Digital Economy', London Essays 2015.) Shoreditch has gained international recognition as the centre of London's digital industry and the statistics back that up - 17% of all jobs in Hoxton, Haggerston and Clerkenwell are in digital industries, compared with an average of 9.6% for London as a whole. The rise of Tech City has helped to shift the centre of gravity of London eastwards.

For the first time, in this report, we have introduced analysis of prices for 3 bed apartments. For this analysis we assume a long lease penthouse of 1,500 sq ft with 3 bedrooms, 2 bathrooms, with exclusive use of the top floor, a terrace and lift but no parking.

The value of a 3 bed penthouse has continued to grow in Docklands but has lost between 4% and 5% in value in City and Midtown in the first half of 2016. This pattern is a clear illustration of the search for value in the current market. A penthouse in Docklands can be acquired for a little over half the price of the equivalent property in Midtown and two thirds of the City which, given the growing status of East London, has a strong appeal (see table 3).

TABLE 3

AVERAGE SALE PRICE OF A 3 BED PENTHOUSE IN THE RESALE MARKET

	2014 £	2015 £	MID 2016 £	Change H1 2016
Midtown	2,750,000	2,600,000	2,500,000	-4%
City	1,800,000	1,900,000	1,800,000	-5%
Docklands	1,200,000	1,250,000	1,275,000	2%

Source: Hurford Salvi Carr *3 Bed, 2 Bath Penthouse, 1,500 sq ft terrace*

CLERKENWELL EC1 - AUTHENTIC LOFT - SOLD MARCH 2016 £795,000

In the past two decades, the price of a one bed apartment in Central London has risen more than six-fold across all of our markets, from Docklands to Midtown. The steepest growth over the past decade has been in the City market, around the periphery of the financial district where the regeneration of Clerkenwell, Shoreditch and, most recently, Aldgate, have driven price rises and narrowed the differential with the more established Midtown areas (see table 4).

Docklands homes lost more in capital value than our other markets in the aftermath of the financial crisis. We do not anticipate the same differential if there are price drops across the market in the aftermath of the EU exit. Docklands and East London have more momentum this time, they are no more at risk of oversupply than many other parts of London and may even become the focus of reduced demand if nervous buyers are reassured by their better value for money.

Between January 2008 and Mid 2009, prices fell by 17% in Docklands compared with 7% or 8% in Midtown and City, and recovered more slowly. But over the last six months Docklands' prices have outpaced growth in both City and Midtown, albeit by a small margin.

TABLE 4

LONG RUN PRICE CHANGES FOR A 1 BED APARTMENT IN THE RESALE MARKET

Submarket	1994 - H1 2016	2000 - 2016	2007 - H1 2016	2008 - H1 2016
Midtown	600%	166%	60%	76%
City	624%	191%	80%	98%
Docklands	611%	172%	57%	81%

Source: Hurford Salvi Carr

New Homes

The volume of new homes under construction remains far short of the Mayor's aspiration for the number estimated to be needed to house London's growing population, particularly when price and target market is taken into account. In Inner London, construction started on over 12,600 new units in the past year and just over 9,000 were completed between May 2015 and May 2016. The total number under construction at the beginning of the year was a little over 22,000. Very few, if any, of the homes under construction in Central London will be priced below £650,000 and the majority will be over £1 million.

It is the emphasis on high priced product that explains the apparent contradiction – a market with a severe and much debated housing shortage where developers with units to sell made some very generous offers to attract buyers, especially during the build up to the referendum. Offers to cover stamp duty were supplemented by guarantees to refund deposits if the UK voted to leave the EU, as well as incentives aimed at investment buyers such as: rental income guarantees or the payment of legal costs, service charges, ground rents and property management fees. The irony was not lost on the stock market and the main housebuilders' share prices lost value in June.

Despite the good intentions of the new Housing and Planning Act 2016 to increase the supply of new homes over the next 5 years to 1 million, the economic challenges that now lie ahead make this target look over ambitious. In the immediate aftermath of the vote to leave the EU, shares in the main housebuilders were hit hard as the markets clearly thought their businesses would be adversely affected.

CANALETTO, CITY ROAD N1 - 1 BED APARTMENT - LET JUNE 2016 £575 PW

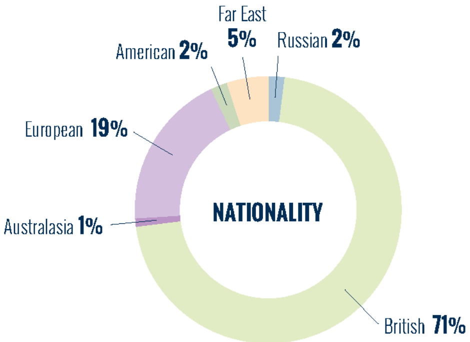
Uncertainty slows activity in residential property markets but London's housing shortage endures and housebuilders will need to generate cash flow. This might lead to more bulk deals whereby bundles of new build apartments are sold to investors building PRS portfolios. There have been some examples of this already in H1 2016.

Many commentators were disappointed that, despite the government's declared support for the emergence of an institutional private rental sector, no incentives were forthcoming in the March budget. In fact the 3% SDLT surcharge, which at first was intended to exclude portfolios of more than 15 properties, was extended to include all landlords irrespective of scale. Another blow to the housing market caused by government tax policy.

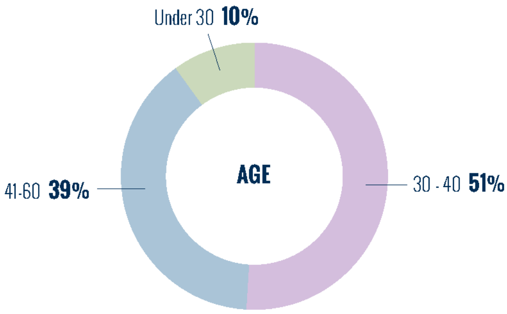
FISH ISLAND E3 - 112 APARTMENTS - SOLD 2015 / 2016 FROM £415,000 - £565,000

H1 2016 BUYER PROFILES

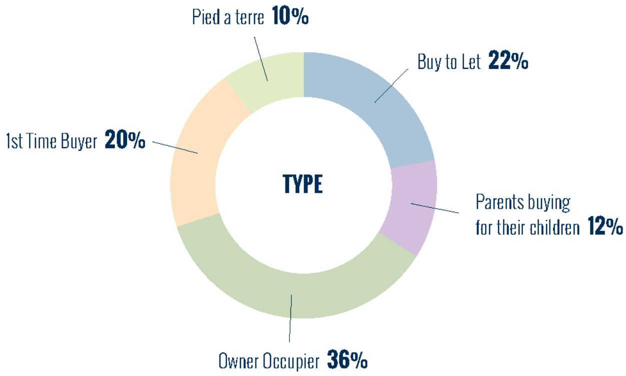
Nationality
British buyers have accounted for a steadily growing proportion of all sales over the last year, rising from 56% in H1 2015 to 71% in H1 2016. Perhaps surprisingly, given the uncertainty over the EU referendum, European buyers have accounted for almost 20% of all sales. The sharpest fall has been from the Far East whose share of sales has fallen from 12% in H1 2015 to 5% in H1 2016, although back in 2013 they made up 25% of all purchases.



Age
Buyers under 30 made up only 10% of all sales in H1 2016 whereas in the first half of last year they accounted for 32%. It is hard to explain this stark contrast. This may be linked to the loss of Far Eastern buyers who may have been arriving as students with parental funds to purchase a base.

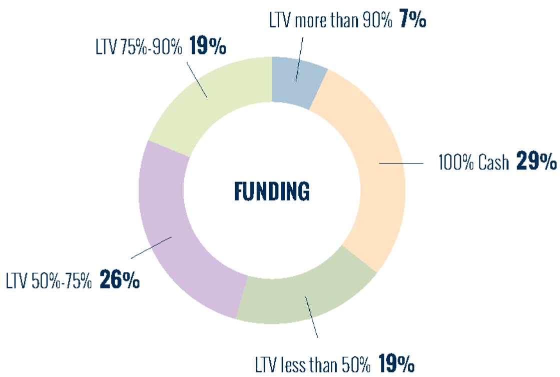


Buyer Type
In one form or another, 56% of all sales in H1 2016 through our offices, were for owner occupation - 36% of purchasers were identified as owner-occupiers, and a further 20% as first time buyers. Around a third (34%) were in some way investors – either parents buying for children or buy to let and the remaining 10% were somewhere between the two buying a pied-a-terre not as a first home but for intermittent occupation. This means that 44% were liable for the 3% additional SDLT applicable to investors and second home owners.



The steep rise in first time buyers may be explained by a restructuring of ownership in response to the stamp duty changes whereby a parent may prefer to hand over a deposit rather than buy an 'additional home' for the use of their children.

Funding
Almost a third of buyers funded their purchases entirely with cash and half borrowed less than 50% of the purchase price. This distribution mirrors 2015 almost exactly with around 20% borrowing 75% or more. This is a far cry from 2014 when almost 46% of all purchases were made with 100% cash, perhaps reflecting the far greater presence of Far Eastern buyers in our markets at that time.



Housing and Planning Act 2016

The Housing and Planning Act became law on May 13th 2016 when it received royal assent after a far from smooth journey through the House of Lords, having suffered 18 government defeats. The length and tone of the debate illustrates the importance now attached to housing issues in the UK. This new Act forms part of the Government's plans to promote home ownership ahead of the rental sector as they believe that home ownership boosts support for the Conservative party. At a time when demand for rental accommodation continues to grow, this crude example of social engineering appears to be at odds with market forces.

Former civil servant, Lord Kerslake, was a leading figure in objecting to policies he believed would damage the housing market, namely the extension of the right to buy policy to Housing Association properties, the obligation on councils to sell high value council homes (in order to fund the sales of Housing Association properties) and the promotion of starter homes in planning, at the expense of alternative forms of affordable housing. He, and many others, remain of the view that the UK needs to build housing of all tenures, including social housing.

Under the new Act, the Right to Buy policy has been extended to Housing Association properties - meaning that tenants can buy their rented homes at discounted prices and councils are obliged to sell 'higher value' council homes - but there is a requirement to replace the sold stock which, in London, must be two new homes for every home sold. Planning authorities now have a duty to actively promote the development of Starter Homes which means that Starter Homes can now be offered as part of the negotiation for planning consent, although there were some modifications to the terms.

The headline policies are:

Planning
- To compile, maintain and publish registers of brownfield land.
- To grant permission on serviced plots to support a doubling of the number of custom-built and self-built homes to 20,000 by 2020
- Ensure that every area has a local plan and more community liaison
- Reform compulsory purchase process to be clearer, fairer and faster
- Simplify and speed up neighbourhood planning
- Starter homes to be delivered on all 'reasonably-sized' sites, as an affordable housing category.

Housing
- Starter homes available at a 20% discount to first time buyers
- Social tenants on higher incomes will pay higher rents
- A duty on councils to consider selling higher value homes when vacant
- Give local authorities more powers over rogue landlords
- Allow local authorities to access data held by Tenancy Deposit Protection schemes.
- Reduce regulatory controls on private registered providers
- Enable lead enforcement authority for estate agents

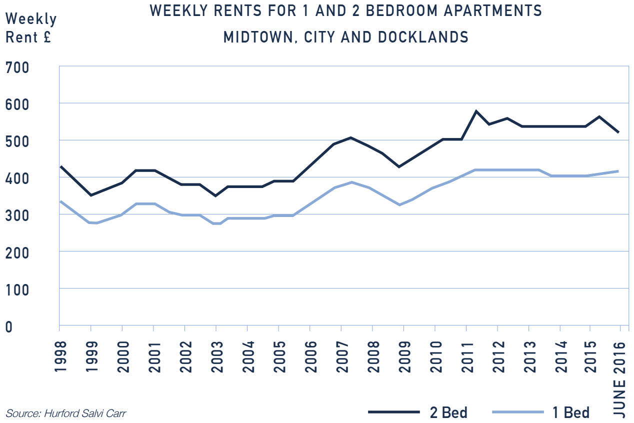
Rental Industry
There were two further enabling amendments and the DCLG will consult on details before the regulations are published next year:
- Letting and managing agents who hold client money, such as rent or service charges, must belong to a client money protection scheme.
- Rented properties in the PRS must meet acceptable electric safety standards.

Lettings Market

SUPPLY INCREASES

There was very little change in rental values across Midtown, City and Docklands in the first six months of 2016, which is perhaps surprising given that the sales market was slow and yet London is famously bursting at the seams as its population expands. It would seem logical to expect a growing population which is shying away from buying property, to create pressure in the rental market - and for that to translate into rising rental values - but that has not been the case (see figure 3).

FIGURE 3
WEEKLY RENTS FOR 1 AND 2 BEDROOM APARTMENTS
MIDTOWN, CITY AND DOCKLANDS



Source: Hurford Salvi Carr

On average, the rent for a one bed apartment has risen by 1% in the first six months of 2016, to £420 per week. Meanwhile rents for 2 bed apartments have fallen by around 2% over the same period. The only part of our market to experience any rental growth at all this year is Midtown and then only for one bed properties, which gained around 5%. Even here, the rental value of a 2 bed apartment slipped back by 2% (see table 5).

The profile of typical tenants has changed in recent years for 2 bed properties. Where once the typical lessee would have been a couple who wanted a spare bedroom, today 2 bed apartments are far more likely to attract a group of 'professional sharers' while couples wanting an apartment to themselves favour a one bed as a way to contain costs without compromising on a Central London location.

TABLE 5
WEEKLY RENTS FOR 1 AND 2 BEDROOM APARTMENTS
IN MIDTOWN, CITY AND DOCKLANDS AT YEAR END

Submarket		2014 £	2015 £	H1 2016 £	% Change 2014 / 2015
Midtown	1 Bed	425	440	460	4.5
	2 Bed	625	640	625	-2.3
City	1 Bed	425	440	440	0.0
	2 Bed	550	580	560	-3.4
Docklands	1 Bed	360	370	370	0.0
	2 Bed	430	450	450	0.0
Annual % change	1 Bed	403	417	423	2
	2 Bed	535	557	545	-2

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

Despite minor fluctuations, rents are broadly at the same level today as they were 5 years ago, in 2011, and the reason for that is a steady rise in supply. This year, rental stock has been boosted by the flow of development completions as properties bought as investments come to the market, in addition to the familiar cocktail of buy-to-let investors and 'accidental landlords' – those who hold on to properties that they own rather than return them to a sluggish sales market. There are also new landlords attracted by the opportunities for short-term lettings that have been opened up by operators such as Airbnb. The upshot is that tenants have more choice and rents have not risen.

NARROW STREET E14 - 2 BED APARTMENT - LET FEB 2016 £400 PW

There has also been a fall in demand from some quarters. There are for instance, fewer corporate tenants looking to rent homes this year. A couple of changes probably explain this: first, a growing number of serviced apartments provide an alternative to more conventional short term rental arrangements – spreading the demand more thinly and second, uncertainty created by the EU referendum has undermined demand from EU nationals. There are other factors contributing to reduced turnover – the financial sector is subdued, the length of time a tenants stays is getting longer and new locations are gaining in popularity in zone 2 and beyond.

TABLE 6
AVERAGE WEEKLY RENTS OF A 3 BED PENTHOUSE

£ per week	2014 £	2015 £	MID 2016 £	CHANGE H1 2016
Midtown	1,400	1,500	1,400	-7%
City	1,300	1,200	1,000	-17%
Docklands	700	725	700	-3%

Source: Hurford Salvi Carr *3 Bed, 2 Bath Penthouse, 1,500 sq ft terrace*

In summary, there is more supply of rental property competing for what is, in effect, a smaller pool of tenants. Landlords understand the dynamics of the market and would rather reduce their asking rent than face a prolonged void period.

For the first time, in this report, we have introduced analysis of the rental market for a 3 bed penthouse apartment, (see table 6). As with the analysis in the sales market, we have assumed a penthouse of 1,500 sq ft with 3 bedrooms, 2 bathrooms, with exclusive use of the top floor, a terrace and lift but no parking. As with the sales market, the rental value in Docklands and East London is half that of Midtown and discounted by around one third of City rents.

The cost of renting larger homes has fallen in 2016 across all of our markets, though it has been most acutely felt in the City with a drop of 17% in six months. We attribute this at least in part to an increase in the supply of 3 bed apartments – as explained above.

While using per square foot values can be misleading because there are so many variables that can affect the valuation of an individual unit even within a single block, it is a useful basis on which to compare value with alternative uses. Residential values per sq ft in our markets range from £31 per sq ft for a two bed in Docklands to £48 per sq ft for a 1 bed in Midtown.

TABLE 7

ANNUAL RENTS FOR 1 AND 2 BEDROOM APARTMENTS IN MIDTOWN, CITY AND DOCKLANDS, H1 2016

Submarket		Weekly Rent	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£460	500	£23,920	£48
	2 Bed	£625	750	£32,500	£43
City	1 Bed	£440	500	£22,880	£46
	2 Bed	£560	750	£29,120	£39
Docklands	1 Bed	£370	500	£19,240	£38
	2 Bed	£450	750	£23,400	£31

Source: Hurford Salvi Carr

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

Across all of our markets these values are below the per sq ft values now achievable for office space. This basic comparison gives a strong signal that residential values can no longer be assumed to outshine commercial. Office space in Clerkenwell, of a basic specification, can command rents of over £60 per sq ft.

Reports in the media of rental growth seem often to be grossly exaggerated and not reflective of Central London rental market. In our markets, rental values have risen by some 30% in just over a decade and a half – that equates to an average of around 2% per annum and is in stark contrast to sales prices - which grew by around 180% over the same period. Rents broadly track wages growth over the long term unless there is a particular local over- or under-supply. One explanation for the misconception is that the quality of a standard rental property in zone 1 has risen significantly over the past couple of decades, so when we compare average rents over time, we are not really comparing like with like.

TABLE 8

LONG TERM RENTAL GROWTH

	2000 - H1 2016	2007 - H1 2016
1 Bed	29%	9%
2 Bed	30%	8%

Source: Hurford Salvi Carr

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

One bedroom apartments are popular as investments in Central London. Their lower price point means that they have generally avoided the increases in stamp duty levies since December 2014 and they attract strong tenant demand in our markets, meaning that they tend to have shorter void periods and better yields than larger units.

In a stable market, tenants are more likely to be satisfied and extend their leases and we have found landlords increasingly willing to accept that a longer period of continuous income, compensates for lack of income growth.

However, it has also created some disappointed investors who may have been set unrealistic expectations of annual rental growth. The buy to let market has certainly been undermined over the past year as the government has introduced successive measures to redress the balance of power between investors and owner occupiers. Investors with buy to let mortgages have been hit by four policy changes that reduce their margins, these are shown in the table below.

TABLE 9

NEW POLICY CHANGES WHICH AFFECT BUY TO LET MORTGAGES

Income Tax relief on mortgage costs	Between 2017 and 2020 income tax relief on mortgage payments will be phased out and replaced by tax credits at a maximum of 20%
Wear and Tear allowance	Landlords can no longer claim a wear and tear allowance which was formerly 10% of rent. In future, the off-set can only relate to actual expenses.
Stamp Duty	There is a 3% surcharge on normal stamp duty rates for 'additional' homes - ie properties that are not a main home.
Regulation of mortgage debt	The Bank of England may impose a rule that says rent must cover 125% of mortgage interest payments at a 'stressed' rate of 5.5%.

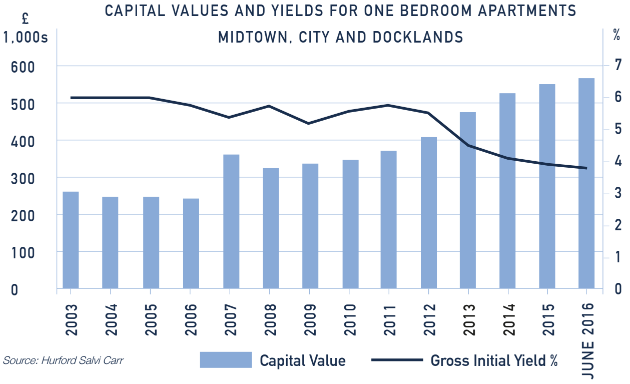
Source: Hurford Salvi Carr

Institutional private rental sector (PRS) does not play a significant part in our markets and we do not expect that to change because high capital values mean that yields are lower and investors cannot compete for land with market sale developers.

From the end of 2015 to mid 2016 there was a small increase in the rental value of a one bedroom apartment and a small increase in capital value. That meant that the gross yield stayed constant at 3.9%. The net yields however have been eroded by the additional costs of acquisition and gradual withdrawal of tax reliefs on mortgage debt for buy to let investors. This gradual erosion of initial yields over the past 5 years has tempered the attraction of investment and helped to dampen capital value growth.

FIGURE 4

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



Source: Hurford Salvi Carr

TABLE 10
INCOME, VALUES AND INITIAL YIELDS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND DOCKLANDS 2002 TO MID 2016

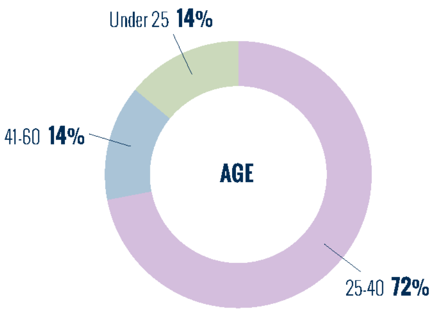
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	MID 2016
Gross Annual Income £	15,600	14,820	14,820	15,340	18,200	20,020	18,200	17,680	19,760	21,840	21,840	21,840	21,060	21,580	21,840
Capital Value £	260,000	245,000	246,000	270,000	340,000	371,000	318,000	338,000	352,000	386,000	405,000	486,000	520,000	550,000	565,000
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	3.9

Source: Hurford Salvi Carr

H1 2016 TENANT PROFILES

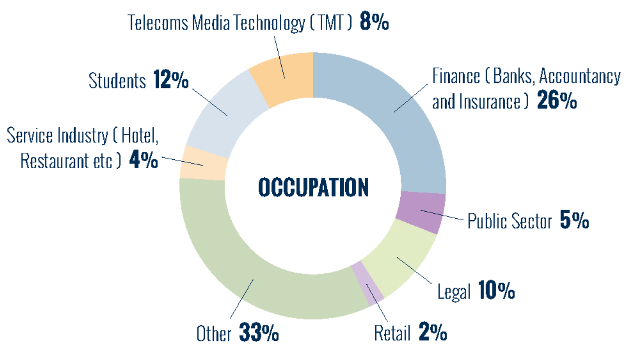
Age

The age profile of tenants taking property in our areas is fairly consistent. There is unsurprisingly a strong bias towards young adults and in H1 2016 around 70% were aged 25 to 40. In the second half of any year the proportion of under 25s rises as students take on new leases in the late summer and early autumn.



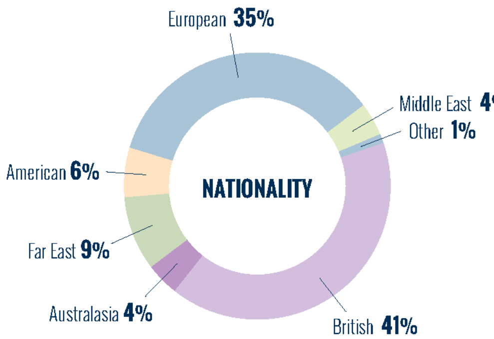
Occupation

People employed in the financial sector consistently make up between one quarter and one third of those signing new tenancies in our markets. Other important employers include tech sector and legal. This pattern reflects the key employment sectors in the City, Holborn and Docklands and growth in these sectors underpins property values in our markets.



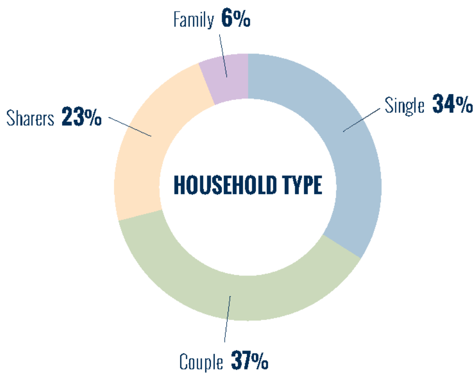
Nationality

British people have made up a growing proportion of all tenants in our markets over the last couple of years and in H1 2016 they accounted for 41%, compared with 30% in 2015 and only 23% in the first half of 2015. We catered for fewer tenants from the Far East – they made up only 9% compared with 13% in H1 2015 and 15% over the whole year. Americans were also less in evidence this year. A year ago 16% of the homes we let were to Americans compared with only 6% in the H1 2016, although their share had already fallen by the second half of 2015. This is not a seasonal fall, but it may reflect uncertainty in the financial sector over Brexit.



Household Type

Very few families leased properties through our offices in H1 2016, the vast majority were singles, couples or sharers, with a balanced mix between the three groups and that is typical of our markets.



The New Mayor of London - Sadiq Kahn

On May 5th Sadiq Kahn was elected as Mayor of London – the first Labour mayor for 8 years.

Housing is seen as a significant threat to the future prosperity and well being of the city and his campaign Sadiq dubbed the election: 'a referendum on housing'.

He had been critical of Boris Johnson's record on affordable housing delivery and during his campaign he set a target of 50% affordable homes with all new development. He also pledged to use his mayoral powers and land to stop 'buy-to-leave' and to give 'first dibs' to first-time buyers and local tenants in order to end what he called 'the scandal of thousands of homes in new developments being sold off-plan to overseas investors each year'.

Some of his policy intentions have the potential to deter development but he will not want to curtail housing delivery so we expect him to work with the industry to find pragmatic, workable solutions.

Following Brexit, Sadiq talked up London's position in the world and advocated that London would flourish despite the fallout for the economy and used the referendum result to push his claim for London to be given more autonomy and more control over taxes raised in the capital.

James Murray has been appointed deputy mayor for housing. While at Islington he built a reputation for robust housing policy - which might be a good guide as to the future intentions of the mayor. That would include a strong commitment to affordable housing, tackling overseas investors and buy to leave and confronting developers over viability negotiations.

Richard Blakeway, Boris's deputy mayor for housing, was a familiar figure at property industry events and is now an advisor to the prime minister.

Some early proposals include :

A Living Rent set at one third of local wages. It is not yet clear whether this will apply to single or household income, median or average earnings etc nor whether it will replace the current definition of affordable rent (80% of market value).

More rigorous viability assessments on affordable housing but he does not seem to be rigidly wedded to the 50% target of his election campaign.

Homes for Londoners will be a new and powerful unit within the GLA set up to plan, finance and build new homes on vacant land in public ownership.

Sadiq wants to review the process for releasing public land, use mayoral powers to accelerate progress and impose rules to ensure that Londoners get first priority on affordable homes, including part rent/part buy.
One idea floated is that large employers could be asked to put up some of the finance to build new homes and in return they would get a guarantee that some of those homes would be for their employees.

Khan has affirmed a commitment to protecting the greenbelt but seems, in early debates, to be open to exceptions.

Landlord Licensing has been highlighted as a way to improve standards in the private rental sector but there are no details as yet.

Schemes in Newham and Tower Hamlets are yet to offer tenants any real benefits from landlord licensing probably because the local authorities do not inspect properties in return for collecting high licensing fees. The cost of a licence is around £500-£600 biannually. The market would be more accepting of this policy if there was an obvious benefit and not seen as a money making exercise.

Khan also wants to encourage the expansion of an institutional private rental sector and create a not for profit lettings agency.

Small business and creative industries will also be given priority by the mayor. He has said that he will put new measures in place to protect small units of affordable business and studio space and to encourage mixed use within housing developments.

Future Prospects

UNCHARTERED TERRITORY

At the end of 2014, ahead of the UK General Election, we wrote: "Looking to 2016, the prospect of an in-out referendum on Europe will have an impact on all aspects of the UK economy including London's housing markets. The most important component in London's housing market is demand, and demand is driven by confidence in the London, UK and global economies. We would expect confidence to evaporate in the build up to a vote on the UK's future and that will stall the market."

Our reports are not published to make headlines, they are simply intended to share our perspective on events and trends in our own markets. Difficult as it is to remember a time before Brexit dominated all forms of media, the referendum was not attracting much, if any, attention at that time. Ours was a quiet voice but it proved prophetic and, as we expected, the market produced very little post-general election bounce in 2015. By early 2016 it was once again mired in inaction, dragged down by a combination of stamp duty rises and Brexit fears.

Unfortunately, the decision to leave the EU, far from putting an end to the uncertainty, has prolonged it for many months and probably years. First we must wait for a new Prime Minister and then the negotiations for a withdrawal from EU and a new set of trading agreements.

Until then, notice to leave under Article 50 will not be served and there is even some doubt over whether it ever will be. Parliament is not bound to give notice to leave although it would be politically difficult to avoid. There is even a possibility that a general election could be called well before 2020.

Political uncertainty will sap confidence from the housing market and what has been a buyers market in the first half of 2016, will now deteriorate into a cycle of speculative offers from buyers that have little or no chance of being accepted by owners. Transaction numbers in the second half of the year will fall further. Unencumbered buyers will have the best opportunity since 2008 to secure quality homes in central London without the pressure of competition from other buyers. By October/November, the spectre of a US election may add to the drag on the market.

Uncertainty in financial markets, and delays in corporate investment decisions plus planned infrastructure projects are likely to lead to some job losses and asset write-downs in the financial sector. This means that bonus pools will shrink and these are normally a significant driver of house price growth in our markets. We predict a 5% fall in house prices in H2 2016 with the potential for further falls in 2017.

It is a truism that every cloud has a silver lining and from this negative sentiment there will be opportunities for some. Currency exchange rates and downward pressure on prices, will present buying opportunities for overseas investors. Housebuilders will relaunch schemes in the autumn or hold off until 2017 in the hope of capturing some of this overseas demand and this will conflict with the new Mayor of London's stated aims to make housebuilders offer homes to Londoners.

The widely expected fall in interest rates this year will offer some welcome relief to UK investment buyers and we also expect to see overseas buyers cautiously return to the London market in early 2017, lured by a combination of lower pricing and advantageous exchange rates. We anticipate a range of buying opportunities for cash rich investors looking for a long term hold.

The rental market will be less exposed to downward pressures and could receive a boost from so much uncertainty. The third quarter is always the busiest for the Central London rental market and this year will benefit from a quiet sales market with people unwilling to commit to long-term decisions, choosing to rent for the time being. However there is a threat to demand if employers restrict graduate recruitment. That is what happened after the financial crisis and there is every reason to expect a lower graduate intake this autumn.

A high level of new homes being added to the supply of rental accommodation on a monthly basis across London will in our view keep rents unchanged over the next 18 months. The private rental market is unlikely to be thrown off course as it moves towards accommodating the predicted 40% of London's population in the next decade.

We expect serviced and short term rental operators to be beneficiaries of a weak pound and can expect a boost from tourism in London.

We cannot forget however, that the referendum was not the only issue slowing the housing market. The punitive rate of Stamp Duty levied on sales over £1 million with an additional 3% levy on second homes and investments, has blighted the top end of the market.

The vote to leave the EU may bring forward a decision to reduce Stamp Duty to free up the impasse for properties over £1 million. Without it we see little prospect for a return to normal market conditions. The Government will want to create activity at the upper end of the housing market to flow through the system.

Parental help, inherited wealth and low interest rates will support transaction volumes below £1 million although, even here, we are not expecting any significant price growth. London's lacklustre rental yields and high Stamp Duty costs will mean London struggles to compete with alternative cities around the globe for investment.

Britain's decision to leave the EU shocked the nation and the world and the impact on the London's housing market is bound to be negative in the short term. Business and political leaders will rally to make the best of the circumstances in which they find themselves and, given that the result was never a foregone conclusion in either direction, most will have made plans for this outcome.

Although some way off we can see the opening of the new Elizabeth Line in 2018 may coincide with an improvement in demand for Central London housing, but expect the next 18 months to be challenging.

WEST END
39 Store Street
London WC1E 7DS
Sales & Lettings
020 7299 3322
westend@h-s-c.co.uk

CITY
37-41 St John Street
London EC1M 4AN
Sales & New Homes
020 7250 1012
sales@h-s-c.co.uk

CLERKENWELL
1 Britton Street
London EC1M 5NW
Lettings
020 7490 1122
lettings@h-s-c.co.uk
Commercial
020 7566 9440
commercial@h-s-c.co.uk
Development & Investment
020 7566 9444
investments@h-s-c.co.uk

ISLINGTON & SHOREDITCH
227 City Road
London N1 7NA
Sales & Lettings
020 7549 6969
cityroad@h-s-c.co.uk

ALDGATE
61 Alie Street
London E1 8EB
Sales & Lettings
020 7680 1888
aldgate@h-s-c.co.uk

DOCKLANDS
9 Branch Road
London E14 9HS
Sales
020 7791 7000
sales.docklands@h-s-c.co.uk
Lettings
020 7791 7011
lettings.docklands@h-s-c.co.uk
Property Management
020 7791 7033
management@h-s-c.co.uk
Renewals
020 7791 7022
management@h-s-c.co.uk

CITY LIVING 20 YEARS ESTABLISHED 1996

HURFORD SALVI CARR

hurford-salvi-carr.co.uk