research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 2016

“

The ‘new normal’

is a low transaction,

post-growth environment.

”

HURFORD SALVI CARR

Market Overview

SALES MARKET GRINDS TO A HALT

2016 was a momentous year for the UK, marked by its mid year shock decision to leave the EU and drawing to a close behind the US's unlikely election of Donald Trump as its 45th president.

Six months on from the EU referendum and after enduring 2 years of the most punitive stamp duty rates, the market actually seems to have reached a state of relative calm. The 'new normal' is a low transaction, post-growth environment. Buyers and sellers have accepted that prices are no longer rising and their behaviour has become more predictable as a result. The same can be said of landlords and tenants who enjoyed a stable market in 2016.

A low growth London market is not unwelcome but it does have consequences. The number of sales completed across Midtown, City and East London in 2016 was 60% lower than in 2015 and 2015 was already 20% lower than 2014. That experience is representative of the wider Central London market according to Land Registry data. It has led to some 'post Brexit' price reductions but, if buyers are not in the mood for buying, no amount of price reduction will change their minds. Indeed seeing prices reduced can undermine confidence in the whole idea of becoming a homeowner. Despite price reductions of around 5% in H2, transaction levels remain stubbornly low.

As we have said many times before in this research report, Central London owners are rarely forced-sellers and when prices are flat or falling, owners simply choose not to bring their properties to the market. That leaves fewer options for those who want to buy, increases the supply of rental stock and yields less stamp duty for the Treasury. The fact that house moves are known to be one of the key triggers for consumer spending, supporting retail sales of home-wares, furnishing and DIY, will be on the government radar.

While all is quiet on the sales front, activity has been channelled into the rental market. Not only are disaffected vendors deciding to let their properties instead of selling but prospective buyers are choosing to rent rather than own a home – thus, crucially, demand and supply for rental property have both increased although the boost to supply has been greater. Supply has had an influx from three sources: investors (who rushed to buy ahead of the April stamp duty deadline on second homes), owners (who have been unable to sell at the price they hoped for) and developers (who have completed schemes pre-sold to investors).

At the same time the government targeted Landlords with additional taxes including an additional 3% stamp duty that was added to investment purchases in April 2016. This further eroded the return along with new restrictions on investor's ability to offset interest on a buy to let mortgage against tax from the rental income which will begin to take effect from April 2017. This is part of a wider anti-landlord agenda which is intended to improve the chances of first time buyers getting onto the housing ladder.

The spectre of Brexit has undoubtedly cast a shadow over 2016 and residential sales were hit by a period of inactivity leading up to referendum. It is a shadow that is unlikely to lift any time soon, particularly since the high court decision to give parliament the right to vote on triggering Article 50 – and Theresa May's appeal. With so many factors in doubt – trade tariffs, border controls, cultural attitudes, political sympathies, employment trends, business confidence, and now the date of Article 50, the temptation for buyers and sellers to 'wait and see' is strong – and without capital growth, there is no pressure to make to a hasty decision.

> “ Central London property owners rarely feel the need to sell in a buyers' market. ”

Residential property markets are driven by the utter inevitability of life events - birth, death, and marriage but in Central London demand is highly discretionary with confidence in the London economy, jobs and the property market all influencing buyers of pied-a-terres, apartments for children studying in London and investments. In 2016 all of these buyer groups decided to stand back and watch and in doing so they lost confidence in the market as so few properties were sold.

THE FACTORY, SHOREDITCH, N1 - DUPLEX PENTHOUSE - SOLD NOVEMBER 2016 £2,370,000

We ended the year with a very welcome sense of realism as buyers and sellers began to return to the market with some reassurance that life after Brexit may not be as daunting as some campaigners had feared.

Economic Overview

BREXIT FALLOUT

UK headline economic statistics have been kinder than expected in post-referendum Britain but few now expect such a benign outlook to continue long into 2017 given the extent of uncertainty surrounding the terms on which the UK will be able to conduct its business with the rest of the world after 2019.

It seems inevitable that the impact of a weak currency will begin to show in inflation trends and balance of trade as imported goods become more expensive for UK buyers. The reverse of course, is the hugely beneficial impact of a weak currency on the amount of money spent by overseas visitors in our shops.

HATTON GARDEN EC1 - 2 BEDROOM PENTHOUSE - LET OCTOBER 2016 £950 PW

The UK economy grew by 0.5% in the third quarter of the year. Business investment rose as did consumer spending. The ONS reported that the economy had, so far, 'shown limited signs of having been impacted by the EU referendum.'

On the thorny subject of Brexit, as long as there is uncertainty around the outcome of the negotiations, businesses must make contingency plans for the 'worst case scenario'. Banks are particularly sensitive and, in the City, they are already in the throes of setting up parallel operations within other EU cities, most often Dublin or Frankfurt, so that they can transfer operations seamlessly and continue to service their clients' needs, in the event that the negotiated settlement is not favourable.

The Office for Budget Responsibility revised down its forecast for economic growth to 1.4% for 2017, substantially below its previous forecast of 2.2%.

It is estimated that the UK economy will be £122 billion worse off by 2020 than previously thought. The UK's low interest rate environment seems set to persist for some time to come. The Bank of England has indicated its intention to keep rates low to protect the fragile post-Brexit economy in spite of inflationary pressures. In a speech in November, Ben Broadbent, the deputy governor of the Bank of England, noted that the real price of shares was the same today as it was 20 years ago and that the same is also true of house prices. Of course that does not reflect the growth trajectory of the London housing market over the past two decades.

In as far as Brexit affects demand for property in our markets, there are no immediate job losses as a result of Brexit. There may be a greater tendency to rent rather than buy and the possibility of reduced demand in the longer term. Subdued hiring from the corporate sector reduced new rental enquiries in Q4.

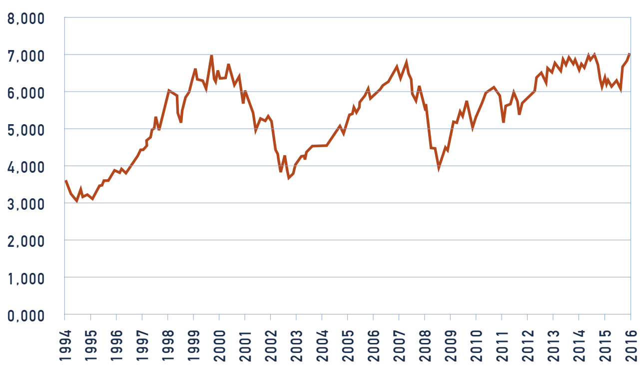
The other stalwart of our markets, the tech sector, appears to have given London an enormous vote of confidence. Google confirmed its commitment to a European headquarters at King's Cross, Apple announced that it would consolidate its operations at Battersea Power Station and the Malaysian Digital Economy Corporation (MDEC) announced that it would open a base in London to promote trade with digital businesses.

The Chancellor did not take the opportunity to reduce stamp duty in the Autumn Statement despite robust lobbying from a number of organisations. The calls for some concessions on stamp duty rose in the weeks following the Autumn Statement with headlines reporting steep falls in transaction volumes and greatly reduced tax take for the exchequer. The Bank of England issued warnings about the risk of banks being over-exposed to buy to let lending. Ironically, given that almost all rental property is in the hands of small landlords, his statement could actually cause the very instability he fears by prompting landlords to sell out of their investments.

In a further knock to the private rental sector, the Chancellor proposed that agents should be banned from charging of fees to tenants – there is a cost to work involved in arranging and documenting new or renewed tenancies and that cost will now be carried by the landlord who, in order to preserve an acceptable rate of return on investment will hope to pass it on to the rent. This, on top of the 3% stamp duty levy on additional properties, the reduction in tax reliefs and extra management obligations is seen by many now as part of an on-going 'war on landlords'.

FIGURE 1

FTSE 100 ADJUSTED CLOSING PRICES (PCM)



Sales Market

TAXATION CRISIS

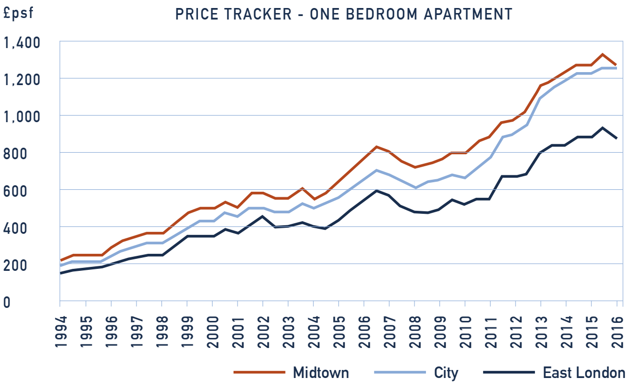
The number of properties sold plummeted in 2016 across prime Central London and our market areas of City, Midtown and East London, reflected that trend - transactions fell by 60% compared to 2015. There is no doubt that the main culprit was Stamp Duty although Brexit added to the torpor. The marked difference between rates of activity above and below £937,500 proves that the December 2014 Stamp Duty increases are the main drag on the market - and the higher the price, the greater the loss of sales. It is no surprise that there is now a growing voice lobbying the Chancellor to consider some concessions on stamp duty rates to support the market and stimulate the economy.

CLERKENWELL EC1 - 5 BEDROOM MEWS HOUSE - SOLD NOVEMBER 2016 £3,500,000

During 2016 a growing number of properties remained on the market for 12 months or more. Most owners in our markets are in a position to hold out for close to their target prices and, in any event, price reductions are relatively ineffective in boosting demand when buyer confidence and buyer numbers are low. In these circumstances, sellers look for alternative strategies. One alternative is to remove properties from the open market but continue with discreet marketing to a selective audience of serious buyers who are ready to commit. In any event, online visibility can be perceived as counter-productive by vendors in the current market – which is a somewhat surprising development.

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*

Prices were remarkably resilient, given the fall in transactions, at least for the smaller properties. The price of a one-bed apartment ended 2016 where it began in Midtown and East London although in both markets, prices had edged upwards and settled back during the course of the year. The City actually experienced a 3% price increase in 2016, all of which occurred in the first half. (Fig 2) .

TABLE 1

PRICES AND ANNUAL GROWTH FOR ONE BEDROOM APARTMENTS IN THE RESALE MARKET AT YEAR END : AVERAGE FOR MIDTOWN, CITY & EAST LONDON

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
2016	1%	555,000	5,000

Source: Hurford Salvi Carr

Buy to let investors and buyers of pied-a-terres purchasing one bed apartments seemed to be willing and able to absorb the 3% additional stamp duty imposed in April 2016 but higher value properties, where stamp duty was already punitive, felt the pressure.

By the final months of the year there were more serious buyers back in the market, viewing more properties and willing to make offers – especially in the market under £1 million. The press is no longer reporting steep rises and some buyers might even secure a price discount.

We have monitored prices for almost 20 years in Midtown City and East London and maintained a watch on prices of resale properties averaged over all three areas. At the end of December the average price of a resale apartment was £555,000, which would give the owner a capital value gain of £5,000 over the year. (Table 1).

LIMEHOUSE E14 - 2 BEDROOM DUPLEX - SOLD JULY 2016 £850,000

Prices for larger properties fell in 2016, as we reported in our half year report, for the first time since the aftermath of the global financial crisis in 2008. It was most acutely felt in the 3 bed market where prices exceed £1 million in all three of our areas but also felt for 2 bed properties. We have noted this downward pressure over the past year as potential buyers compromise on size or location to keep a lid on the cost of property. In other words, buyers who might otherwise have wanted a spare bedroom or study in Central London are more likely to settle for a 1 bed flat assuming that they are committed to a Central location.

The price of a 3 bed apartment (penthouse) in Midtown dropped by 15% this year – underlining the weakness of demand is this segment of the market. There is oversupply of 3 bed apartments and they are more likely to appeal to sharers than to families for whom the planning system intended them.

TABLE 2

PRICES & PRICE CHANGES FOR 1,2 & 3 BED APARTMENTS IN THE RESALE MARKET

		2014 £	2015 £	2016 £	Change % 2015-16
Midtown	1 Bed	620,000	650,000	650,000	0%
	2 Bed	960,000	1,000,000	950,000	-5%
	3 Bed	2,750,000	2,600,000	2,200,000	-15%
City	1 Bed	595,000	630,000	650,000	3%
	2 Bed	810,000	840,000	840,000	0%
	3 Bed	1,800,000	1,900,000	1,750,000	-8%
East London	1 Bed	420,000	450,000	450,000	0%
	2 Bed	600,000	625,000	600,000	-4%
	3 Bed	1,200,000	1,250,000	1,100,000	-12%

Source: Hurford Salvi Carr *1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths, 3 Bed is 1,500 sq ft with • Baths*

The price of London residential property has been on a fairly strong upward trajectory for more than two decades with little reprieve. Our long run time series, (Table 3), shows that very clearly with capital value growth of around 600% in all three of our markets. The growth has been driven by a number of factors including: the re-population of Central London; the colonising of new areas and the injection of overseas investment capital.

KINGS CROSS N1 - 2 BEDROOM HOUSE - SOLD SEPTEMBER 2016 £1,200,000

SHOREDITCH EC2 - 2 BEDROOM APARTMENT - SOLD OCTOBER 2016 £1,250,000

The role of overseas buyers in London has been controversial, as a recent article in The Guardian pointed out: "Many Londoners take it as read that the high cost of housing in the capital is the fault of wealthy foreigners". But the article, by Dave Hill, goes on to flag up the fact that much of the recent development in Central London has relied heavily on overseas buyers and they have thereby played an essential part in helping to deliver affordable housing.

The Mayor has commissioned research to gather a robust evidence base and to provide a clear understanding of the role overseas investment plays in development viability. The opening sentence of the brief makes it clear that, far from being intended to vilify overseas investors, it is acutely aware of their importance: "London is open to people and investment from around the world. We welcome people from all countries who want to make London their home, and we welcome investment from around the world in building new homes".

TABLE 3

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

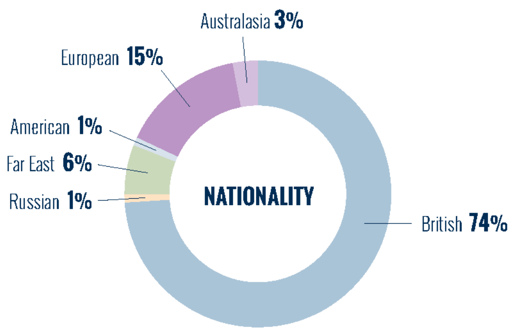
Submarket	1994 - 2016	2000 - 2016	2007 - 2016	2008 - 2016
Midtown	574%	156%	54%	70%
City	624%	191%	80%	98%
East London	577%	159%	49%	73%

Source: Hurford Salvi Carr

2016 BUYER PROFILES

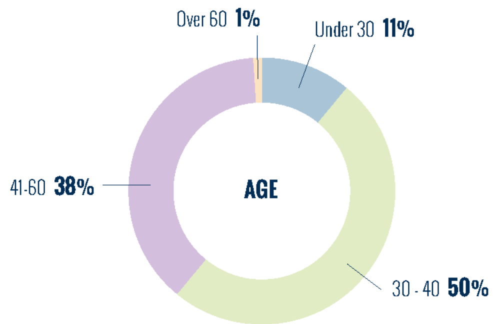
Nationality

In 2016, three quarters of the buyers who purchased in our areas were British. The proportion of properties sold to British buyers rose steeply in the first half of the year and that trend continued throughout the year. At the beginning of 2015 they accounted for just 56%. The biggest retrenchment, in our experience, has been amongst Asian buyers who accounted for between 20 and 25% of buyers in 2013 and 2014 and only 6% in 2016.



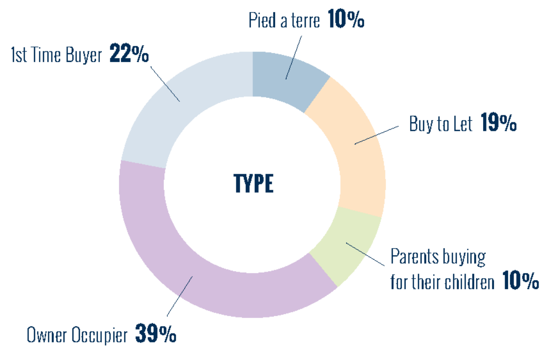
Age

The age distribution of buyers is relatively constant with the under 30s making up less than 10% and the 30- 50s making up around 90% of the total. The balance between those in their 30s and those in their 40s seems not to exhibit a very distinct pattern. The City is the exception with a significantly older age profile than our other markets. Bloomsbury is strongly influenced by its student population.



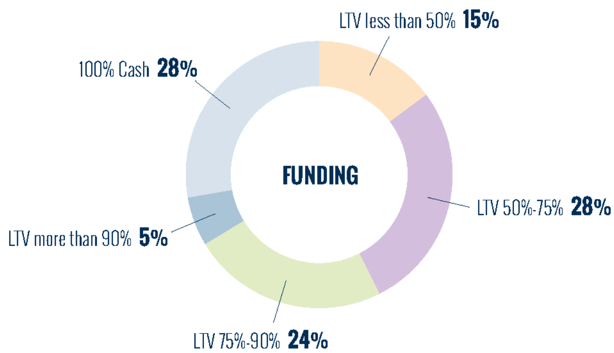
Buyer Type

There was a significant swing in the buyer intention data for 2016, with a notable increase in first time buyers from less than 10% of buyers to 22% in 2016 and a compensating reduction in the proportion of buy to let purchasers from around 30% or more to just under than 20%. Perhaps this illustrates that government policy has had some impact even in our high value markets to encourage more people on to the housing ladder – interesting though that there was no corresponding fall in the age profile, suggesting that first time buyers are not the under 30s but fall solidly within the 30-40 age bands.



Funding

28% of buyers in 2016 funded their purchase with no debt and a further 15% were able to put more than 50% down as equity. The cash-only buyers were more prevalent in 2013-4 but nevertheless they remain a significant proportion of the buyers in our markets, reinforcing the point that we often make about the resilience of owners in these markets. They are not generally exposed to high gearing and therefore not so vulnerable to interest rate (or tax) rises on buy to let mortgages.



Comparing submarkets

These charts illustrate averages across all our areas but there are some sharp distinctions between the submarkets. For instance, while 28% of buyers funded their purchases with 100% cash across all markets, the proportion was 50% in Midtown and just 10% in East London.

First time buyers on the other hand were far more prevalent in East London where they accounted for 24% of the total compared with 17% in Midtown and just 8% in the City. A third of all buyers in Midtown were buy to let investors compared to 21% in East London.

New Homes

SLOWDOWN HITS CONSTRUCTION STARTS

Development activity in Central London began to slow in 2016 as projects were completed and the number of new starts and new planning applications declined, probably marking the end of a prolonged development cycle. While London still needs new housing stock at the rate of around 60,000 new homes a year, it looks increasingly unlikely that this will be delivered by the private sector as price growth has stalled and demand faltered.

The number of private housing starts in Inner London peaked in March 2015 when 3,510 new units were put under construction according to data from the DCLG. By the middle of 2016, that had dropped to just 1,330 in the quarter to June 2016. The March 2015 peak was exceptional however and the average over the past 3 years was 1,740 per quarter.

LIMEHOUSE E1 - NEW RESIDENTIAL DEVELOPMENT OF 21 APARTMENTS - 2016

As UK and overseas investors deserted the new homes market, developers became dependent on owner-occupiers, which made off-plan sales difficult to secure. On schemes where prices were below £600,000 the Government's Help to Buy scheme for first time buyers proved popular. In fact, its success for buyers and vendors, meant that developers who had previously ignored the scheme rushed to register their developments so that first time buyers could benefit. In our markets, the impact was in East London where price thresholds are lower than City or Midtown.

The market for new build was undoubtedly more difficult in 2016 and that even led to a number of schemes being put into receivership - including one in a highly sought after street in Bloomsbury. Here the developers had stripped out a former office building to convert to residential but had made not one sale between January and August. It was a salutary reminder for anyone with development ambitions.

Office to residential conversions have helped to boost the supply of residential units in recent years, a policy that is increasingly controversial as concerns rise over the loss of employment space. Although the Central Activity Zone is exempt from the automatic right to conversion under the Permitted Development Rights, even when schemes go through the planning process, it is often difficult for planners to resist the logic of the viability test which can be called upon to demonstrate that alternative uses are not economically viable. The Mayor has an active initiative to explore the impact of the viability test and to what extent it clouds the issue of allowing changes of use to take place.

2016 was the year that the institutional private rental sector really caught the industry's imagination. It had been mooted for a couple of years by UK and overseas investors keen to build portfolios but there was very little existing stock in the UK and there needed to be a lull in the sales market to allow providers to acquire multiple units or to compete for sites and develop their own.

2016 brought the lull in the sales market and not only did opportunities arise to acquire sites for investors to create new stock - Build to Rent - but it also meant that developers would seriously contemplate holding on to new developments, which were originally intended for sale, as rental investments.

Developers convert their financing from development finance to investment finance and take long term control of buildings that they already know well and understand the maintenance requirements.

Towards the end of the year, the Mayor of London announced a major concession to institutional PRS investors. Draft supplementary planning guidance (SPG) was put out for consultation that would allow planned PRS schemes to provide their whole affordable housing contribution at 'discounted market rent', as long as the scheme meets certain conditions. The industry had been lobbying for this concession for some time and it compensated for the failure to persuade the chancellor to exempt the sector from the 3% stamp duty premium on additional homes.

'Discounted market rent' in this case is the GLA's London Living Rent (LLR), (defined as a third of the local income calculated by London ward.) To qualify as a PRS scheme the development, or phase within a development, must have a minimum of 50 units, all for rent and they must remain as PRS for a minimum of 15 years.

The guidance also states that qualifying units must be under unified ownership and management, with a prescribed level of on site management and services, and available on three-year minimum assured shorthold tenancies with no letting fees. The landlord must also be a member of an ombudsman scheme.

Overseas investors in the London Residential Property Market

In late November, the Mayor of London commissioned a research report to 'review the scale and nature of overseas investment into London's residential property market', with the stated aim that: 'any discussion of policy responses is underpinned by clear evidence and understanding.' The contract was awarded to the LSE and the team is due to publish its findings in April 2017.

The brief issued by the GLA suggests that sales to overseas buyers begins by stating:

'London is open to people and investment from around the world. We welcome people from all countries who want to make London their home, and we welcome investment from around the world in building new homes'.

In setting the context, the brief points out that sales to overseas buyers 'are highly localised, with almost half of new build sales in prime Central London in 2012 ... to buyers resident overseas or to people born overseas pointing out that it is not clear whether they were resident overseas or in London.'

Importantly, the brief highlights 'the positive role that overseas buyers play in enabling developments to go ahead. They are much more likely to be cash buyers and willing and able to reserve or buy homes off-plan well in advance of domestic buyers reliant on mortgage finance. These off-plan sales are an important part of development viability: industry bodies report that development finance can be difficult to obtain until 40% of units have been reserved, and that most developers will not start construction on a development until a third of its units have been pre-sold.'

It goes on to say: 'given the uncertainty in the housing market following a number of taxation changes and the recent vote to leave the European Union, it is vital that any policy that seeks to support Londoners' access to new homes has a robust evidence base and is developed with a clear understanding of the role overseas investment plays in development viability'.

Overseas buyers are to be defined by their primary place of residence, not their place of birth, thus it should 'include UK nationals living abroad for a period of time but exclude foreign nationals who are normally resident in London'.

The significance of this initiative is underlined by Dave Hill writing in The Guardian, pointing out that 37% of people living in London were born overseas and that over 300 languages are spoken in the city. It concludes that: 'It may be that in these unsteady nationalistic times, London is going to need those much-derided rich foreign investors more and more.'

Our analysis of buyers by nationality shows a steep decline in the number of sales to overseas nationals in the past year – perhaps this research will be a timely reminder of how much London relies on its international status.

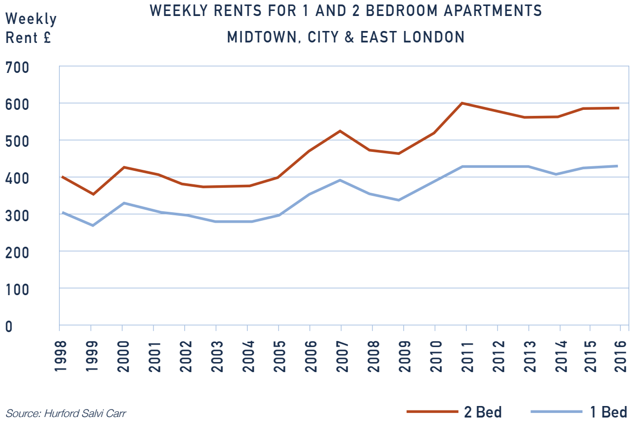
Lettings Market

RENTS UNCHANGED OVER 5 YEARS

The average cost of renting a one bed apartment across our markets at the end of 2016, is £420 per week - the same today as it was in 2011. That is in stark contrast to the sales market. Only Midtown bucked the trend – here, rental values continued to edge upwards during 2016 but it was the exception.

For a 2 bed apartment, the average rent has not yet returned to its 2011 peak. This truth runs counter to popular belief while soaring rents tend to be the 'story' that grab headlines. The supply of property to rent has expanded enormously in recent years and it is this that gives tenants more choice and keeps rental growth in check. A combination of factors has made investment in London residential property particularly attractive in recent years – capital value growth being only one amongst them.

FIGURE 3
WEEKLY RENTS FOR 1 AND 2 BEDROOM APARTMENTS
MIDTOWN, CITY & EAST LONDON



Source: Hurford Salvi Carr

Rents and capital values seem to be caught in some kind of feedback loop. Rising prices encouraged investment which suppressed rental growth and, in turn, made long term rental seem more viable, or at least less vulnerable. That means there is a larger pool of renters which underwrites investment even without the prospect of capital growth. If investment is valued as an income return rather than capital appreciation, then the market has reached a balance, at least for the time being. Becoming an owner is made less attractive for first time buyers by the up front costs of acquisition (stamp duty, amount needed for a deposit) and, in most London apartments, there is also the responsibility for service charges – which fall to the landlord for rented properties.

New rental properties have been added to the stock from three sources: owners - who have chosen to rent rather than sell; investors - who bought properties before the additional 3% stamp duty on second homes kicked in and developers completing new schemes with large numbers of units pre-sold to investors during the previous two or three years.

A sharp spike in sales volumes in March 2016, added to the already burgeoning supply of rental property. The spike was caused by investors rushing to complete purchases before the additional 3% stamp duty levy that became payable on second homes in April 2016. That 'rush to invest' was one of three factors that has boosted rental stock, the other two were: owners who have been unable to sell at the price they hoped for and therefore decided to rent rather than sell and developers who completed schemes that had been pre-sold to investors.

The number of renters has risen too over the past decade. London's population has increased and the proportion living in the private rental sector has risen.

SHOREDITCH E1 - 2/3 BED APARTMENT - LET SEPTEMBER 2016 £1,200 PW

Rental uptake is always strongest in the summer months but in the second half of this year we have noted fewer corporate enquiries as businesses rein in budgets in an uncertain economic climate and people are more reluctant to relocate. The corporate rental market has also been affected by the rise of other options such as Airbnb. The reduced demand is reflected in weekly rents - which have declined by 21% for penthouses in the City.

TABLE 4
WEEKLY RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON AT YEAR END

Submarket		2014 £	2015 £	2016 £	% Change 2015 / 2016
Midtown	1 Bed	425	440	475	8
	2 Bed	625	640	660	3
	3 Bed	1,400	1,500	1,300	-13
City	1 Bed	425	440	430	-2
	2 Bed	550	580	560	-3
	3 Bed	1,300	1,200	950	-21
East London	1 Bed	360	370	360	-3
	2 Bed	430	450	450	0
	3 Bed	700	725	675	-7

Source: Hurford Salvi Carr *1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths, 3 Bed is 1,500 sq ft with • Baths*

The weakening of corporate tenant demand has been particularly noticeable in the City – primarily because there has been so much addition to the stock through new developments sold to investors on the City fringe around City Road, Aldgate and South Bank. It is also inevitable that more larger properties have come to the rental market because sales uptake has been poor.

In another response to uncertainty, more tenants have asked for flexible break clauses or periodic tenancies as they become concerned about their employment status. It is also interesting that 2 bed properties in East London have been able to maintain their rental levels as they represent better value for money for sharers. Even the 3 bed apartments in this part of town have been more resilient for the same reason.

TABLE 5
ANNUAL RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON 2016

Submarket		Weekly Rent £	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£475	500	£24,700	£49.40
	2 Bed	£660	750	£34,320	£45.76
	3 Bed	£1,300	1,500	£67,600	£45.07
City	1 Bed	£430	500	£22,360	£44.72
	2 Bed	£560	750	£29,120	£38.83
	3 Bed	£950	1,500	£49,400	£32.93
East London	1 Bed	£360	500	£18,720	£37.44
	2 Bed	£450	750	£23,400	£31.20
	3 Bed	£675	1,500	£35,100	£23.40

Source: Hurford Salvi Carr *1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths, 3 Bed is 1,500 sq ft with • Baths*

The differential in £ per sq ft is marked. In East London, sharers occupying a 3 bed apartment could secure property for £23.40 per sq ft, less than half the rate in Midtown and a substantial discount to the 1 or 2 bed equivalents.

TABLE 6
LONG TERM RENTAL GROWTH

	2000 - 2016	2007 - 2016
1 Bed	29%	9%
2 Bed	37%	11%

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

Rental value growth has not come close to mirroring the steep rises recorded for capital values of property in our markets. Indeed in the 9 years since the global financial crisis the increases have averaged only 1% per annum.

BEDFORD SQUARE WC1 - 2 BED APARTMENT - LET AUGUST 2016 £725 PW

Rental values have risen by around 30% since the year 2000, while sale prices rose by 150 -200% over the same period. This is contrary to popular perception and reflects the expansion of supply as investment has increased and new development has continued. While we do not have the hard evidence to prove it, we have little doubt that the quality of the average rental property has greatly improved over this period too – at least for the tenants who come through our doors.

Holiday Lets come under Scrutiny

In early December Airbnb publicly stated that it would introduce new measures to help police the number of nights in a year that a homeowner can rent out a property using its website. Airbnb and other short term rental sites compete with the hospitality sector. What began as a way for homeowners to share their homes from time to time, is used by some as a platform on which to base a significant business in the holiday sector.

This announcement followed a court ruling in September confirming that flat owners whose leases state that their property can be used 'as a private residence only' and must have 'a degree of permanence' would be in breach of their covenants if they rent out their home on sites such as Airbnb.

Both of these actions are part of a wider trend to address the unforeseen consequences of disruptive technology businesses on conventional business models and to introduce regulation that could offer some protection to existing models. The black-cab backlash against Uber has a parallel.

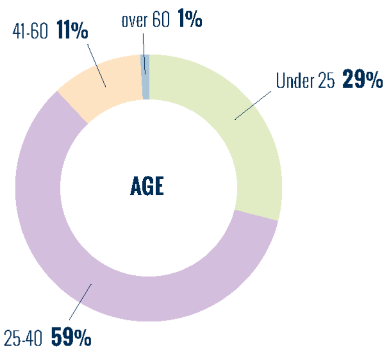
After the court ruling, an Airbnb spokesperson said: "We advise all our hosts to check and follow local rules before they list their space". The announcement that they would ..... came some 6 weeks later and means that Westminster's restriction on short-term letting for under 90 days will be easier to enforce.

In December Airbnb announced that they will now be enforcing the 90 day restriction under the Deregulation Act from 2017 and once a property has been let via their platform for 90 days it will not be shown as available until the following year.

2016 TENANT PROFILES

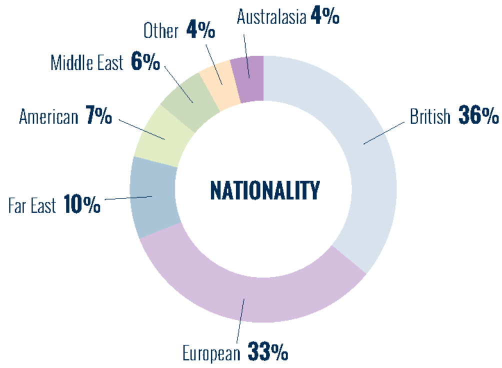
Age

The majority of tenants in our areas are aged between 25 and 40. In 2016, this group made up 59% of all tenants who rented property in City, Midtown and East London. The under 25s were equally prevalent if we take into account the fact that this age band only represents around 5, or at most 7, years while the 25-40 covers 15 years of adult life. The number of people renting after the age of 40 is low.



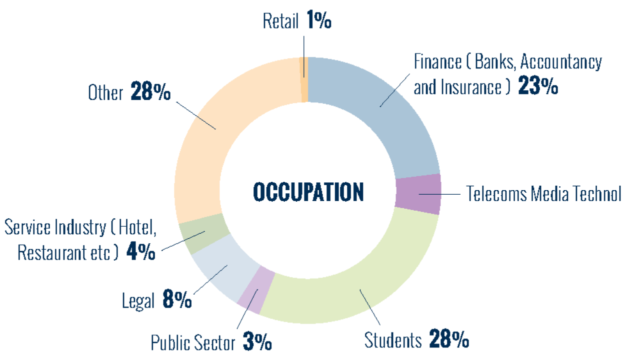
Nationality

British people have made up a growing proportion of all tenants While European nationals made up 15% of buyers, they account for 33% of renters – only a little less than the British renters who made up 36% of the total. As an institutional rental sector is gradually established in the UK, European cities are often taken as a model of successful rental markets. Around 10% of tenants during 2016 came from the Far East compared with 15% in 2015 showing that the decline in the proportion of were fewer buyers and tenants from that part of the world in 2016.



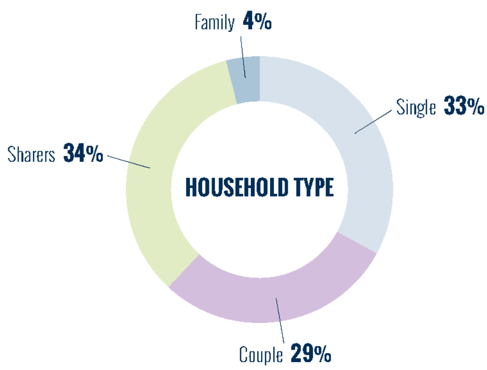
Occupation

The student market is most active in the second half of any year for obvious reasons but overall they make up around 30% of all renters – that includes post-graduates. The banking sector is the other stalwart of our rental markets although there has been a notable decline in its share of the total over the past 3 years, and in 2016 it accounted for 23%. The only other significant sector is law, which provided 8% of renters in 2016 – a larger proportion than in any of the three previous years, in fact double.



Household Type

There was a fairly even split between singles, couples and sharers while, perhaps unsurprisingly, families accounted for only 4% of the total. This pattern seems to be typical of our markets.



Investment

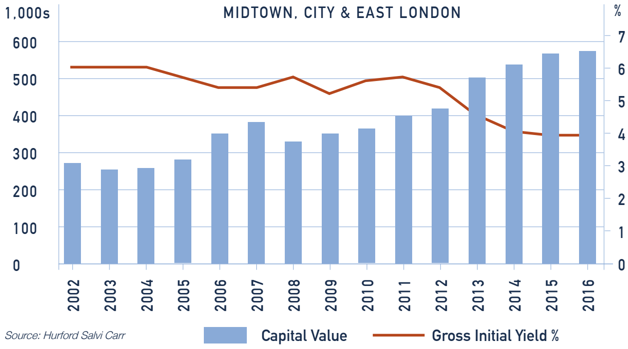
YIELDS UNCHANGED OVER 12 MONTHS

One and two bed flats in Central London have been, and remain, popular with investors, including overseas investors and there is no doubt that it has supported capital value growth over the past two decades in Central London.

We noted in previous issues of this report that there was a growing tendency during the past year or two, to widen the search for investment properties to Inner London and Outer London as prices climbed in the centre and yields fell.

In 2006 an investor could have expected to get a 5.4% initial yield on a one bed flat in our markets and with capital growth adding another 10% between 2006 and 2007, property was a highly attractive asset. Over the last decade, yields have gradually fallen and today they are just 3.9% gross.

FIGURE 4
CAPITAL VALUES AND YIELDS FOR ONE BEDROOM APARTMENTS
MIDTOWN, CITY & EAST LONDON



Source: Hurford Salvi Carr

The 3% additional stamp duty that was added to purchase costs in April 2016 further eroded the return on investment along with the new restrictions on an investor's ability to offset the interest on a buy to let mortgage against tax from the rental income - which will begin to take effect from April 2017.

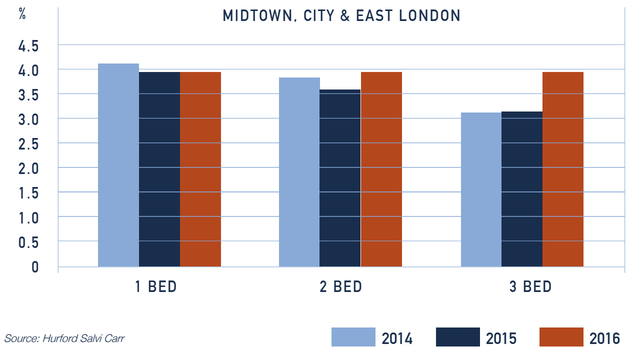
The recent proposal to stop agents passing on fees to tenants for taking up references, checking inventory and other documentation, will only add to the burden of costs on the landlord and squeeze investment returns still further. No wonder then that the Prudential Regulatory Authority is about to tighten the rules on buy to let lending because of concerns that some landlords may be over-extended.

We see this as part of an 'anti-landlord agenda' which is intended to improve the chances of first time buyers. At the same time the Government is promoting a new larger scale Private Rental Sector supported by institution investors in preference to smaller landlords who represent 97% of the market in the UK.

It has meant that investing in Central London residential has lost some if its appeal. Investors effectively took the place of first time buyers for a generation but that looks likely to slow down from now on, as returns are less attractive.

Nevertheless, the combination of an income yield and the very real prospect of capital growth at least in the medium term, as well as the tangibility of property investment, still represent an attractive investment proposition for many – especially as the returns on other forms of investment are suppressed by low interest rates.

FIGURE 5
CHANGE IN YIELDS 2015 / 16
MIDTOWN, CITY & EAST LONDON



Source: Hurford Salvi Carr

The yield on a larger property has improved over the last year as capital values have fallen by a wider margin relative to rental values.

FOLGATE STREET E1 - 1 BED APARTMENT - LET NOVEMBER 2016 £505 PW

TABLE 7
INCOME, VALUES AND INITIAL YIELDS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2002 TO 2016

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	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	555,000
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

Future Prospects

TRANSACTION NUMBERS TO REMAIN LOW

The slowdown in the Central London housing market was no surprise - it simply continued the trend that began immediately after the introduction of higher Stamp Duty rates for sales above £937,500 in December 2014. At that point, buyer enquires fell steeply.

Post-Brexit economic uncertainty has undoubtedly been a drag on the UK housing market but the primary cause of confidence draining out of the market was the Government's decision to increase Stamp Duty to unprecedented levels. Put simply, UK buyers do not understand why anyone would pay between 8-12% tax in cash on a house purchase. Its particular targeting of buy to let investors has only added to the malaise.

Owner occupiers, second home buyers and investors all put plans on hold. Even if government listens to calls for Stamp Duty to be reduced in 2017, the weakness in the London market will mean that transaction numbers will return only slowly and prices will take longer to recover.

We do not however, expect to see distressed sales or bank repossessions in our areas, even if there is a period of price corrections because most owners have low levels of borrowings - including investors. The Bank of England's concern that investors may flood the market with stock for sale is illogical because property generates better returns than other investments in a low interest rate environment and certainly better than cash on deposit. Lenders acted responsibly in the period after the GFC in 2008 and we see very few owners who are over-exposed from their property investments.

That said, the sales market is more balanced going into 2017. Owners have become more realistic on pricing and, in the final months of 2016 buyers finally showed the first tentative signs of returning to the market, reassured that the fiercely competitive market experienced between 2009 and 2014 has finally subsided.

Buyers will remain cautious in 2017 and tread carefully towards buying decisions in the hope that prices may fall further. We expect the general slowdown to extend over the wider London market in 2017 and we forecast further small price reductions averaging 5% across Midtown, City and Docklands in 2017, returning prices to 2013 levels. It may well take a further 2-3 year period for house prices to recover.

Stock turnover across Midtown, City and much of East London will remain low throughout 2017 as so many properties are owned by investors who tend to hold property for the longer term. In any event, Central London property owners rarely feel the need to sell in a buyers' market.

The current correction is more severe than the 2008 downturn in London, that was fundamentally a banking crises linked to the sub prime mortgage markets and matches the forecast given by George Osborne the former Chancellor of the Exchequer of a price correction in the region of 18% in the event that the UK was to leave the European Union.

House-builders will return their attentions to overseas buyers in 2017 – especially if sterling remains weak - in order to help generate much needed sales. Future developments are likely to be put on hold until sales volumes improve. It will be difficult for the mayor to realise his housing targets if house-builders cannot see any prospect of profitable business.

All of this has repercussions for the rental market. With lower margins for investors, the generation that lost its opportunity to buy will get another chance to get a foot on the housing ladder. Bank of Mum and Dad seems to have become a less enthusiastic lender in 2016.

On the other hand, without the spectre of escalating capital values, and in the face of uncertain economic conditions, many tenants will be happy to remain longer in the rental market. While they remain as renters, many can gradually accumulate capital for a deposit – sometimes from earnings, or through promotion, inheritance or combining resources.

The stock of rental property will continue to expand for a while longer as pre-sold developments are completed. Some developers have now abandoned their sales ambitions and instead converted the stock to long term rental investments. This may be the time that institutional investors manage to acquire or build rental portfolios at scale.

But the government continues to lash out at the rental sector. At the end of 2016 it pledged to ban agents from charging administration fees to tenants. In Scotland, where this was introduced earlier, it has added to landlords' costs. Someone will have to pay for the services and it remains to be seen who will pick up the cost of referencing, undertaking right to rent immigration checks, inventory check-ins and check-outs, registering of the tenants' deposit with an approved scheme, preparing rental agreements, addendums and the additional costs of processing tenant-instigated swaps mid tenancy.

WINE OFFICE COURT EC4 - 3 BED HOUSE - LET SEPTEMBER 2016 £1,150 PW

We expect to see a gradual recovery in demand and price growth in 2018 if, by then, the Government has makes significant and meaningful concessions on Stamp Duty.

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