research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 1ST HALF 2017

“

The big surprise in the first half of 2017 was the weakening of the rental market

”

Market Overview

CONFIDENCE STRUGGLES TO RETURN

The 2017 General Election did not deliver the political certainty intended, indeed it left the UK with a weakened Prime Minister and a disgruntled governing party which will inevitably be a drag on housing market confidence. It was a disappointing turn of events because there had, until then, been real signs that confidence was returning to the market. At the end of June, the prospects of a deal on EU citizenship looked promising - but there is a long list of other issues to agree as part of the Brexit negotiations and ultimately the scale of the task will lead to further uncertainty across the economy.

The dreadful fire at Grenfell Tower in June, caused national anguish and triggered a programme of tests for flammability on tower blocks across the country. There is no doubt that the incident and its aftermath had a negative effect on confidence – which flowed through to the economy and the housing market. Although the issue came to light in the public housing sector, it had ramifications across all housing as private block owners were encouraged to check fire precautions in their properties too. There will no doubt be a range of policy changes as a result.

Beyond the political turmoil, the Central London market found a new status quo in 2017 - with low demand, low supply and prices stabilising, after three years of slowing demand. Ironically, the run-up to the election had little impact because the result was deemed a 'foregone conclusion' and, in any event, the market was overhung by bigger issues such as Stamp Duty and landlord tax changes. By June however, there seemed to be a continuing stream of events impacting on the London residential market: the election result; three terrorist attacks; deteriorating economic data; the Grenfell fire and the official beginning of Brexit negotiations.

Even in 2016, before that run of events, price reductions did not tempt buyers back into the market. In fact, the number of people actively looking to buy a property fell further in first half of 2017. That fall in demand did not however, lead to any significant price falls in the first half of 2017- because the number of properties on the market fell too, so the balance was restored. For UK buyers and sellers in particular, we sense a strong feeling now that 'this is the wrong time in the cycle to act'. It is as if the market has gone into hibernation until the outlook is more certain. We now expect a prolonged period of relative price stability.

Unlike the mainstream UK housing market, which is driven by the rhythm of major life events - births, deaths, marriages, Central London residential can be regarded as a 'discretionary purchase', with a high proportion of second homes and when the conditions are not right, buyers do not act. That can have a knock-on effect and during 2017, the rest of the UK has been affected by the housing market slowdown that we reported across Central London at the end of 2014.

The big surprise in the first half of 2017 was the weakening of the rental market. The number of tenants moving around the market has fallen while the number of properties available to let has risen. Thus, with more choice for a smaller pool of tenants, rental values have headed downwards for the first time since 2011 and the short-term prognosis for this market is weak. Brexit uncertainties are partly responsible for the slowdown in demand, but the real cause of the imbalance is the supply-side, which has been fed by an army of buy-to-let investors, joined by owners who choose to let rather than sell - because they do not wish to accept prices lower than 2015.

Irrespective of this short-term slowdown in demand for rental, the shift from owning to renting remains an important trend in the London housing market (and indeed across the UK). There is a change underway in attitudes to home ownership and it is increasingly common to make a conscious choice to remain in the rental sector for longer, perhaps permanently, rather than take on mortgage debt. This is more like the European model.

Indeed, as sales values stagnate, people living in rental properties generally become more relaxed about remaining in the rental sector as the threat of prices rising ever further out of reach, recedes. We have noticed a slowdown in the number of moves between one rental home and another. This suggests a trend towards longer tenancy lengths (if not longer leases) which will be widely welcomed by all the stakeholders - whether landlords, politicians, tenant-groups or agents.

Rents fell more steeply than capital values in the first half of 2017, which means that the yield on capital value has fallen too, making property investment a little less attractive than it was, compared to alternatives.

A rental market with no or low growth rates has repercussions for the institutional private rental sector (PRS) or build to rent (BTR). It is our understanding that this sector will look for steady rental growth over a long period to support its investment model. Short term falls in income will be problematic for their internal rate of return (IRR) calculations. This could affect the expansion of the sector, although, at present the weight of money poised to invest as and when opportunities arise, suggests that there could be a significant shift in the rental landscape over the next decade.

Government policy on housing has been slow to emerge, despite their thorough analysis of the malfunctions in the market in the Housing White Paper. Calls for reform to Stamp Duty have, so far, fallen on deaf ears. Now, with the acute focus on fire precautions and tower blocks, it seems extremely unlikely that the government will listen to gripes about taxation for high value properties any time soon – even if there is a trickle-down effect on the mainstream market. In our view, the private housing market in Central London will not recover unless and until there is some reprieve on Stamp Duty.

ALDGATE PLACE E1 - 2 BEDROOM APARTMENT - LET MARCH 2017 £760 PW

Economic Overview

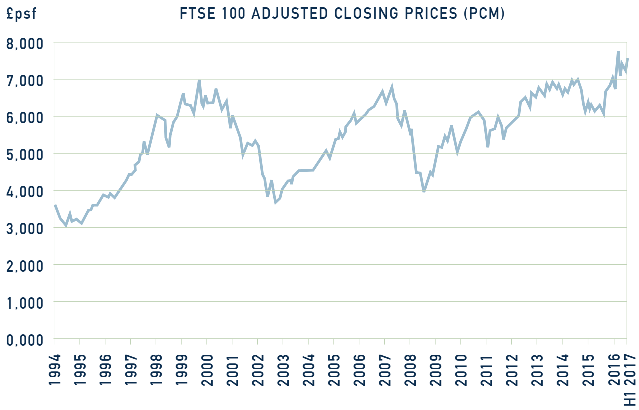
INFLATION RISES TO 2.9%

The UK economy fared better than expected in the immediate aftermath of the vote to leave the EU in June 2016 and many people felt that the risks had been exaggerated. By early 2017, and as Article 50 was triggered in March, the nation seemed to be relatively strong and stable - both economically and politically.

Things look a little less certain after the summer election. Not only did the Prime Minister fail to secure her mandate which would have at least given her a strong negotiating position but cracks are beginning to show in the economic data after all.

Few people are now under any illusions about the scale of the task ahead of the Brexit negotiators and the threats that it poses to economic stability, not to mention the prospects of growth over the next few years. One thing that seems sure, this would not be the right time to undermine the position of London on the global stage and that means that attempts to rebalance the UK economy away from London would also be highly risky. It is critical to protect employment, inward investment and social cohesion in our capital city to minimise the potential damage to the UK as it negotiates its exit from the EU.

FIGURE 1
FTSE 100 ADJUSTED CLOSING PRICES (PCM)



GDP monthly growth averaged 0.6% in the second half of 2016 which reassured many that the UK would not, contrary to the threats voiced by Mark Carney amongst others, face a recession. It continued to grow in 2017 and has an annualised rate of 1.8% by the end of Q1. However, the monthly rate of growth in Q1 fell to 0.2% and a similar figure was expected for Q2.

A fall in the value of sterling was the most immediate and visible sign of damage to confidence in the UK economy. It plummeted on the news of the vote to leave the EU and again in January 2017 when the Prime Minister signalled that the UK would in all likelihood leave the single market too. It has struggled to recover any value since then and the reduced buying power of the pound has created inflationary pressures.

Inflation has risen from 0.5% in June 2016 to 2.9% in May 2017. That has led to a fall in real wages for UK workers (earnings increased by 1.7% over the same 12-month period) and has a knock-on effect on living expenses. Interest rates remain at 0.25% for the time being but in the June meeting of the Monetary Policy Committee suggested that change was on its way with a 5:3 vote in favour of holding rates steady.

The economic growth was primarily driven by consumer spending as low interest rates encouraged borrowing and gave little incentive to save. That might change as inflation rises.

Commentators are sounding increasingly pessimistic about the ability of the UK to leave the EU unscathed. Writing in the FT on June 24th 2017 one year on from the Brexit vote, Chris Giles reflected:

"Each protectionist move will raise costs, undermine competition and duplicate processes.... Some losses might be mitigated by more rapid liberalisation of trading ties with non EU countries ... but no one should underestimate the trade-offs inherent in any such deals."

"The first year since the vote to leave has been difficult. Living standards are down, the economy is more fragile and there have been few signs of the fabled investment-led balanced growth. No one should take great comfort from the fact we have avoided recession."

In the aftermath of the decision to leave the EU, two widely respected reports, from PwC and Oliver Wyman, estimated the number of financial sector jobs that could be relocated from London, could range from a modest 3-4,000 to 70-100,000[1]. In February 2017, Brussels think tank Bruegel estimated that 10,000 UK banking positions could be shifted to the EU because of Brexit.

By June, several banks had announced an intention to relocate jobs from London to Dublin, Frankfurt and Luxembourg. However, the plans involve 100s rather than 1,000s of jobs and in an interview with City AM in June 2017, the head of the BBA said: "I know the banks are very keen not to relocate jobs, not least because their staff are keen not to move. They've got homes here, they've got kids in school and so forth."

All banks will have made contingency plans to relocate in the event of the UK losing its passporting rights. They will need to have a base within the EU. Beyond that, it will be some time before the future of London's employment markets becomes clearer.

There are many reasons why the future might not look like the past. Firstly, although Article 50 made certain the UK's intention to leave the EU, it left enormous uncertainties around the duration and effectiveness of negotiations for new trading arrangements, particularly regulation of the financial sector and the appetite of overseas businesses to remain faithful to London. European citizens living in London cannot yet be certain of their future right to remain in the UK, or whether the terms will be attractive and they are understandably more reluctant to commit for the long term. UK citizens are also more cautious until the future direction of Brexit and its impact on the economy, becomes clearer.

If the government cannot regain its credibility at home or overseas, that will be to the detriment of the economy and housing market. The Autumn Statement will be an opportunity to win back voter confidence if they announce spending plans that satisfy the craving for an end to austerity. After a negative reaction to its deal with the DUP, many are concerned that this fragile government will not last the course until November.

1 PwC (2016) Leaving the EU: Implications for the UK Financial Services Sector
Oliver Wyman (2016) The Impact of the UK's Exit from the EU on the UK-based Financial Services Sector

Sales Market

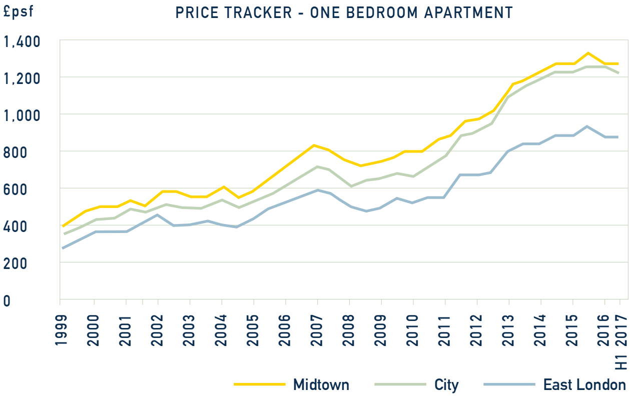
INERTIA SETS IN

There was some downward movement in asking prices in the City in the early months of 2017 but, overall, the price correction in our markets was modest – following a more marked downward correction in 2016. The market had come to terms with the adjustments and seemed to have settled. However, the surprise result in the General Election upset the status quo, prolonging the uncertainty surrounding Brexit and injecting renewed anxiety about the future. This, when SDLT is already a disincentive to buy a home in Central London where prices for 2 bed flats are typically close to or above £1million.

In these conditions, few people are willing to speculate on the prospects for price growth and the market stagnates. This has the potential to prompt further price pressures because of the impact on confidence – particularly amongst those looking from outside the UK - and that affects activity levels and confidence throughout the market.

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*

At this point in the cycle, with evidence of price falls, it might seem logical to think that buyers would sense an opportunity to pick up a bargain. In our experience however, they are more likely to retreat, worrying that it is the wrong time in the cycle to fix a price and believing that there may be better opportunities in the future. Lenders are also more cautious in these conditions. Prices for one bed flats have not moved much in either direction but two bed apartments have been slipping. What started as a reaction to SDLT has developed into a general inertia fuelled by negative press coverage of the London residential market – 'it just feels wrong.'

CLERKENWELL EC1 - 1,249 SQ FT LOFT - SOLD JUNE 2017 £1,200,000

Properties priced at under £1million have been fairly immune but higher priced homes have lost value. Those in the price bracket £1-2million dropped 10% in 2016 and those over £2million by 20%. These numbers are explained by Stamp Duty – properties attracting the highest rate of duty experienced the largest price falls.

There is an exception to the high value rule – penthouses with moderate price tags appear to have reached a level at which buyers are interested once more. The penthouse is a relatively rare product and has suffered the steepest price falls over the last year – now there is a feeling that this may be the right time to secure what is a premium product, at an attractive price, without the intense competition of the recent past. There is still a resistance at £2million but high-end apartments on the market for under £2 million with private terraces, are attracting interest - from buyers who may have been waiting for the 'right moment'.

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
Mid 2017	-1%	550,000	-5,000

Source: Hurford Salvi Carr

Attitudes to home ownership are changing and this is reducing the number of prospective buyers. No-one would pretend it is always a choice, affordability (or lack of it) has clearly made renting the only realistic option for many young people - but there is no doubt that there is a cultural shift underway associated with the emergent 'sharing economy'. It is increasingly common to make a conscious choice to remain in the rental sector for longer, perhaps permanently, rather than take on mortgage debt. Not only does renting overcome the obstacle of a deposit for buying a home but it also provides a far more flexible solution for people who have not made a long-term commitment to an employer, or place of work.

A stagnant sales market will encourage this shift. As long as there is little prospect of making money from owning a home, the pressures to get on the housing ladder evaporate. Indeed, there are real concerns that a property bought today incurs high purchase costs and could even fall in value. These conditions, combined with an expectation that surely an interest rate rise must be imminent, are causing a generational shift in attitudes to renting and owning.

TABLE 2 PRICES & PRICE CHANGES FOR 1,2 & 3 BED APARTMENTS IN THE RESALE MARKET						
		2015 £	2016 £	Mid 2017 £	Change H1 2017	Change % 2015 peak
Midtown	1 Bed	650,000	650,000	650,000	0%	0%
	2 Bed	1,000,000	950,000	950,000	0%	-5%
	3 Bed	2,600,000	2,200,000	2,200,000	0%	-15%
City	1 Bed	630,000	650,000	630,000	-3%	0%
	2 Bed	840,000	840,000	800,000	-5%	-5%
	3 Bed	1,900,000	1,750,000	1,700,000	-3%	-11%
East London	1 Bed	450,000	450,000	450,000	0%	0%
	2 Bed	625,000	600,000	600,000	0%	-4%
	3 Bed	1,250,000	1,100,000	1,000,000	-9%	-20%

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*

On the supply side, we see too many owners who remain in denial about recent price falls and are still keen to set an inflated asking price in the hope that they will 'get lucky'. The normal outcome of this strategy is for a series of price reductions to be followed by the property being withdrawn from the market and placed in the rental market, reinforcing the inertia in the sales market and boosting the supply of rental stock. Owners who have been invested in Central London residential for 20 years or more have seen their properties increase in value six times over (Table 3). In the past decade values have gained more than 75%.

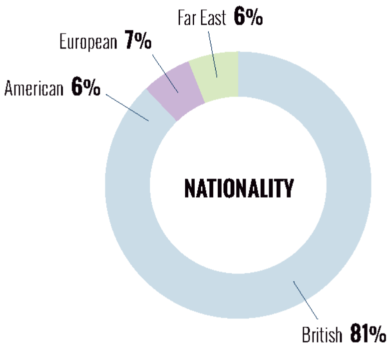
TABLE 3 LONG RUN PRICE CHANGES FOR A 1 BED APARTMENT IN THE RESALE MARKET				
Submarket	1994 - H1 2017	2000 - H1 2017	2007 - H1 2017	2008 - H1 2017
Midtown	584%	160%	57%	72%
City	620%	190%	79%	97%
East London	592%	165%	53%	76%

Source: Hurford Salvi Carr

H1 2017 BUYER PROFILES

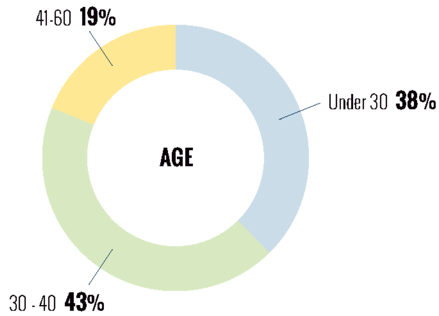
Nationality

The resurgence of the UK buyer, which began in late 2015, has persisted and in the first half of 2017, 71% of all purchases through our offices were made by UK citizens. EU citizens have continued to be a significant presence and accounted for 11% of purchases – though lower than in the second half of 2016 when they were 15%. The area with the highest proportion of EU buyers in H1 2017 was East London.



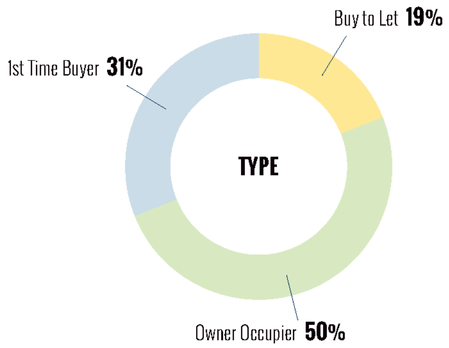
Age

83% of buyers were aged under 40 in our offices in H1 2017. The only office weighted towards buyers over 40 was the West End – perhaps reflecting the higher starting prices there. At the other end of the age spectrum, the locations with the highest proportions of buyers aged under 30 were in Aldgate and City – not a factor of prices but perhaps of the changing character of these areas and their association with financial and tech sector jobs.



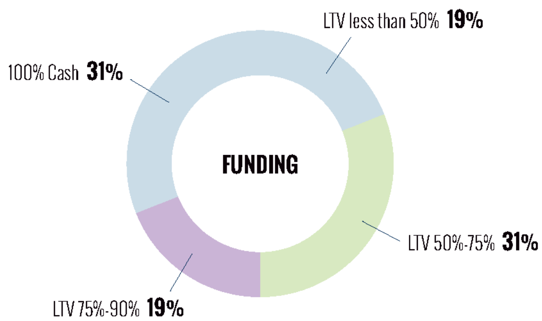
Buyer Type

We reported a significant swing in 2016, away from buy to let purchases and in favour of first time buyers. That trend has played out into 2017, with first time buyers up to 28% of all transactions and buy to let down to 19%. Now, more than half of sales are to owner occupiers, excluding first time buyers, and together they make up 84%.



Funding

A third of sales were funded entirely from equity (100% cash) and half have been able to fund more than 75% of the cost with equity. This is typical of our markets and the significance of this, as we have emphasised in previous reports, is that these buyers are not exposed to interest rate rises and nor are they affected by the tax changes for buy to let mortgagees. These buyers are in a position to hold rather than sell when the market is weak or activity levels low.



Conservative Housing Policy

In late June the government agreed a partnership deal with the DUP which will strengthen their position in Brexit negotiations but it is not at all clear how it will affect their ability to progress housing policy.

The government has appointed a new minister with responsibility for housing and he, Alok Sharma, MP for Reading and a former Chartered Accountant, is the seventh person to hold the housing brief in the last 10 years.

Housing policy is likely to rise up the political agenda in the light of the terrible events at Grenfell Tower and subsequent testing of tower blocks across the UK. Local authorities have called for government to help to fund the fire prevention measure which will cost £millions. Private apartment blocks will be left to fund their own remedial works where required.

In their manifesto, the Tories made these core commitments:

- 1 million new homes by 2020 (in keeping with the 2015 manifesto) and a further 500,000 by 2022. The Green Belt, National Parks and Areas of Outstanding National Beauty will be maintained.
- Support for high-quality design and place-making – including infrastructure, parks and high-quality, high-density housing.
- Provide greater flexibility to housing associations and introduce a new generation of fixed-term council housing linked to a new Right to Buy.
- To end the practice of charging letting agents' fees to the tenant.

These are in addition to intentions set out in the Housing White Paper in February which included:

- Protection for the Green Belt.
- A register of land for housebuilding run by the Land Registry.
- Encouraging development on brownfield land, land in public ownership and estate. mechanisms to help housing associations and local authorities find the funds to build more affordable/social housing.
- Promote small and medium sized builders and support for modular construction and for custom build.
- Measures to encourage an institutional private rental sector.
- They also committed to starter homes; Help to Buy equity loans up to 2021; right to buy for housing association tenants and longer tenancies for build to rent tenants.
- Mandatory electrical safety checks will be introduced for rented properties.

New Homes

CHINESE BUYERS ACTIVE

A fall in the value of sterling has made investment in the UK look more attractive to overseas investors over the last year but it only goes some way to counter-balancing the low returns now on offer. The result is that there are fewer active overseas buyers in our markets. Developers still take schemes to exhibitions overseas but the rate of sales has dropped to a fraction of those achieved a few years ago. The result of the summer election depressed sterling further but the associated political instability is discouraging to prospective buyers.

There are exceptions; the Chinese buyers are still active, the new homes market has become highly dependent on Chinese money despite the restrictions on the amount they can take out of the country in any one year. For some, buying in the UK on behalf of student off-spring, enables them to overcome stringent controls on overseas investments.

THE HUDSON, SHOREDITCH EC2 - 3 BEDROOM DUPLEX - SOLD JUNE 2017 £1,540,000

As long as the UK buyers remain cautious, developers will seek out new sources of buyers. Singapore was a significant market for UK developers until its government cautioned against over-exposure to the UK and the flow of capital dried up. Some developers are now taking schemes to the Middle East and South Africa.

Help to buy has been very successful in attracting UK buyers in areas where the prices fall below the £600,000 London qualification threshold value. In our markets that only applies in East London and parts of Docklands.

As developers struggle to meet sales targets, they are more open to approaches from PRS investors who may wish to make bulk purchases in order to expand their portfolios.

Despite the deterioration in the sales market, developers continue to start on site but very often the intention now is to retain the homes as rental stock in their own ownership, rather than to seek market sales. A change from sale to rental means development is viable even when the sales market is flat - especially while borrowing costs remain low. In this case, the return on investment is calculated as an income return (rent) from the up-front capital cost of land and construction but without the need to factor in a profit on sale.

On the supply side, the government is keen to promote new development by streamlining planning to release more brownfield land, supporting small builders and encouraging innovation in construction, funding and ownership structures. As long as the government relies on the private sector as the main channel for delivery of new homes, then the prospect of price rises is an essential component of the market. In order to boost supply, there probably needs to be greater flexibility on density and design standards so that private sector developers can see an attractive return. Unless and until the government chooses to fund social housing, it will need to find ways to help developers build, or accept a slower delivery pipeline. The tragedy at Grenfell Tower has, amongst other things, deepened the housing crisis and accelerated the need to build social housing.

The building boom across Central London that has fuelled the supply of rental apartments is now starting to slow. Part of the slow down can be attributed to the price points which typically exceed £1 million and buyer reluctance to pay higher rate Stamp Duty.

There is no doubt that policy-support has helped first time buyers and, while the price threshold puts Midtown and City out of reach, the Help to Buy scheme has fuelled demand in East London where the entry level prices are lower. The scheme has, to a large extent, kept the first-time buyer market alive. There is however, a risk of unintended consequences if and when interest rates rise. Higher interest rates will increase the borrower's monthly mortgage repayments, and that impact will be exacerbated when the interest-free government loan expires after 5 years and the owners need to refinance that element too.

BOW WHARF E3 - 4 BEDROOM HOUSES £999,950 - £1,100,000

The Role of Overseas Investors in the London New-Build Residential Market

In our last report, we highlighted a piece of research commissioned by the Mayor to investigate the role of overseas investors in London's residential market. The authors, a team at the London School of Economics (LSE), looked at the proportion of new homes sold to buyers who live abroad and at the proportion of those homes left empty. It also considered the contribution of overseas sales and finance to new development. That research was published in June 2017 and its key findings are summarised here.

- Significant proportions of new units are bought by overseas residents. The percentage is highest in Central London but the total number there is small;
- A clear majority of units bought by overseas investors are let out to Londoners;
- Others are used by owners' family members, children in education or returning expats, and are fully occupied;
- A small but highly visible subset is lived in only occasionally. However, there was almost no evidence of homes being left permanently empty;
- Pre-sales to overseas buyers enable developers to build faster and thus make more market and affordable housing available than would otherwise have been the case;
- International investment and finance have helped bring stalled sites into use and speed up development on larger sites. They have also been key to creating our Build to Rent sector.

A related research study, undertaken by the University of York examined Land Registry records to estimate the proportion of new homes sold to overseas investors. It found that around 13% of private market sales completed between April 2014 and March 2016 were to overseas buyers (accounting for 10% of all new dwellings when affordable and social units are included).

An article written on the LSE website to accompany the research added the following observations:

However demand from overseas buyers for new property has impacts beyond just the number of homes built. While beyond the remit of LSE's research, they should not be ignored. First, the built form of new housing may reflect overseas buyers' preferences – e.g., in terms of the use of glass and indeed the size of units and numbers of bedrooms. Second, their involvement may affect the tenure split in the capital, as it increases the likelihood that Londoners will live in these units as tenants rather than owners (although that is equally the case if units are bought by UK-based investors).

Finally there is the issue of price. The direct impact on the price of London housing is clearly limited as new build is such a small proportion of overall transactions. However their interest has probably meant that more apartments have been delivered at higher price points, so average prices have been affected by the change in mix.

Lettings Market

MORE CHOICE, LESS RENT

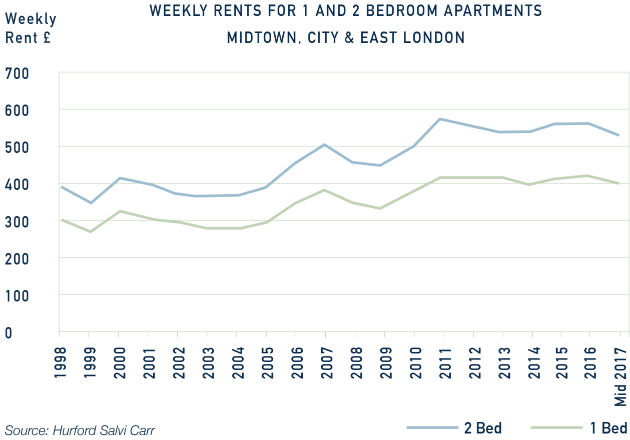
Rental values fell in the first half of 2017, as a direct result of an increase in the supply of properties to rent, at the same time as the employment status of EU nationals in London is in question and confidence in the UK's future, is waning. Our reading of the market is that renting rather than buying remains a rising trend in London but that households already living in the rental market have been moving around less frequently than before and that, combined with far greater choice of property, has caused rental values to fall.

The rent for a one bed apartment in Midtown has dropped by around £25 per week, and by £40 for a 2 bed over the first six months of the year. That is not a dramatic fall in earnings for a landlord and we do not expect the downward trend to continue for long, but it will reduce the return on investment.

CITY EC2 - 2 BEDROOM LOFT APARTMENT - LET JUNE 2017 £1,300 PW

For landlords it is a disappointment and for new entrants, an added deterrent. Rents had not risen since 2010 and, while the fall averaged 7% across our markets, the decline was more than 10% in East London – where much larger numbers of new homes were completed over the last 12 months than in other parts of Central London.

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



Source: Hurford Salvi Carr

For tenants, the picture seems rosy. They have more choice, the cost of renting has fallen after being relatively stable for the past 5 years and, on top of that, the government is proposing to shift some of the up-front costs of agreeing a new tenancy, from the tenant to the landlord.

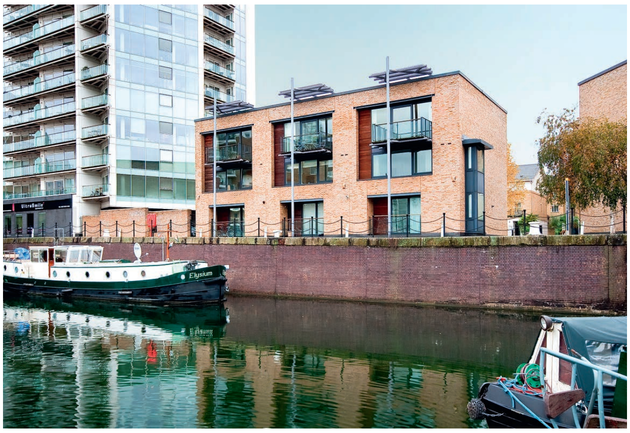
This change in market conditions has been caused by an increase in supply, combined with a reduction in demand. The increase in supply is part structural, part cyclical. London has been through a construction boom and much of the new stock has passed via investors into the rental market. That is structural. On top of that, there was an artificial peak in investment purchases in early 2016, ahead of the Stamp Duty deadline for additional homes, which caused a mini-surge in the supply of rental stock in mid 2016 and that has flowed through to 2017 supply.

On the demand-side, there are a number of explanations for the decline. One issue is Brexit and a more general economic malaise which discourages people from making decisions about the future. To some extent the fall in confidence has shifted demand from the sales market into rental but it also leads to inactivity in the rental market as renters stick with the same property for longer and our experience suggests that fewer EU nationals will wish to take up employment opportunities in London. Certainly, the corporate rental market has slowed in the first half of 2017 across Central London.

CLERKENWELL EC1 - 2 BEDROOM APARTMENT - LET MAY 2017 £900 PW

Despite rents falling, affordability is still an issue for tenants which encourages people to look for alternative solutions. For instance, young people whose parental home is within commuter distance of London, can choose to stay out of the property market altogether, whether for rent or sale. There is evidence that this is a growing trend – it is not always safe to assume that if the next generation choose not to own, they will necessarily choose to rent.

The other related change, is a growing number of couples sharing – where 2 or 3 couples choose to share a 2 or 3 bed apartment, whereas in the past they would have opted for a spare bedroom. There is a changing attitude to sharing in the wider economy – uber, Airbnb, co-worker spaces and car share schemes are all born of this changed attitude and it is reflected in living arrangements. The fact that a whole personal library or music, photographs, books and correspondence can be stored on a single devise makes this kind of collaborative living more feasible.



LIMEHOUSE E14 - 4 BEDROOM HOUSE - LET JUNE 2017 £910 PW

There are several benefits to being a tenant rather than an owner. The most obvious benefit is having access to a home without raising debt finance or saving a substantial deposit. Monthly outgoings are not necessarily lower but there is no long-term commitment to repayments. As a tenant, you are not responsible for the service charge and yet, in the current market, there is no significant premium on the rent for a block that comes with amenities like a concierge or a gym. This makes a serviced block rather good value for money.

TABLE 4

WEEKLY RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS IN MIDTOWN, CITY & EAST LONDON AT H1 2017

Submarket		2015 £	2016 £	H1 2017 £	% Change H1 2017
Midtown	1 Bed	440	475	450	-5
	2 Bed	640	660	620	-6
	3 Bed	1,500	1,300	1,200	-8
City	1 Bed	440	430	430	0
	2 Bed	580	560	550	-2
	3 Bed	1,200	950	925	-3
East London	1 Bed	370	360	320	-11
	2 Bed	450	450	425	-6
	3 Bed	725	675	575	-15

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*

In our experience, tenants want the services on offer and can keep moving to upgrade to the latest facilities without incurring any significant transaction costs. In the current climate, political pressures are working in favour of the tenant, rental values go down as well as up and, with interest rates likely to increase, that is another advantage over buying. Landlords are more willing to reduce a rent than vendors are to reduce a price because it is a reversible decision – sacrificing rent for a year or two does not preclude receiving the higher rent in the future, whereas a price reduction on a sale property cannot be recouped later.

The growth in rental values has been far more moderate than sale prices. Investors have, of course, benefited from both capital as well as rental growth but as the investment market is professionalised, this will be an important metric. Also, the commercial market has regained its strength in the past 3 to 5 years.

Values for commercial rents now exceed residential rents in our markets as Table 5 illustrates. This demonstrates why smaller residential developments are no longer as popular with developers and investors as they once were.

TABLE 5

ANNUAL RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS IN MIDTOWN, CITY & EAST LONDON H1 2017

Submarket		Weekly Rent £	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£450	500	£23,400	£46.80
	2 Bed	£620	750	£32,240	£42.99
	3 Bed	£1,200	1,500	£62,400	£41.60
City	1 Bed	£430	500	£22,360	£44.72
	2 Bed	£550	750	£28,600	£38.13
	3 Bed	£925	1,500	£48,100	£32.07
East London	1 Bed	£320	500	£16,640	£33.28
	2 Bed	£425	750	£22,100	£29.47
	3 Bed	£575	1,500	£29,900	£19.93

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*

Table 6 shows long term rental growth in our markets. Over 17 years, the rent for a 1 bed flat has risen by 23% - little more than 1% per annum. This contradicts most media reports on London rents. The difference is that our rental value time series reports on a consistent quality of product whereas rent indices generally do not acknowledge that the quality of rental accommodation has risen enormously over that period, so any measure based on a large sample, probably means it is not comparing like with like. This has important implications for the institutional rental sector. Based on our records, there has been no significant increase in rents across our markets since 2007.

TABLE 6

LONG TERM RENTAL GROWTH

	2000 - H1 2017	2007 - H1 2017	2007 - H1 2017
1 Bed	23%	4%	14%
2 Bed	29%	5%	15%

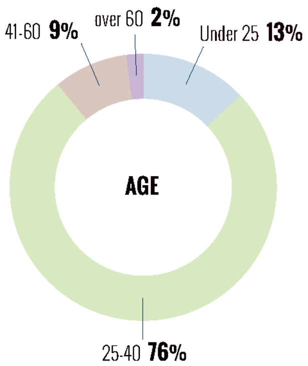
Source: Hurford Salvi Carr *1 Bed is 500 sq ft, 2 Bed is 750 sq ft with 2 Baths, 3 Bed is 1,500 sq ft*

CANALETTO, CITY ROAD EC1 - 3 BEDROOM APARTMENT - LET MARCH 2017 £1,500 PW

H1 2017 TENANT PROFILES

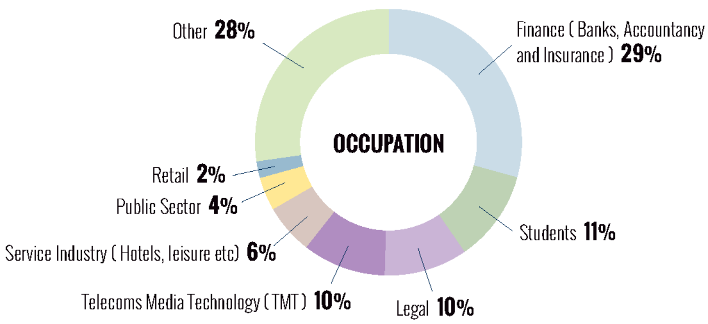
Age

Three quarters of all tenants were in the age band 25-40 – this is high. In the second half of the year, student rentals boost the share of under 25s. Over the whole period 2014-2017, the under 25s made up 24% across the whole year and 33% in the second half year. The bulk of tenants are aged 25-40, accounting for 64% overall while the over 40s made up 11%.



Occupation

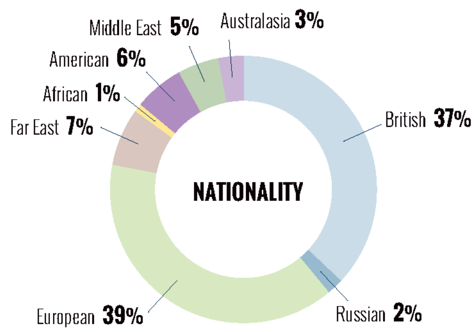
There was a reasonable spread of occupations in H1 2017. Banking/ finance was the largest group followed by students, law and tech which equalled banking/finance between them. There are very distinct differences between the first and second half of the year primarily because of student lets. Over the period 2014-H1 2017, students accounted for 14% of lettings but in the second half years they made up 35%.



Nationality

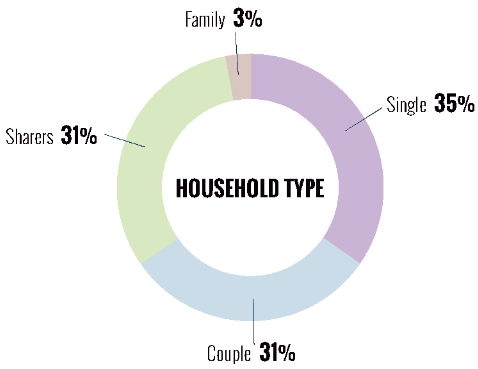
UK citizens make up a little over one third (37%) of all renters who agreed new leases in our areas in the first half of 2017. The other 63% are from overseas. It is surprising to see that European nationals accounted for more renters than UK citizens but perhaps this reflects their increased reluctance to commit which could have pushed some from the sale to the rental market.

We now have three years' worth of tenant profile data. In the whole three year period, the Far East supplied 12% of tenants, compared with just 7% in H1 2017. UK and Europeans have been consistently around a third each.



Household Type

Singles, couple and sharers make up broadly a third apiece of the lettings in H1 2017 and this broadly reflects the distribution in the three-year data. Interestingly, that does not really change if we look at half 1 data – suggesting that students are no more likely to be sharers in these markets than the general rental population.



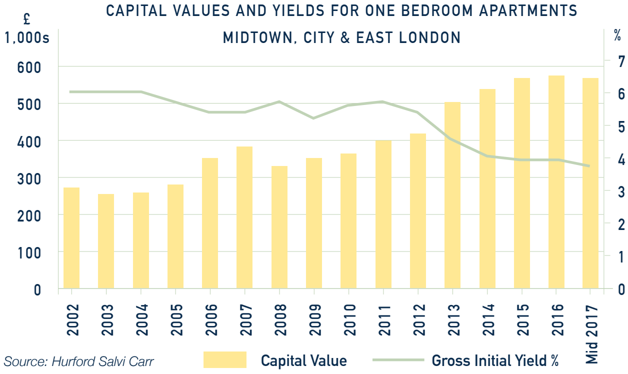
Investment

PRESSURE GROWS ON LANDLORDS

With capital values broadly stable in the first half of the year and rental values in decline, it is inevitable that yields have fallen further this year. The gross initial yield on a one bed apartment is now 3.7%, and the net return on that will deteriorate as the new regulations come in to force around mortgage interest tax relief and other allowable expenses. If the up-front fees associated with new tenancies are also transferred to the landlord that will also affect the return on investment.

One bed apartments continue to be the best investments in our market, with higher yields and a better track record on capital growth. In a pure investment sector, falling yields would logically lead to falling capital values as investors seek to maintain their return on capital but property is less liquid than other investment classes and the growing burden of purchase costs (Stamp Duty) mean that it is becoming increasingly illiquid. In our experience, most owners prefer to hold on to their assets in a downturn, take a longer-term view and wait for capital growth.

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

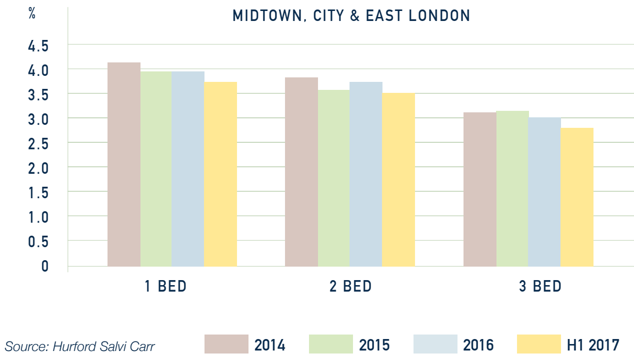


Source: Hurford Salvi Carr

Central London buyers are not generally highly geared and have the luxury of taking a longer term view. However, we sense a growing fatigue amongst landlords and if they could get a similar return on their money elsewhere, they may well be tempted to sell at least part of their property portfolio.

A combination of economic uncertainties aroused by Brexit, fear of rising interest rates, the 3% additional home levy and reducing the tax benefits for landlords, have stifled new demand for buy to let investments in Central London, at least for the moment. There does not however seem to be any significant rush to sell properties. The phasing means that changes this year are not too punishing and most landlords will absorb the changes after a prolonged period of high returns. Landlords of portfolios with, say, 5-10 properties might do some 'selective selling' to weed out properties that perform less well, realise any gains, reduce their gearing and refinance the portfolio. But the fact remains that landlords in Central London are not highly exposed to mortgage debt.

FIGURE 5
CHANGE IN YIELDS 2014 / 17
MIDTOWN, CITY & EAST LONDON



Source: Hurford Salvi Carr

BLOOMSBURY WC1 - OFFICE SOLD TO A RESIDENTIAL BUYER JUNE 2017 £2.5 MILLION

TABLE 7
INCOME, VALUES AND INITIAL YIELDS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2003 TO H1 2017

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	H1 2017
Gross Annual Income £	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	20,540
Capital Value £	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	550,000
Gross Initial Yield %	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	3.7

Source: Hurford Salvi Carr

Future Prospects

STAMP DUTY REFORM ESSENTIAL

Following a slow but stable residential sales market in first 5 months of 2017, the events in June resulted in a weakened minority Conservative Government, at the same time Brexit negotiations commenced, converged to undermine buyer confidence.

With fewer homes coming to the market, the prospects for pricing look better than 2016 when Central London experienced significant price falls and while we would expect to see some minor corrections in the second half of 2017, they are likely to be moderate by comparison.

Political turmoil may be with us for some time but the impact on Stamp Duty remains the most significant dampener on activity levels and transaction numbers across Central London and there appears little appetite amongst politicians to lower taxes.

We have made this point many times before in our reports but it merits repetition: distressed sellers are a rare beast in the Central London market. Owners with low-gearing tend to hold on to their assets for the long term unless they are tempted, by steep price growth, to crystallise gains. When prices are stable, activity levels plummet and that reinforces the stable pricing. Low levels of debt to equity also means that banks are less exposed and it would, in our view, take a widespread correction of at least a further 20% before vendors come under any pressure to accept lower prices.

Bank lending since 2008 has been prudent with loan to value (LTV) typically falling below 70%. In our area, around 30% of purchasers are cash buyers and many of those with mortgage debt are simply taking advantage of historically low interest rates. As prices rose between 2009 and 2014, owners have often written down debt through capital repayment and that coupled with low borrowing costs means they are able to wait for an upturn in the market before considering a sale.

The upshot of all this is that fewer homes come to the market. That in itself (supply-constraint) will help to maintain price stability in what is now widely established as a low turnover market. On the upside, stable pricing is reassuring for prospective buyers and that will help to rebuild confidence.

History shows that, where the Central London market leads, other areas of the UK follow. The slowdown that we first reported here in 2014 spread to the outer London boroughs and the Home Counties in 2017. Normally, we would expect Central London to be first to show signs of a recovery but with the current political and economic uncertainty plus unacceptably high levels of Stamp Duty (SDLT) buyers show no sign of returning to the market. We believe that it will take a change in SDLT to kick-start the London market.

Quite simply our typical UK buyer looking to buy a two bedroom flat as a pied a terre or family apartment in Central London for children at University for say £950,000, would have to find £67,250 (effective rate of 7.1%) to pay the Stamp Duty from already taxed income and not be able to add this to their mortgage. They could rent an equivalent flat over two years for that amount, hold on to their cash deposit and stay mortgage free. Bank of Mum and Dad are instinctively less inclined to lend when the market shows little signs of capital growth.

Until activity rates and prices fall across the wider UK, it looks as though the government will resist the pressure to intervene in the market – a recession in high value London and Country House markets is not unattractive to politicians. If the current Government can weather the storm and hold out until 2021 for the next election (not a total certainty) then, we may have to wait until 2019 before taxation policies are challenged and that will postpone any prospect of a recovery in demand across Central London for a few more years.

The same factors affect the New Homes market where developers and housebuilders will continue to offer a range of incentives to entice purchasers to choose well specified and expensive products.

The rental market gives us greater concern as it looks set to suffer further downward pressure on rents from additional stock being delivered from the completion of new homes that were purchased off-plan pre-2016, the arrival of more institutional landlords plus would be sellers unable or unwilling to accept the prices available from sales market.

We expect rents to stabilise over the busier summer months at the reduced rental levels outlined in this report, and we do not expect to see a recovery in rent levels by the year end. We anticipate fewer company lets from the corporate rental sector due to ongoing uncertainties over Brexit the rental market faces.

The ban on charging fees to tenants is likely to come into force in early 2018 and will make renting a more attractive option for tenants and add to the cost of being a landlord. Landlords face a more difficult future with the prospects of interest rates rising, an end to tax relief and lower income.

We believe more landlords would consider exiting the market if they could get a better rate of interest from banks. High maintenance costs and a reduced net return have become more of a disincentive in a market where capital values have fallen.

We expect to see the trend from owning to renting in Central London continue to increase and the age of first time buyers increase further with buyers becoming more reliant on inherited wealth later in life.

At the time when the UK is pursuing its future outside of the European Union it would appear that London's housing market is moving in the clear direction towards a traditional central European housing model with lower levels of house price inflation and more people renting. By 2025 London's rental private sector will accommodate 40% of London's population.

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

HURFORD SALVI CARR
CITY LIVING
ESTABLISHED 1996

HURFORD SALVI CARR

hurford-salvi-carr.co.uk