research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 1ST HALF 2018

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A low volume housing market has implications for other sectors of the economy.

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Market Overview

LOW SALES VOLUMES

At mid-year 2018 the residential sales market continued to struggle with weak demand against a backdrop of political and economic uncertainty that undermined buyer confidence.

Price reductions have done little to stimulate demand and the majority of buyers, particularly investors and second home owners, remain unwilling to commit given the high rates of Stamp Duty Land Tax and the second home surcharge imposed in 2016.

The current market does however present an opportunity for owner occupiers to return after a 4 year downturn, although it is also apparent that a greater number need to sell before they can move. We have also seen first time buyers able to skip the typical first rung of the ladder to acquire larger homes at attractive prices. These first time buyers have often delayed buying into their 30s and are far more likely to view their purchase over a longer time horizon than in the past.

ALDGATE E1 - 2 BEDROOM APARTMENT, SOLD JUNE 2018 £1,160,000

Investors, on the other hand, remain scarce. We suspect that the retreat of investors and the rise of affluent first time buyers is related. Parents are choosing to channel capital into the housing market via their adult off-spring, rather than directly into Buy-To-Let. The bank of mum and dad, which emerged over the past decade, has evolved into a family version of Help to Buy and the government appears to have succeeded in its mission to quash the Buy To Let market with higher taxes.

Prices fell by an average of 4% in the first 6 months of 2018 and vendors recognise that prices are now back to 2014 levels with little scope for growth in the immediate future. Indeed, we expect the low level of sales transaction to result in price falls in the second half of 2018 - by a further 5% across central London.

By 2019, prices should stabilise in our markets as, by then, there should be more clarity on the economy post-Brexit. The completion of the long-anticipated Elizabeth Line (Crossrail) should also boost a feeling of confidence in the capital. We expect buyers to return, safe in the knowledge that any further price changes are likely to be minor and easily absorbed over the longer term.

A low volume housing market has implications for other sectors of the economy and retailers also suffer when people do not move house – the failures of high street retailers cannot only be attributed to the rise of e-commerce and punitive business rates. As slowdown in the housing market spreads outside of the capital we expect Government to become more concerned for the performance of the sector.

BLOOMSBURY WC1 - 2 BEDROOM MEWS HOUSE , LET APRIL 2018 £835 PW

Rents have remained broadly unchanged in our markets this year, as they have for the past six years, for one and two bed apartments. Demand has followed its seasonal norm and, on that basis, we expect the third quarter to be the busiest period in the rental market.

It was inevitable that there would be some impact from the decline of buy to let investment after April 2016 and reinforced by legislation to reduce returns for investors. There is less new supply coming into the market. On the other hand, some renters will find themselves in a better position to buy, without the competition from investors.

We have not detected renters ending their tenancies because of Brexit, although it may be that the impact on executive employment will occur later in the process of leaving the EU.

There is certainly plenty of anecdotal evidence that it has already become harder to recruit EU citizens into lower paid service sector employment. So far, the impact on financial and professional employment has been limited but there are serious concerns about the decisions banks might have to make if the terms of Brexit are not advantageous.

Interest rates are expected to creep upwards over the next year but to remain moderate and exposure to mortgage debt in central London is in any case contained. We believe that the Government will be keen to kick-start the post-Brexit economy. Economic stimulus generally feeds through to the housing market in some form especially following a prolonged period of austerity.

It is clear however in 2018 that the Government has achieved its stated aim of cooling the top end of the housing market and its unstated aim of increasing revenue with higher rates of Stamp Duty Land Tax.

Economic Overview

BREXIT UNSETTLES MARKETS

The UK economy has continued to emit confusing and contradictory signals, as it has done since summer of 2016. Even the Bank of England is struggling to read the runes, and the much-anticipated interest rate rise was delayed again in June. Brexit negotiations continue to dominate news headlines as we head towards the October 2018 deadline for a provisional deal, only briefly displaced by an uplifting Royal Wedding in May and the England's team performance at the FIFA World Cup in June.

In Q1 UK growth (and indeed global growth) looked promising. Consumer confidence, rose to -7% in March which, although it remained negative, was a significant improvement on the December 2017 figure of -13%. Incredibly given the number of retail failures on the high street in the first half of 2018, employment levels reached record high this year and keep on improving.

Then, in April, new figures changed the mood. Consumer confidence fell back by 2 points to -9, while news that the UK economy grew by just 0.1% in the first quarter of 2018, the weakest quarterly growth since 2012, quashed the interest rate rise expected in May. The Bank of England voted to keep the base rate at 0.5%, although a rate rise to 0.75% is widely expected in August, despite the lack of inflationary pressure.

In fact, for the last five quarters the UK economy has grown at a slower rate than that of the Eurozone. The Q1 2018 growth figure was revised upwards from 0.1% to 0.2% but remained down on the 0.4% achieved in Q4 2017.

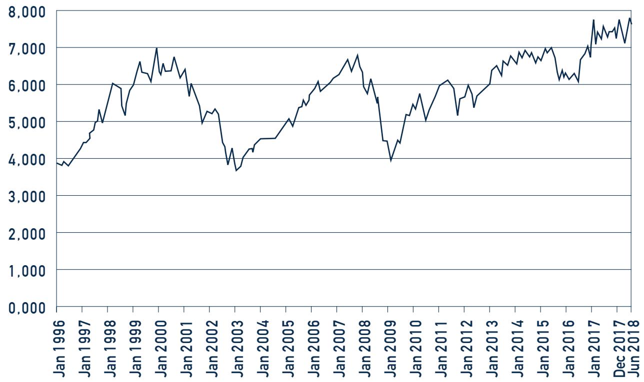
Year on year, the economy grew by just 1.2%, well below its five-year average of 2.2%. Construction was down by a substantial 3.3% while manufacturing slowed to 0.2%. Inclement weather late February and early March, including the 'beast from the east' certainly affected construction activity but not to the extent that would explain such a fall. Services, which account for 80% of the UK economy and are a key driver in our area, grew by 0.3%.

The crisis on the UK's high streets continued with House of Fraser added to the list of casualties. Most analysts agree that the rash of CVAs has been caused by out-dated and inflexible business models unable to adapt to the new retail landscape and competition from e-commerce, exacerbated by the cost of business rates. Using the CVA route, rather than administration, enables the business to close under-performing stores, negotiate rent reductions restructure debt and make changes to the management team. This has significant repercussions for commercial property investors.

Wage growth, like employment, is more positive. In April, wages began to rise faster than inflation for the first time in over a year. Average weekly earnings (including bonuses) rose by 2.5% in the three months to May compared to the same period a year earlier, although growth is moderating. Inflation rose by 2.4% in the three months from March, down from 2.7% in February, which is good news for household incomes

FIGURE 1

FTSE 100 ADJUSTED CLOSING PRICES (PCM)



Disappointing economic growth seemed to have little affect the Stock Market. The FTSE 100 lost 10% off share values between January and end of March but by May it had rebounded and reached a record all time high of 7,877 on 22nd May.

The value of sterling remains lower than pre-Brexit highs, against $US reached 1.43 in mid-April (16th) (just 3% lower than pre-Brexit peak of 1.48), and against Euro 1.15, (11% lower, than 1.31), although has fallen back against both since.

The unsettling process of Brexit continued to affect sentiment in London's housing market along with the direct impact of higher Stamp Duty rates which act as disincentive to invest in residential property. It should be noted that theses higher rates do not apply to commercial property sales transactions.

Sales Market

LOW TRANSACTIONAL MARKET

2015 turned out to be the peak of the price cycle in our markets. Since then, values have declined and sales volumes have been very low across central London. The average price of a one bed flat in our area fell by £25,000 in the first half of 2018, losing just under 5% in value, following a similar loss in 2017. Average prices are now 10% lower than in 2016 and more in line with the market of early 2014, where we expect them to settle for a while.

One bed apartments held their value for longer than larger homes, with stable pricing through 2015 and 2016 while larger properties began to lose value from early 2015, hot on the heels of the stamp duty increases in December 2014.

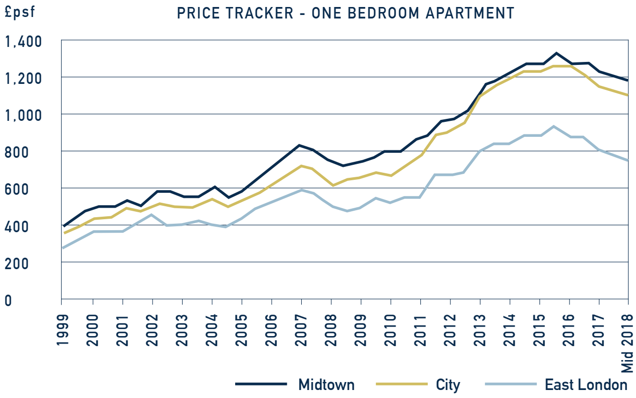
CLERKENWELL EC1 - 2 BEDROOM APARTMENT, SOLD JANUARY 2018 £1,140,000

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
2017	-4.5%	530,000	-25,000
H1 2018	-4.7%	505,000	-25,000

Source: Hurford Salvi Carr

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

While newspapers are still focused on falling values, our principle concern is the continuing low levels of sales transactions in 2018. We have seen renewed interests from owner occupiers, however many have to sell before they can buy. Widespread reporting of price reductions has helped to entice new buyers into the market although total buyer numbers remain low compared to the boom years of 2010-2014.

The fall in value of one bed apartments in H1 2018, takes the total decline over the past year to almost 10%. The withdrawal of Buy to Let investors has hit the one bedroom market in London hard and we expect a further 4% to be lost by the year end. Midtown is beginning to stabilise and falls there are likely to be limited to a further 2%, but we expect City and East London to lose up to 5% in H2 2018.

SHEPHERDESS WALK N1 - 1 BEDROOM LOFT, SOLD MARCH 2018 £840,000

The strongest segment of the market in 2018, has been mid sized two bedroom apartments. This segment had lost value between 2014 and 2017 but prices held their value in Midtown and City and lost only 3% in East London, whereas the values of one and three bed apartments slipped by around 5%.

TABLE 2

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

		2015 £	2016 £	End 2017	End 2018	Change % H1 2018	Change from 2015	£ per Sq ft
Midtown	1 Bed	650,000	650,000	625,000	600,000	-4%	-8%	1,200
	2 Bed	1,000,000	950,000	900,000	900,000	0%	-10%	1,800
	3 Bed	2,600,000	2,200,000	2,000,000	1,900,000	-5%	-27%	3,800
City	1 Bed	630,000	650,000	630,000	600,000	-5%	-5%	1,200
	2 Bed	840,000	840,000	800,000	800,000	0%	-5%	1,600
	3 Bed	1,900,000	1,750,000	1,600,000	1,550,000	-3%	-18%	3,100
East London	1 Bed	450,000	450,000	430,000	410,000	-5%	-9%	820
	2 Bed	625,000	600,000	580,000	560,000	-3%	-10%	1,120
	3 Bed	1,250,000	1,100,000	1,000,000	950,000	-5%	-24%	1,900

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*

The market for properties priced above £1.5 million remains very quiet. We sense no increase in interest for large apartments, despite price corrections of between 20% and 25% since 2015. We put this down entirely to the burden of Stamp Duty. A buying tax bill of £100,000 plus is a major disincentive in any market.

CLERKENWELL EC1 - 2 BEDROOM PENTHOUSE, SOLD JUNE 2018 £1,400,000

The exception is for large family houses at around £2million. We find that buyers are prepared to sink large sums of money in stamp duty in order to secure a spacious family home with outdoor space. A house that can fulfil a practical need for space during the child-rearing years is a rare commodity in central London. These buyers though, will expect to keep the property for 20 years, in order to justify the upfront cost of stamp duty.

BLOOMSBURY WC1 - FREEHOLD HOUSE, SOLD MAY 2018 £2,050,000

The long-term performance of house price growth in central London has outstripped the wider property market. An owner who bought in 1994, would have seen the value of their asset grow by around 500%. Even owners who bought into the London market just before the Global Financial Crisis, will have had growth of around 50% in our areas of the housing market.

TABLE 3

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

Submarket	1994 - 2018 H1	2000 - 2018 H1	2007 - 2018 H1	2008 - 2018 H1
Midtown	521%	136%	42%	56%
City	534%	155%	57%	73%
East London	485%	124%	29%	49%

Source: Hurford Salvi Carr

POPLAR E14 - 2 BEDROOM APARTMENT, SOLD JUNE 2018 £450,000

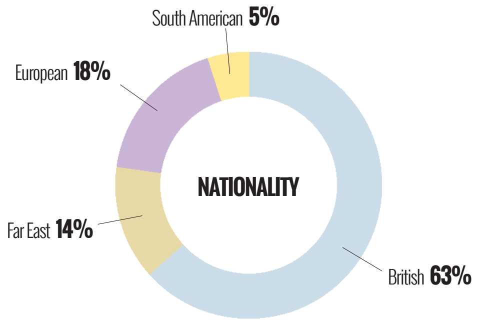
H1 2018 BUYER PROFILES

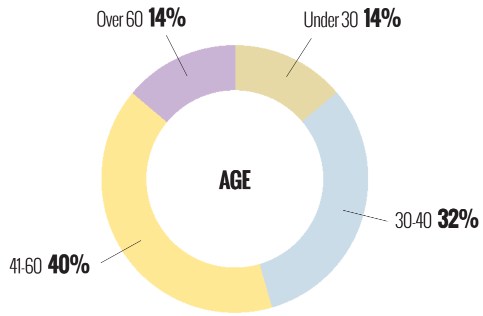
Nationality

British buyers accounted for almost two thirds of purchases in H1 2018. Surprisingly, it is lower than the average of 72% over the period from 2015-18. EU citizens have not disappeared entirely from the London market, but these tend to be buyers who have made London their long-term home. Far Eastern buyers, predominantly Chinese, are still an important source of demand, although their level of interest seems to be waning.

Age

The number of buyers in 2018 is low but the spread of ages is wide. The proportion of buyers over 60 was particularly unusual at 14%, compared with an average of 6% over the whole period 2015-18. In fact both the under 30 group and the 30-40 group were under represented in H1 2018, while the older age groups were more prevalent. Affordability seems to be the most obvious explanation.



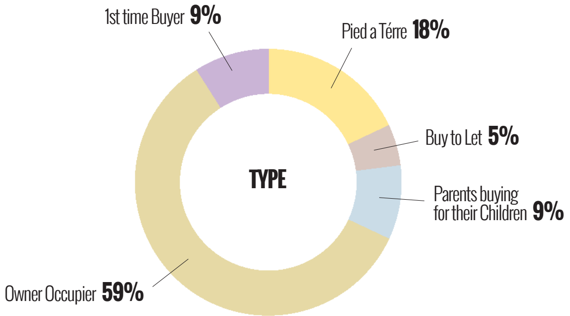


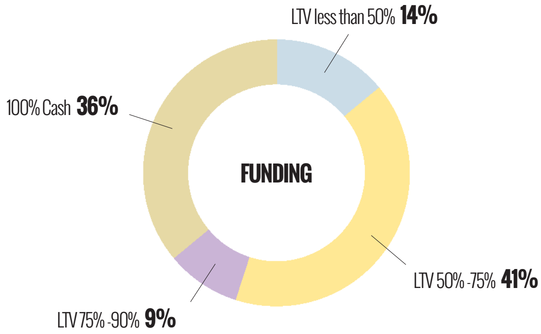
Buyer Intention

The majority of buyers in the first half of 2018 were owner occupiers or buying a pied a terre. Investors have all but disappeared from the market, although the number of parents buying for or with children has risen.

Funding

Half the buyers in our markets were able to fund at least half of their purchase price with cash and a third were 100% cash buyers. That trend has been consistent over the whole time between 2015 and 2018, since we began recording this data.





How buyers have changed 2015 - 2018

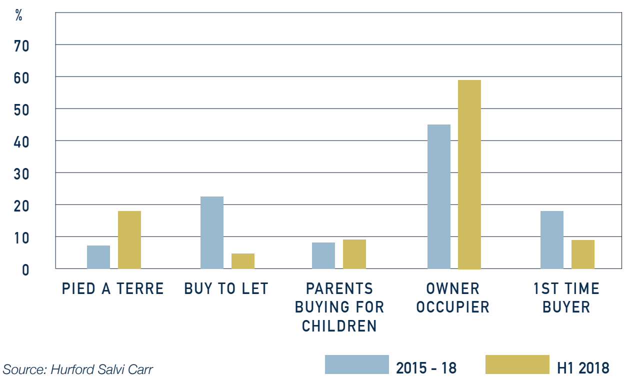
OWNER OCCUPIERS REPLACE INVESTORS

Midtown, City and East London have undergone substantial change over the last two decades and tend to attract buyers looking for character, innovation and vitality. It is important to understand our buyers and, since 2015, we have recorded data about their motivations and priorities so that we are alert to changes. We have compared the buyer profiles for the whole three-year dataset, with the results for H1 2018.

Buyer Type

The most dramatic change in buyer type has been in the proportion of purchases intended as buy to let investments. Over the whole period, investors accounted for almost a quarter of all purchases but that has fallen to just 4% of purchases in H1 2018. The withdrawal of investors from our markets has made room for buyers intending to live in their properties and owner occupiers rose as a proportion from 45% to 59%.

BUYER TYPE: COMPARING H1 2018 WITH 2015-18

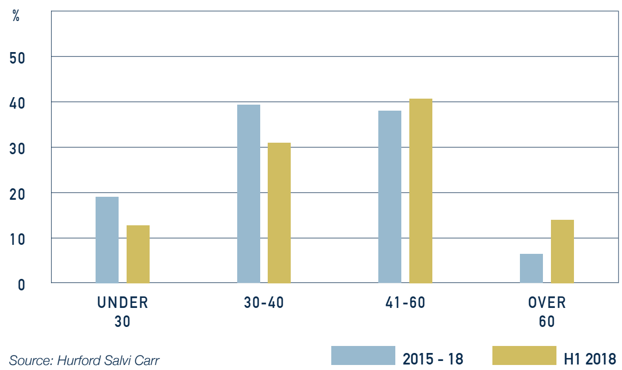


Source: Hurford Salvi Carr

Age

There was a notable rise in the presence of older buyers in our market with the over 60 age group rising to 14% in H1 2018, compared to just 6% over the whole period. This is perhaps surprising given the loss of investors, suggesting that these buyers intend to live in the area or at least use it as a pied a terre. We are watching the older demographic with interest to see whether they are attracted to the new generation of luxury blocks with high level of servicing and amenities as a lifestyle choice.

AGE: COMPARING H1 2018 WITH 2015-18

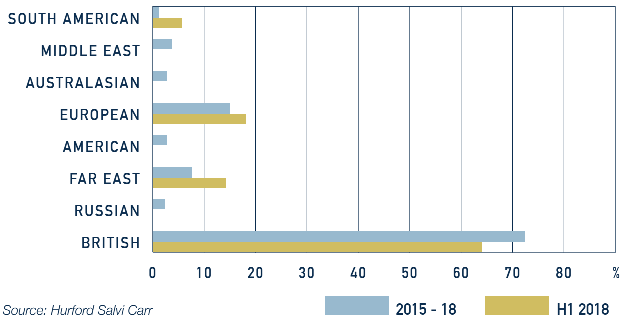


Source: Hurford Salvi Carr

Nationality

The most striking thing about the nationality chart is the loss of international diversity. We classified our non-domestic buyers into seven broad geographical regions of the world but in H1 2018, we needed only 3 of them. This reflects trends in our markets of City, Midtown and East London.

NATIONALITY: COMPARING H1 2018 WITH 2015-18

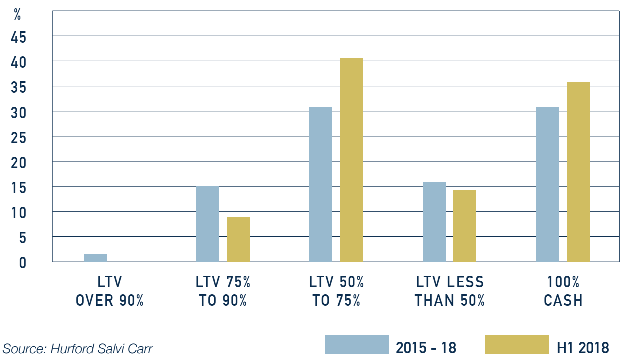


Source: Hurford Salvi Carr

Funding

Cash buyers have always been a significant presence in our markets but in the H1 2018, they accounted for an even larger proportion than the average. Buyers with less than 25% equity all but disappeared in H1 2018, accounting for only 9% of buyers, which, given that a one bed apartment in our area has a price tag of over £500,000, shows that our markets are driven by equity-rich buyers.

FUNDING: COMPARING H1 2018 WITH 2015-18



Source: Hurford Salvi Carr

Buyer behaviour and off-market listing

Buyers no longer walk into our offices, phone or email to register at the start of their search process. In common with buying habits for most goods these days, homebuyers begin their search at home, online, via the portals. Buyers engage directly with estate agents only after they have identified properties of interest and wish to arrange a viewing, or have a technical question about the property or its lease.

Not every vendor wants their home to be so widely available for online viewing and a growing number request a period of 'Discrete Marketing' made available only to serious and suitable buyers. This has spawned a new type of service for agents: the 'off-market listing'. It means that buyers who engage with agents are given privileged access to opportunities that meet their search criteria two to three weeks ahead of any wider marketing campaign.

New Homes

BUILDING BOOM TO END

London now has a plentiful supply of new build developments with resident facilities such as sky bars, gyms, spas, cinema rooms, resident lounges and 24-hour concierge. Such amenities make rental stock more appealing but the jury is out on whether they translate into additional rent for the investor. For owner occupiers with mortgage debt, the additional outgoing of a high service charge is a major consideration.

Housebuilders are in a competitive marketplace and the provision of amenities has become something of an arms race, designed to achieve the required sales values. Service charges in the order of £5,000 - £10,000 per annum are often viewed as prohibitive for owner occupiers but less of an issue for investors who can off-set the cost against rental income.

TUFNELL PARK N19 - OFFICE TO RESIDENTIAL, 13 APARTMENTS

There is undoubtedly an element of London's affluent and international population that actively chooses to live in highly serviced hotel-style buildings but, for the time being supply exceeds demand in this sector of the market. With an affluent baby boomer population enjoying long and active retirements, we are alert to the possibility that this style of living might be attractive to those who wish to downsize from a family home, live centrally and minimise the burden of responsibility for repairs, maintenance and security.

Developers with amenity-rich luxury schemes remain reliant on overseas exhibitions, predominantly in China, to secure off-plan sales. The GLA's 'London-first' policy is effectively redundant if there is no appetite from London buyers to commit two or three years in advance of completion.

There remains a concern over whether overseas investors who reserved apartments under pre-sales agreements in the last 3 years, will fulfil their commitments on completion, or will seek to sell their interest if their price expectations have not been realised. Or, those who planned to sell, may choose to rent instead, while the market recovers.

Even in the more mainstream market, sales of new build apartments has slowed. According to respected data from Molior, sales of new homes in Q4 2017 was over one-fifth down on Q3.

BLOOMSBURY WAY WC1 - 7 NEW APARTMENTS LET TO CORPORATE TENANTS

Construction starts also declined but not to the same degree and the rate of new development continued to exceed sales.

Any new build scheme with Help to Buy (up to £600,000) in our areas of London does well – but they are rare. The prospect of an equity loan is a tantalising proposition and focuses demand on this small segment of the market. The Help to Buy scheme comes to an end in 2021. Developers are willing to help buyers too but generally prefer to maintain headline prices and agree private discounts which do not register in sale price statistics.

The Stamp Duty concession for first time buyers on the first £300,000 of properties sold for up to £500,000, hardly registers in our markets. The only area that might be able to offer homes at this price point, is East London and even there, they are scarce.

As we have previously reported since 2014 developers have become increasingly wary of building in zone 1. Development activity gradually contracted and by mid 2018 it culminated in the closure of Crest Nicholson's London office and an announcement from Barratt that it would re-focus its efforts outside of central London, where demand is stronger. It seems that London has finally come to the end of its most recent residential building boom in the city centre.

WHITECHAPEL E1 - 3 BOUTIQUE APARTMENTS, £575,000- £695,000

Lettings Market

YIELDS START TO RECOVER

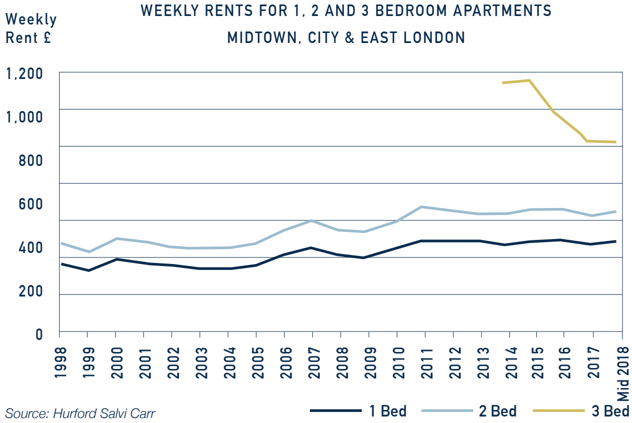
Rental values have remained broadly stable in our markets in 2018, as they have for the past six years, for one and two bed apartments. Demand has followed its seasonal norm and, on that basis, we expect the third quarter to be the busiest period of the year in the rental market.

The boom in Buy to Let investment over the past 20 years has left the market with a good balance of supply and demand. Renters have enough choice to preclude any upward pressure on rents for the time being.

Larger apartments followed a different trajectory – for them, values dropped steeply between 2015 and 2017 and recovered a little lost ground this year. The premium for a three bed over a two bed apartment was more than 100% in 2013/14 but today the gap has narrowed to 62% - still considerably wider than the margin between one and two bed apartments. Three bed apartments in our markets are most often designed as luxury residences, often as the penthouse – rather than family homes as might have been intended by the planners.

FIGURE 3

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



Source: Hurford Salvi Carr

There has been some variance in some sub-segments of our markets. The rent for a two bed apartment in Midtown actually grew by around 5% in the first half of this year although remaining below 2016 rents. In the City, 3 bed apartments gained around 3%, again, they remain significantly below their peak levels.

Renters, unlike buyers, are often willing to compromise on the size of their living accommodation in return for a central location and in order to keep within a rental budget – particularly if they are saving for a deposit, or sometimes because they choose to prioritise lifestyle spending. This is the reverse of the trend we see in the sales market, where buyer are tending to aim for larger homes that will satisfy their needs for several years ahead. In the case of the sales market, buyers are motivated to avoid transaction costs. This difference highlights one of the key benefits of renting – the flexibility to relocate with minimum cost.

It was inevitable that there would be some fall-out from the drop in buy to let investment after April 2016 especially with the added burden of legislation that reduces net returns and makes it harder to borrow. The volume of new stock has declined from the peak. On the other hand, a decline in supply might be off-set by a decline in demand as more renters find themselves in a position to buy without competing with investors.

TABLE 4

WEEKLY RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON AT H1 2018

Submarket		2015 £	2016 £	2017 £	Mid 2018 £	% Change 2017 - H1 2018
Midtown	1 Bed	440	475	450	450	0
	2 Bed	640	660	600	630	5
	3 Bed	1,500	1,300	1,100	1,100	0
City	1 Bed	440	430	450	450	0
	2 Bed	580	560	560	560	0
	3 Bed	1,200	950	925	950	3
East London	1 Bed	370	360	320	320	0
	2 Bed	450	450	425	425	0
	3 Bed	725	675	575	575	0

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*

We have not detected a significant number of renters ending their tenancies because of Brexit, although it may be that the impact on executive employment will occur later in the process of leaving the EU.

There is certainly plenty of anecdotal evidence that it has already become harder to recruit EU citizens into lower paid service sector employment. So far, the impact on financial and professional employment has been limited but there are serious concerns about the decisions banks might have to make if the terms of Brexit are not advantageous.

ALDGATE PLACE E1 - 3 BEDROOM APARTMENT, LET JUNE 2018 £865 PW

We have noted for some time that renters are tending to stay longer in the same property. The recently announced government consultation on 3 year tenancies, with the likely provision of tenant-only break clauses comes at a time when the market has, in any event, moved that way as the investment sector has professionalised. In our experience, three year tenancies will be welcomed by the majority of landlords, while tenants are reluctant to commit for more than 12 months at a time.

TABLE 5

ANNUAL RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS IN MIDTOWN, CITY & EAST LONDON MID 2018

Submarket		Weekly Rent £	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£450	500	£23,400	£46.80
	2 Bed	£630	750	£32,760	£43.68
	3 Bed	£1,100	1,500	£57,200	£38.13
City	1 Bed	£450	500	£23,400	£46.80
	2 Bed	£560	750	£29,120	£38.83
	3 Bed	£950	1,500	£49,400	£32.93
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*

As we have stated repeatedly in these reports, rents in our areas of London have not grown at the pace so often suggested in the press. Our comparison of rental growth with inflation shows that the cost of renting has been far out-stripped by inflation over all three time periods and when the impact of the post-Global Financial Crisis downswing is taken into account (2007-2008), the difference is striking.

TABLE 6

LONG TERM RENTAL GROWTH

	2000 - 2018	2007 - 2018	2008 - 2018
1 Bed	25%	5%	16%
2 Bed	32%	7%	17%
Inflation (CPI)	44.4%	29.4%	26.8%

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*

There are indications that the buy to let investment market is being 'professionalised'. Accidental landlords are being supplanted by a growing breed of small portfolio owners who are well-informed and strategic in their investment activities. Contrary to much press comment, we have not seen evidence in our markets of investors selling in the current conditions – we would expect them to hold on to income-producing assets until the sales market is stronger.

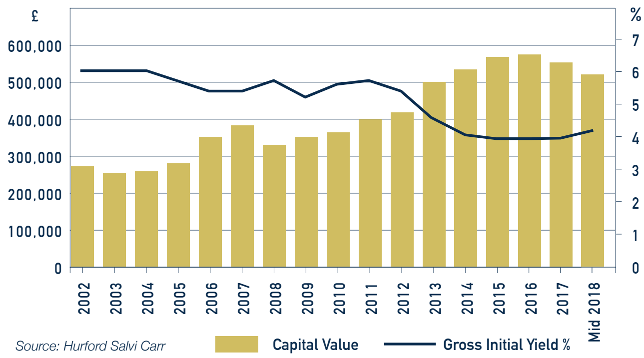
Margins have been squeezed for investors and this is reflected in the net yields. Our analysis shows gross yields – which have risen this year as capital values have dipped.

The introduction of Landlord licencing in several London boroughs has added to the burden for landlords without any obvious benefits for the vast majority of tenants. It is hard to see it as much more than a way to raise revenue for local authorities - which may well be sorely needed.

FIGURE 4

CAPITAL VALUES AND YIELDS FOR ONE BEDROOM APARTMENTS

MIDTOWN, CITY & EAST LONDON

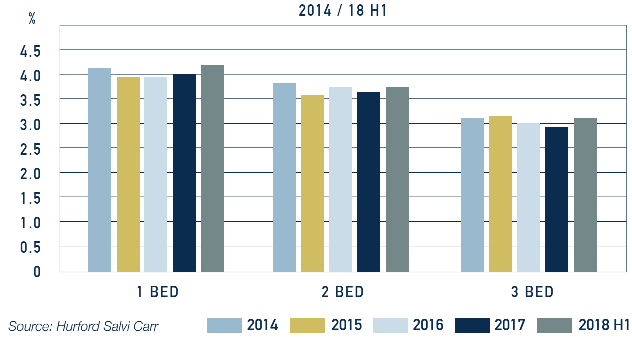


Source: Hurford Salvi Carr

FIGURE 5

YIELDS FOR CITY, MIDTOWN & EAST LONDON

2014 / 18 H1



Source: Hurford Salvi Carr

TABLE 7

INCOME, VALUES AND INITIAL YIELDS FOR ONE BEDROOM APARTMENTS

AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2003 TO Mid 2018

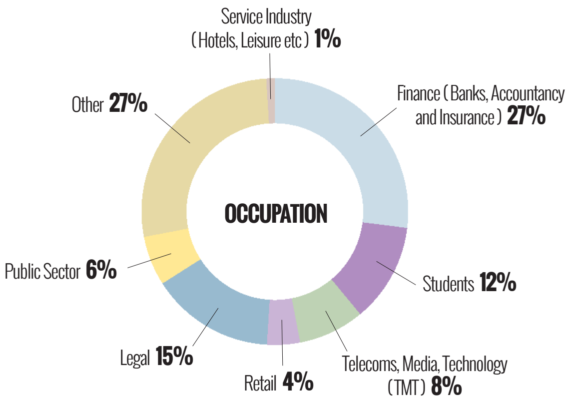
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Mid 2018
Gross Annual Income £	14,820	15,340	18,200	20,020	18,200	17,680	19,760	21,840	21,840	21,840	21,060	21,580	21,840	21,060	21,060
Capital Value £	246,000	270,000	340,000	371,000	318,000	338,000	352,000	386,000	405,000	486,000	520,000	550,000	555,000	530,000	505,000
Gross Initial Yield %	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	3.97	4.17

Source: Hurford Salvi Carr

H1 2018 TENANT PROFILES

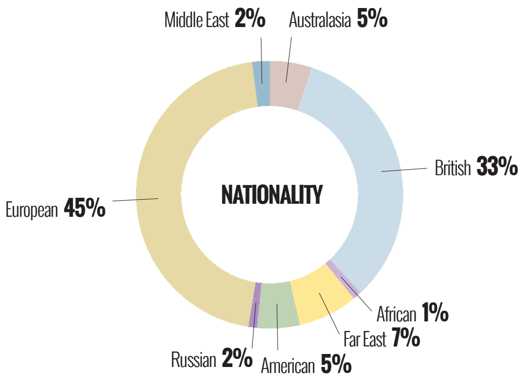
Occupation

Renters working the financial sector made up around one quarter of all transactions in H1 2018 and that is consistent with the three year trend. Students are less significant in the first half of any year and over the three year period they accounted for 12%.



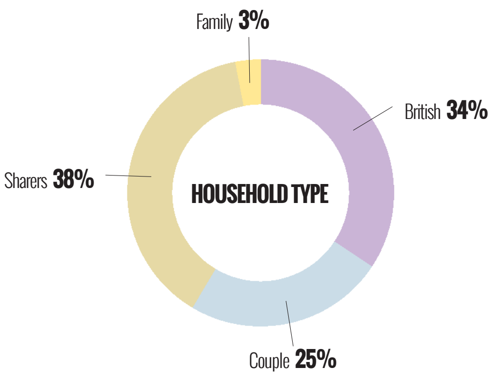
Nationality

Two thirds of renters in our areas originate from overseas, with Europe being the most significant group and accounting for almost half of the renters in H1 2018. In a comparison with the last three years, 2015-2018, the distribution is more balanced with a third from Europe, a third from UK and just under 15% from the Far East – a group that has declined substantially this year.



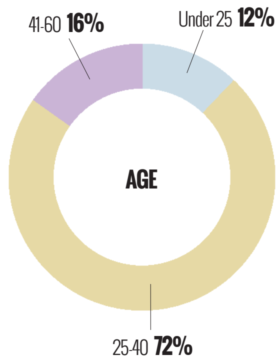
Household Type

Families that rent are relatively rare in our markets but the other three household types are fairly evenly distributed in H1 2018. Sharers are slightly under-represented compared to the picture for the three-year period, because of the student influence in H2. The figures for 2015-2018 are 34%, (singles) 29% (couples) and 34% (sharers).



Age

It is perhaps little surprise that almost three quarters of renters are aged between 25 and 40. The proportion of younger renters always dips in H1 compared with H2 because of the student population, which is particularly significant in Bloomsbury.



TENANT FEES BAN

The Tenant Fees Bill, first announced in the 2016 Autumn Statement, was introduced to parliament on May 2nd 2018 and will become law in 2019. Under the new legislation, landlords and/or agents cannot charge tenants any fees other than the rent and a deposit.

The only exceptions are:

- A change or early termination of a lease requested by the tenant.
- Utilities, communication services, Council Tax Payments arising from default such as replacing a lost key Change of sharer charges, capped at £50 unless the landlord can demonstrate higher costs.

And there are restrictions on rents and deposits:

- Security deposits capped at the equivalent of six weeks' rent.
- Holding deposits capped at one week's rent.

Penalties and enforcement:

- Fines of £5,000 for a first breach of the ban.
- A second breach within 5 years is a criminal offence.
- Financial penalties of up to £30,000 as an alternative to prosecution.
- Trading Standards will enforce the ban and tenants will be able to recover unlawful fees via a First-tier tribunal.

David Cox, Chief Executive of ARLA Propertymark, the body representing letting agents, has stated publicly that, in his view the new legislation will have unintended consequences and that "tenants will end up worse off and banning fees will not result in a more affordable private rented sector".

The ban on tenant fees will help to professionalise our sector. Less scrupulous agents have been able to offer lower fees to landlords and recouping their costs from tenants via a range of compulsory add-on services. This will no longer be possible and it is a welcome change to our sector. Headline fees of 10% reflect the true cost of delivering the service and these will become standard.

Some landlords will absorb the additional costs, some will seek to impose it on the tenant via rental increases – but that may be difficult in a market with a balance of supply and demand.

REGULATION OF LETTING AND MANAGING AGENTS

The enormous expansion of private rental across the UK over the past two decades has been largely achieved through the rise of 'buy to let' investors and that has created a highly fragmented and often informal system. Not all landlords understand the responsibility that comes with providing a service and the government has come under pressure to impose regulation to ensure minimum standards.

In April 2018, DHCLG announced a new round of policy proposals to clamp down on "unfair and abusive practices within the leasehold system".

It will address the area of service charges and specifically support leaseholders challenging unfair fees. Service charge accounts are often opaque and the process of requesting information for conveyancing is often long and costly for the leaseholder. Publicity given to excessive and escalating ground rents on new housing developments finally prompted action which was probably overdue.

Managing agents take responsibility for complying with hundreds of pieces of legislation around repairs and maintenance, health and safety, energy efficiency and all of these costs are wrapped up in the service charge. Leaseholders will be given far more power to identify how and why their money is being spent. The government has set out plans to make sure residents "pay only for the services they receive".

In the same round of new policy, government has proposed that letting agents should be required to comply with a new 'code of practice' and undertake continuing professional development. For members of ARLA, the new code will not change business practices but it will bring less disciplined agents into line.

Future Prospects

BREXIT TO DOMINATE

March 2019 is a critical date for the UK, after which it will no longer be a member of the EU. The process of leaving has curtailed economic growth since 2016, although retail failures are as much to do with changing business models as reduced disposable incomes. We believe that it is likely that the government will be keen to kick-start the post-Brexit economy by introducing economic stimulus in the wake of March 2019, to rebuild economic confidence and political stability.

NEW ELIZABETH LINE - DUE TO OPEN DECEMBER 2018

Interest rates are expected to creep upwards over the next year but to remain moderate and exposure to mortgage debt has been contained. Any sort of economic stimulus generally feeds through to the housing market in some form especially following a prolonged period of austerity. Given that so much personal wealth is tied up in the UK housing market, it may even be the vehicle used directly by the government to boost the national mood and bolster poll ratings, or we envisage tax breaks or financial incentives, which may be phased in to reduce the short-term cost.

Stamp Duty reform now looks unlikely. The Government has achieved its stated aim of cooling the housing market and its unstated aim of increasing revenue for the treasury. We do not expect to see Government giving up additional revenue but equally we do expect to see a fall in receipts from Stamp Duty as the malaise in the housing market spreads to other parts of the country.

High rate Stamp Duty Tax on housing transactions has reduced liquidity in the market for higher value homes and that has implications lower down the chain too. The one area that government must, at some point address, is the disincentive for older people in the post-family years, to downsize property.

We expect sale prices to fall in the second half of 2018, by an average of 4%, 2% in Midtown and 5% in City and East London. Next year, in 2019, we believe that prices will stabilise in Midtown, but continue to dip in other parts of our market, losing a further 2% in City and 5% in East London.

It is now 4 years since the market turned and we are yet to see any green shoots in demand.

The greatest challenge to this outlook, will be for the government to avoid political chaos in the final months leading up to Brexit. The other threats are, as ever, extraordinary events such as international security breaches, terrorist attacks or weather events.

New development will continue to tail off in London. Housebuilders have shifted their attention to other locations. The market for overseas sales has contracted but it remains critical in this sector. The London First policy has not achieved its objective of limiting sales to overseas buyers – they are simply in a better position to commit and these homes were designed with this market in mind.

We see a potential untapped market for the number of luxury, highly serviced new build apartments in London. These types of home could represent an attractive option for older buyers who are downsizing, or moving into the city from a family home, particularly if the service providers include healthcare, wellbeing and other support options on the menu of services. This would also help address the issue of releasing family homes.

The volume of investor stock coming through to the rental market will continue to subside but we do not foresee an imbalance of supply and demand. We expect rental values to be stable for the rest of 2018.

The residential rental market has proven to be robust in the face of economic and regulatory hurdles and we can see no reason why that will not be the case moving forward.

The Elizabeth Line, formerly (and still widely) known as CrossRail is now only months away. It will begin to operate before the year is out and it is a source of pride for London. We expect that the successful opening of this grand infrastructure project on time will give a boost to confidence in the city and while we do not forecast house price growth in our markets until 2020, we do expect a feel-good factor post Brexit.

As ever, this is all set against a backdrop of uncertainty, dissent and dismay over the Brexit negotiations and housing markets remain highly sensitive to national pride and public confidence.

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