research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 2018

“

Owners have more

realistic price expectations

”

HURFORD SALVI CARR

Market Overview

BUYERS SEIZE THEIR MOMENT

We have had more interest from prospective buyers in the second half of 2018, than at any time since Q4 Of 2014. It's not a dramatic upturn, the market remains quiet but the stirrings of activity are encouraging.

The simple passage of time is a significant factor. After a prolonged downturn, households with a need for more space, or a different home, become restless; a new generation comes into the market; downsizers lose patience. There is a build-up of frustrated demand and so when prices re-set, prospective buyers begin to feel that the balance of power is no longer quite so stacked against them.

More sales were agreed in the autumn but the real change was is in attitude rather than action. Often new buyers are window shopping, waiting for more clarity around the Brexit outcome. But the market seems a little fairer and some people feel they want to seize the moment, while there is room for negotiation and just in case there is a surge of activity.

Existing home-owners have accepted the low level of buyer enquiries and are now realistic about price expectations. While this improved understanding of market conditions is welcome and while we note more interest from buyers, transaction numbers remained low in 2018. The low level of sales transactions since 2015 seems to be the new normal – at least until there is some reprieve on the high level of Stamp Duty rates.

Prices that slipped by 4% in the first half of the year across the City, Midtown and East London, continued on a similar trajectory in the second half of the year to finish 7% below December 2017. With hindsight, 2015 proved to be the peak of the market and prices today are back to their 2014 levels having slipped by some 16% since 2015.

Brexit has dominated the UK political landscape for well over two years and there is no doubt it has undermined buyer confidence in the London property market. In our markets, we lost the young professional buyer who prefers to stay in the rental sector rather than risk become a home-owner with a 25 year mortgage, especially as there is no prospect of rising prices to create any urgency. Government policies, designed to entice renters into becoming first time buyers, have had little impact in Central London, except perhaps to divert attention to outer London.

With owners and tenants both choosing to stay put, the number of homes coming to the market is greatly reduced and demand is suppressed, resulting in low transaction volumes. As we have said in previous reports, even if market values have fallen, it does not stimulate any increase in transactions unless owners are prepared to bring properties to the market.

Rents remained largely unchanged in 2018 for the seventh consecutive year, although one bedroom apartments had a 3% increase in the second half of the year. Expanding stock of rental homes from the completion of new builds and the rise of 'accidental landlords' who have been unable to sell their apartments, has helped to keep rents at affordable levels.

Buy to Let investors have all but withdrawn from the market although capital is still routed in to the market under the guise of parents helping the next generation with deposits, either way, it has opened up opportunities for first time buyers. The main beneficiary however, has been outer London markets which are more affordable. Enquiries from first time buyers are rare in Central London where entry level prices remain prohibitive. Without investors, we now have a shortage of buyers for entry level one and two bedroom apartments.

Overseas cash-rich buyers, underpinned London's construction industry in the decade since the Global Financial Crisis but have been feeling less welcome since changes to Capital Gains Tax and the clamp down on corporate ownership structures.

Most people supported or at least understood the sentiment behind these policies to redress the balance but what once seemed fair began to feel unfair against a backdrop of Brexit discussions, together with UK-first sales campaigns and negative media coverage about the supposed impact of foreign investment. All of this has seriously undermined demand from overseas buyers even with a weak Pound.

In the immediate aftermath of the Brexit vote, many hoped that the fall in the value of the Pound against the Dollar and the Euro would keep overseas buyers interested. While its impact has been limited on the second hand market, it has helped to maintain sales in new developments where off plan sales to overseas and in particular Far Eastern buyers remained crucial over the past 12 months.

However, the proposal to introduce an additional 1% Stamp Duty for overseas buyers will dampen interest and reinforce the impression that the government will continue to make investment of foreign capital unattractive. The claim that overseas buyers push up house prices was examined in depth and disproved by researchers at the LSE in 2016 in a report for the GLA but it seems to endure as a belief – despite the evidence of falling prices for 4 years.

The government is determined to make conditions favourable for UK first time buyers and is not happy that new homes are purchased off plan by overseas buyers. The mismatch between Central London new homes and first time buyer needs seems to be lost on government policy makers. The most likely outcome is that development activity will dry up – unless the government finds a way to control land values.

The new overseas buyer SDLT rate was first suggested by the Association of Accountants who claim that 78% of its members backed an extra tax for foreign buyers and briefed MPs accordingly. They claim the additional tax will raise £40m to £120m at the same time as reducing demand from overseas buyers. This message plays well with politicians as the UK prepares to leaves the European Union.

HACKNEY WICK E3 - TWO BED APARTMENT, SOLD NOVEMBER 2018 £575,000

Economic Overview

END OF AUSTERITY

Better than expected data on the public finances in October, emboldened the Chancellor ahead of his Autumn Budget, leading him to pronounce the 'end of austerity' – a landmark moment for the UK after eight years of belt-tightening and public sector cuts. It took many by surprise because it meant setting aside his target of balancing the books. Instead, the Chancellor chose to honour manifesto pledges to reduce tax by raising the personal allowance and to increase spending on the NHS, by £84 billion.

The government had been on course to achieve a budget surplus in 2022-23 but that timescale will now be pushed out, although the Chancellor retains the ambition to eliminate the budget deficit altogether and the government's current forecast is for a deficit at 0.8% of GDP by 2023-24, compared with 10% back in 2009-10.

CITY EC1 - 2 BEDROOM TRIPLEX, LET OCTOBER 2018 £900 PW

Despite an improvement in public finances, the performance of the UK economy has been 'less impressive' than expected according to the Office of Budget Responsibility (OBR) and it reduced its forecast for growth from 1.5% to 1.3% in 2018. In fact, this is the weakest rate of growth since the economy shrank by 4% in 2009 - which has been blamed on a combination of an inflationary squeeze on household incomes and uncertainty caused by Brexit for business and consumers.

Looking ahead, the general view is that the UK economy is going to experience a period of low economic growth for at least three years. The OBR remains cautious, describing 'a relatively stable but unspectacular trajectory for economic growth', with forecasts of 1.6% in 2019 and falling back to 1.4% in 2021 and 1.5% in 2022.

Employment remains strong in the UK. The OBR expects 800,000 new jobs to be created by 2023 in the UK, on top of the 3.3 million increase since 2010. Average earnings were up by 3.3% in the three months to August, compared to the equivalent period 12 months earlier the fastest rate for nearly a decade and outpacing inflation. Unemployment, at 4% remained a 43-year low but the Bank of England is not expecting that to drive unsustainable levels of wages growth, forecasting 2.5% for 2018, rising to 3.5% in 2020.

Inflation fell to 2.4% in September from its six-month high of 2.7% in August. The fall is largely driven by downward pressure on prices for food and non-alcoholic beverages. The OBR expect that rate to be maintained to the end of 2018.

The Bank of England increased interest rates increased by 0.25% to 0.75% in August but the consensus is that rates will remain below 2% for the foreseeable future.

Bank lending of residential mortgages has been at prudent Loan to Value ratios since 2008 and, after 4 years of decline in sales prices, there are no signs of distressed sellers or imminent bank repossessions. As the London sales market continues into its fifth year of a downturn, the banks for once do not look exposed. Responsible lending in the period after the Global Financial Crisis, has left very few owners over-exposed to falling prices. This is a peculiar characteristic of the current downturn and is unlike previous property recessions when banks reacted with panic.

There was no new policy announced in the 2018 budget likely to have a significant impact on the London housing market. The prospect of a surcharge for non-resident overseas owners was already in the public domain and in the event, the chancellor announced a consultation to consider a charge of 1%. This is negligible compared to previous initiatives and looks to be designed as a subtle fund-raiser rather than a strong statement of intent.

On October 10th the US stock market sneezed and the world financial markets caught a cold. It is not unusual for financial markets to have a mid-October wobble, often coinciding with the hurricane season. This time it was prompted by further rises in US interest rates which caused a global ripple and nudged the FTSE to fall 1.9% on 11th October, finishing at 7,006 and wiping £1.6 billion off values. By mid December it had hit a low of 6,730 reflecting US trade arrangements with China and UK political difficulties.

In December the Prime Minister postponed bringing the Brexit Agreement with the European Union to the House of Commons for ratification until 21st January 2019. There remained a real prospect of the deal not receiving enough votes from parliament so a further period of economic uncertainty can be expected.

ISLINGTON CANAL N1 - 2 BEDROOM APARTMENT, SOLD NOVEMBER 2018 £840,000

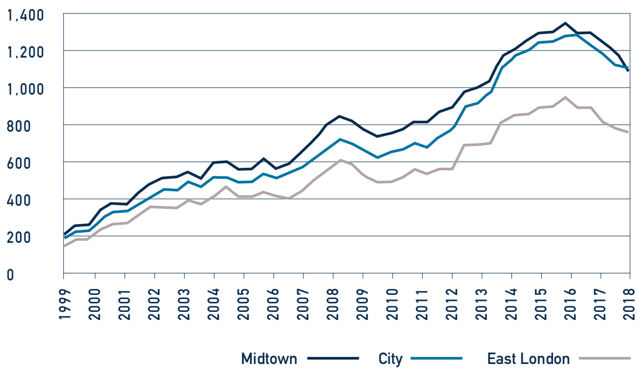
Sales Market

PRICES BACK TO 2014 LEVELS

Once again, our markets were characterised by low levels of activity in 2018. There were stirrings of renewed interest from prospective buyers in the closing months but overall the volume of sales was little more than half the level recorded in 2014. A comparison of figure 1 and table 1 below show clearly how strong demand fuelled price rises, until sharp increases in Stamp Duty in 2014 (and other smaller policy interventions) reversed both trends. The government intended to manage price rises but could not have anticipated Brexit which drained confidence from the market.

The number of residential sales in Central London fell by 40% between 2014 and 2018, with just over 70 sales per month during the hot summer of 2018. There was a similar rate of decline across Greater London as a whole. Looking back over the decade since the Global Financial Crisis in 2008, activity peaked in 2014 and despite the sharp but brief upturn in Spring 2016 (caused by Stamp Duty surcharge for additional homes in April 2016) activity has drifted downwards since then. Prices continued to rise for another two years after 2014 but have ultimately settled back to 2014 levels.

FIGURE 1
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*

A fall in transaction volumes nearly always leads to a fall in values as sellers come under increased time pressure to strike a price. As we have said repeatedly in these reports, there are few forced sellers in our areas and most investors are in the market for the long term.

However, for those who want or need to secure a sale, asking prices have found a new level. From a peak of £555,000 in 2016, the price of a one bed apartment in the resale market across City, Midtown and East London, has dropped by 12.5%, losing £70,000 of capital value over two years. Most of this fall occurred in 2018 and we believe that the market has now reached a sustainable level. This compares with falls averaging 18.4% in South West London prime housing market since 2014 according to Savills.

Homeowners have had to accept the changes and their expectations of sale prices are now realistic. Often that means they simply do not put properties on the market, preferring to retain their stake in Central London and often turning to the rental market as an alternative. We can see the current climate of high taxation keeping prices at their new affordable levels for the next 2-3 years. In the end there will be almost

TABLE 1
TRANSACTION VOLUMES IN PRIME Central London AND GREATER LONDON : FROM PEAK TO TROUGH

	Prime Central London	Greater London
Peak annual transaction volume (date)	June 2014	October 2014
Peak annual transaction volume	6,840	125,473
Lowest annual transaction volume (date)	June 2009	June 2009
Lowest annual transaction volume	3,594	57,868
10 year average transaction volume per annum	5,305	98,859
Current annual level	3,671	87,862
Current versus peak (%)	-46.3%	-30.0%

Source: Land Registry/Dataloft

a decade of low or no growth and that will be welcomed by a new generation of first time buyers as well as creating buying opportunities for anyone looking for a long term home.

The steepest price changes in 2018 were in Midtown and for one and three bed apartments. Two bed apartments were less affected, dropping by 4%, although it should be remembered that two bed apartments lost more value in the previous year, so this is, in effect, a rebalancing.

Since 2015, larger apartments have lost more value than their smaller counterparts. In Midtown, three bed apartment prices are 33% below their peak values, while in East London they have come down by 26% and 21% in the City. The number of buyers looking for larger apartments is always small in our markets but, there is a special place for the penthouse - that rare opportunity to own a slice of London in the sky with spectacular views across the city. We have written in previous reports about the penthouse market – in our experience, penthouses generally attract individual buyers who emerge from unexpected quarters but there are no guarantees for these special homes.

The average price change for all apartment sizes across all of our areas, has dropped by 7% in 2018, with total falls since 2014 averaging 16%.

The upfront cost of Stamp Duty is being factored into prices and brings a buyer's total purchase costs back to closer to 2014 price levels. There are no winners in this scenario other than the Treasury.

Owners with low gearing, who consider putting a property on the market, often elect to avoid these punitive transaction costs and instead, hold onto their assets for the long term. In today's market, there are no rising prices tempting owners to sell and the prompt is most often one of the classic life-events – a death, birth, marriage or divorce. These have always been key drivers in any housing market but today, owners generally are reluctant to sell and stock levels remain low.

TABLE 2

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
2018	-8.5%	485,000	-45,000

Source: Hurford Salvi Carr

After the government introduced a series of policy measures to discourage investors, we predicted that parents would begin to shift investment from Buy to Let, into cash deposits for their adult children – in a move that would help their adult children and also help their own pension planning. This has become a reality. Avoiding higher rate SDLT on investment purchases at the same time that their children are offered tax incentives to become First Time Buyers has multiple benefits. While investment purchases attract a 3% SDLT levy, First Time buyers pay no SDLT on purchases under £300,000 and a special low rate up to £500,000. This reduces the cost of purchase for the first-time buyer and helps them to meet borrowing requirements.

TABLE 3

PRICES & PRICE CHANGES FOR 1,2 & 3 BED APARTMENTS IN THE RESALE MARKET AT YEAR END 2018

		2015 £	2016 £	End 2017	End 2018	£ per sq ft	Change % 2018	Change from 2015
Midtown	1 Bed	650,000	650,000	625,000	550,000	1,100	-12%	-15%
	2 Bed	1,000,000	950,000	900,000	850,000	1,133	-6%	-15%
	3 Bed	2,600,000	2,200,000	2,000,000	1,750,000	1,167	-13%	-33%
City	1 Bed	630,000	650,000	630,000	585,000	1,170	-7%	-7%
	2 Bed	840,000	840,000	800,000	800,000	1,067	0%	-5%
	3 Bed	1,900,000	1,750,000	1,600,000	1,500,000	1,000	-6%	-21%
East London	1 Bed	450,000	450,000	430,000	400,000	800	-7%	-11%
	2 Bed	625,000	600,000	580,000	540,000	720	-7%	-14%
	3 Bed	1,250,000	1,100,000	1,000,000	925,000	617	-8%	-26%

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*

Recognising the risks of listing a property online in a sluggish market, many more of our clients are choosing our discreet marketing service. This means properties are listed for sale at our offices but not on the online websites. This avoids the risk of over-exposure online. It is rather like the resistance to agent's boards in the past and increasingly, vendors are electing to stay offline. As a result, serious buyers who engage with our agents are introduced to properties that are not available on Rightmove, Zoopla or On The Market.

TABLE 4

STAMP DUTY PAYABLE AT VARIOUS PURCHASE PRICES 2018

Purchase Price	Main Home SDLT payable	% of purchase price	Second Home SDLT payable	% of purchase price
£650,000	£22,500	3.5%	£42,000	6.5%
£850,000	£32,500	3.8%	£50,000	6.8%
£1 million	£43,750	4.4%	£73,750	7.4%
£1.25 million	£68,750	5.5%	£106,250	8.5%
£1.5 million	£93,750	6.3%	£138,750	9.3%
£2 million	£153,750	7.7%	£213,750	10.7%

Source: Hurford Salvi Carr

During 2018, especially since the summer, serious buyers have been able to reap the rewards of a slower market to pick up some great deals and avoid competition from other buyers.

We have noticed more enquiries this year for 3 and 4 bedroom family houses with outside space. This part of the market has had the steepest price correction over the past 4 years but now families are finding opportunities to secure a spacious home for the longer term, in the heart of Central London.

Buyers with shorter time horizons, or contemplating a Central London home investment, are often dissuaded in the current market, by the need to cover SDLT of up to 15% of the purchase price, up-front, out of taxed income and which cannot be added to their mortgage. Our research indicates that the average SDLT payable on a 2 bed apartment in our markets, would cover up to 2 years' of rental on the same home. As long as there is little sign of capital growth, the calculation is not lost on potential buyers.

The long-term performance of house price growth in Central London remains impressive in all three of our markets since 2008 with the City outstripping the two other markets because of the material change in the area from primarily offices to a more mixed environment.

An owner who bought a home 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 2008, will have secured capital growth of between 25% and 50% in our areas of the market and if the property was rented, it would have produced a healthy income return of around 4% per annum over that period too.

TABLE 5

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

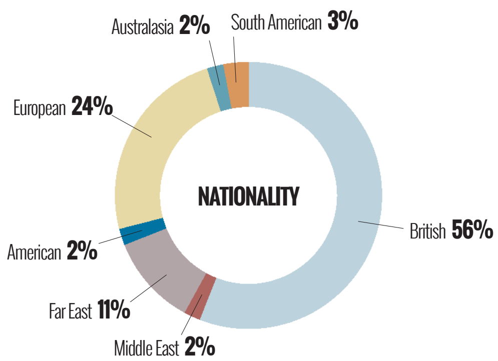
Submarket	1994 - 2018	2000 - 2018	2007 - 2018	2008 - 2018
Midtown	468%	116%	30%	43%
City	523%	151%	55%	70%
East London	473%	119%	26%	46%

Source: Hurford Salvi Carr

2018 BUYER PROFILES

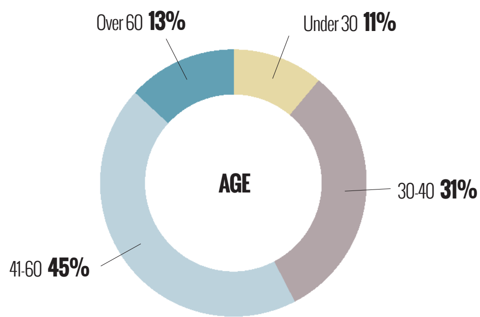
Nationality

British citizens accounted for more than half of all buyers but the market remains highly international and it is perhaps reassuring to see that almost a quarter (24%) of buyers in our markets were EU nationals – despite the disarray in the government over the Brexit negotiations. Perhaps some savvy Europeans see the slow market as an opportunity to establish a foothold in London for the long term.



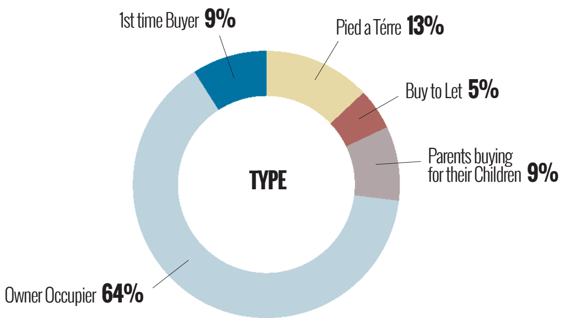
Age

There has been no typical age group buying in our markets this year – a third were aged between 30 and 40 but 13% were over 60. We noted in our half year report that older age groups had become more active and, as we said before, affordability seems the most obvious explanation for that. All of the buyers over 60 were in City and Aldgate.



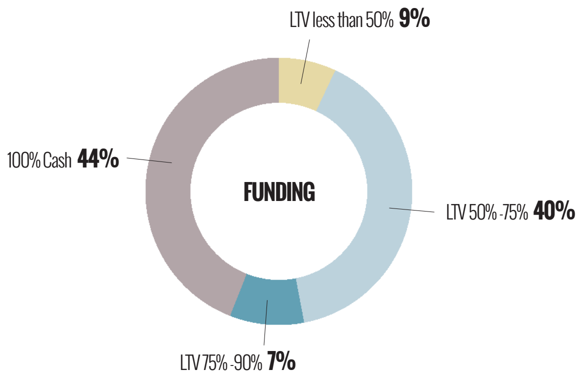
Household Type

The majority of buyers in 2018 were owner occupiers and investors had shrunk to just 5% of purchasers. We noted elsewhere the rise in parents buying for adult off-spring, which might be an alternative route to investment. They made up 9% – the same proportion as first time buyers. Buying a pied-a-terre has always been a significant segment in our market and 2018 was no exception, accounting for 13% of purchases.



Funding

Buyers in our markets are generally cash-rich and a large proportion do not use any mortgage debt. In 2018, 44% of purchases were made using only cash and another 9% were able to fund more than half the price with equity.



How buyers have changed

OWNER OCCUPIERS REPLACE INVESTORS

The areas of London where we operate have generally experienced substantial material change over the last two decades, both physical and social. Often they were predominantly commercial locations but over the years they have become established and highly sought after residential localities. Such areas 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 can pick up early signs of further change.

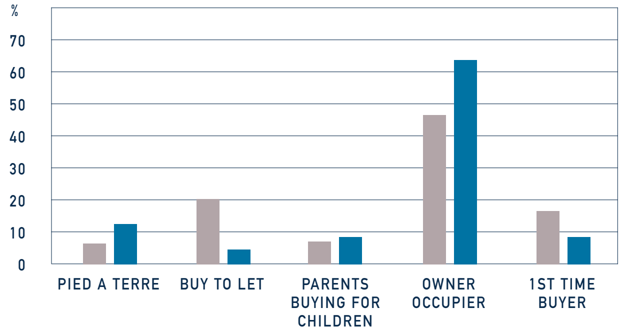
For this year-end report we have compared the buyer profiles for the whole four-year dataset, with the results for 2018, to assess how far the market has shifted this year.

Buyer type

There is no mistaking the shift away from investors and towards owner occupiers. Buy to let investors made up 21% of buyers over the whole period but only 5% in 2018. The proportion of owner occupiers on the other hand, has risen from 47% to 64%, many of these are people who see an opportunity to move into a part of the market that has been vacated by investors.

FIGURE 2

BUYER TYPE: COMPARING 2018 WITH 2015-18



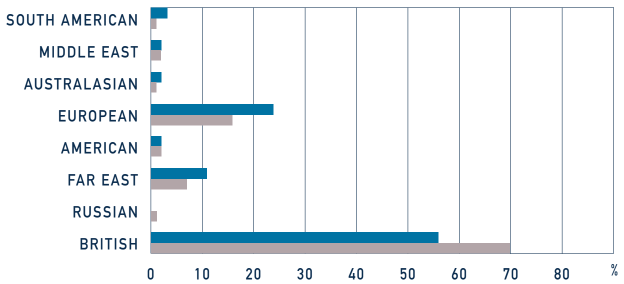
Source: Hurford Salvi Carr   2015 - 18   2018

Nationality

Our markets have always been diverse international communities, being in the heart of a global city and close to world-renowned universities and international financial markets. That remains true in 2018 and EU nationals have been reassuringly active this year, accounting for 24% of buyers.

FIGURE 3

NATIONALITY: COMPARING 2018 WITH 2015-18



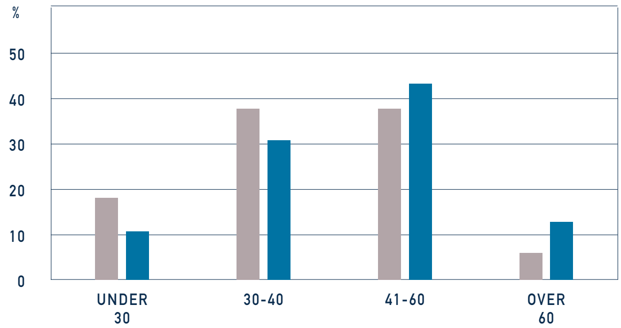
Source: Hurford Salvi Carr   2015 - 18   2018

Age

The age profile is more consistent over time although there is a discernible shift up the age range with a reduction in under 40s and rise in over 40s and particularly the over 60s. These are high value markets and it is an inevitable consequence of affordability. As we pointed out in our half year report, we watch 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.

FIGURE 4

AGE: COMPARING 2018 WITH 2015-18



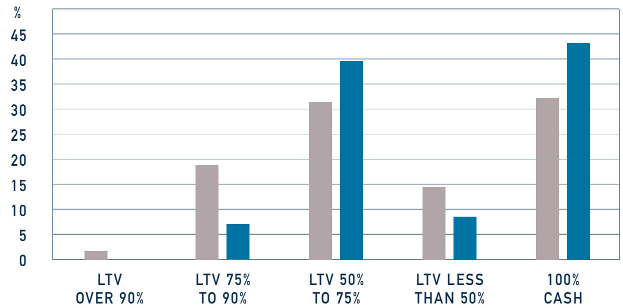
Source: Hurford Salvi Carr   2015 - 18   2018

Funding

The typical buyer in our markets is cash rich. In 2018, the proportion of cash buyers rose to 44% while those using mortgage debt were generally well-funded. Given that the price of a one bed apartment is around £500,000 across all our markets, it is clear that our markets are driven by equity-rich buyers.

FIGURE 5

FUNDING: COMPARING 2018 WITH 2015-18



Source: Hurford Salvi Carr   2015 - 18   2018

New Homes

620,000 LONDON HOMES DELIVERED SINCE 1998

The foundations of the new homes market in Central London have been undermined in the past couple of years by the dramatic decline in investor-buyers and a shortage of off-plan pre-sales. The combined effect has been to shift the focus of housebuilders' and developers' marketing, to owner occupiers. Buyers looking for a home rather than an income stream, understandably, prefer to see finished show homes before committing to a purchase. So 'completion' has replaced 'off-plan' as the primary point of sale and the quality of access, presentation and furnishing of show homes has become critical.

We have also noted the rising importance of residents' amenities and smart technology in new homes. The ability to offer a range of features including intelligent lighting, comfort cooling, 24 hour concierge and leisure facilities, offer a real competitive advantage over the sale of older homes.

As prices flattened and demand retrenched, the number of construction starts and new planning applications has begun to decline. Many of the smaller residential developments were converted from offices but as office stock shrank, office values rose and the relative pricing of commercial versus residential has shifted back in favour of offices in our markets. The cost of refurbishing office space is low compared to expectations in the residential markets so change of use to residential is rarely viable today and now the number of boutique residential developments across Midtown, City and East London of less than 20 units has fallen.

Planning applications for residential developments in London have been falling since 2014 and are now 40% below 2014 levels. In 2018 in Central London construction starts were down 50% since 2015 and planning permissions granted at their lowest level since 2009.

During this time larger residential projects with residents' facilities at Kings Cross, Islington, The City, Shoreditch, Aldgate, Hackney Wick and Canary Wharf have filled the void created by the loss of the smaller traditional London scale residential conversions and developments.

Current planning guidelines promoting commercial uses over residential in the inner London boroughs together with higher commercial values will curtail residential development and ultimately restrict the number of new homes coming to the market in the City and City fringe in the next 3-5 years.

London's housing shortage has made the headlines for several years and politicians of all persuasions acknowledge the need to keep driving more residential construction activity. In the past two decades, land values for residential property outperformed commercial across much of London and there have been two unplanned and in many ways, unwelcome, consequences. First, the city has lost large areas of commercial floorspace where offices have been converted into homes and secondly, the new homes market has focussed on high value high density development.

There is no doubt that London requires more affordable rented homes and family houses with gardens for rent and for sale. At the same time London has experienced a building boom over the past 20 years which delivered around 450,000 private and 170,000 affordable apartments, according to the London Development Database.

620,000 new homes in 20 years in a city of 8 million people is an impressive output and has made and significant contribution to London economy and overall housing standards.

In the first 6 months of 2018 the Build to Rent sector accounted for almost a third of all new homes completed according to Research analysts Molior. There were 57,000 new homes in the development pipeline earmarked for the rental market under the control of 200 Build to Rent companies. Very few of these units are situated with Central London with no construction starts for this sector within Camden, Islington, City of London, Tower Hamlets, Hackney or Westminster in the first half of 2018. The additional supply came from the outer London boroughs including Barnet, Brent, Hounslow, Newham, Croydon, Ealing and Hammersmith.

WHITECHAPEL E1 - ONE BEDROOM APARTMENT SOLD SEPTEMBER 2018 £575,000

In October The Prime Minister announced that the cap on the amount local authorities can borrow to build council houses, will be scrapped. This is intended to allow local authorities to build up to 100,000 more homes a year. This is welcome news and will in time help to provide more affordable homes as well as providing a boost to the construction industry.

Developers and house builders continue to rely on the Help to Buy scheme to attract new buyers in London up to £600,000 and have employed a range of additional incentives including Stamp Duty and legal fee contributions to hit sales targets.

The Government is considering introducing steps to control the level of ground rents being charged on new leasehold homes proposing a £10 pa to address concerns that this unregulated sector of the market had been used to exploit home owners.

The slowdown in the London sales market is exactly the outcome that the Government intended when they introduced higher rate SDLT rates in December 2014 and the 3% additional homes surcharge in April 2016. And now, late in 2018, they have followed with a consultation on adding a further 1% to the Stamp Duty burden for overseas buyers. Most commentators are of the view that this is a cynical political move and will inflict damage on the London market just at the moment it will need to be supported. If this goes ahead it will stem the flow of new construction, discourage second hand sales, reduce demand and feed additional stock into the rental market.

Lettings Market

YIELDS IMPROVE

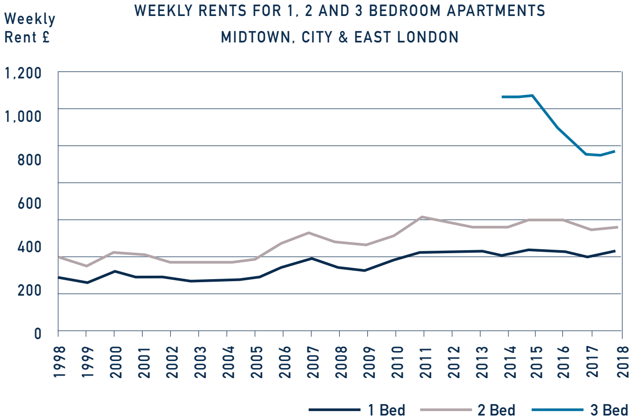
SHOREDITCH E1 - 3 BEDROOM APARTMENT, LET SEPTEMBER 2018 £1,150 PW

Rents remained broadly unchanged in our markets in 2018. In fact, for one and two bedroom apartments, rents have been broadly stable for the past seven years. The market has a seasonal rhythm and modest increases typical of the busier summer months, were offset by decreases in the quieter winter months. It is fair to say that the residential rental market in our areas is well-balanced, with supply sufficient to meet demand from a cross section of tenants.

Larger apartments have been the exception. A lot of stock came to the market from owners who were unable to sell at an attractive price (after the Stamp Duty reforms) and elected to rent out their home instead– the 'accidental landlords'. In this segment of the market, supply exceeded demand and rents fell during 2016 and 2017. However, this market too, seems to have stabilised in 2018.

FIGURE 6

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



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 growth of the Buy to Let investment played a critical role in building a balanced market over the past two decades and, in our experience, landlords continue to maintain and improve their portfolios so that they can attract good, responsible, tenants while minimising any rental void periods.

As we have previously reported, the supply of rental homes across Central London was significantly boosted by the 20-year-long building boom and today's tenants have a wide choice and predictable monthly outgoings. Rents for one bedroom apartments have hovered around £420 per sq ft per week since 2011, and the gentle 3% rise during the second half of 2018, simply restored values that were first established in 2011.

There is a stark reality that acts as a pressure valve on the rental market - every month that a rental property lies empty, the landlord loses out on a twelfth of the annual income. No wonder then, that landlords see the benefit of offering competitive rates and the market adjusts quickly and smoothly to cycles of supply and demand.

A large three bed apartment in East London can now be rented for little more than the cost of a one bed apartment in City or Midtown, making the additional travel time an appealing trade-off for space. The differential between the rent in Midtown and East London for a one bed apartment is 40% but for a three bed it is 91%. Nevertheless, the demand for small apartments in Central London is always robust – and renters are often prepared to compromise on the size of their living space in return for a central location.

TABLE 6

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

Submarket		2015 £	2016 £	2017 £	2018 £	% Change 2017 - 2018
Midtown	1 Bed	440	475	450	475	6
	2 Bed	640	660	600	640	7
	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	340	6
	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*

The expansion of London's private rented sector, which now accommodates 40% of the capital's households, has not been lost on local authorities and central Government. Both local and national policymakers have aggressively targeted private landlords for additional tax revenue through a number of unrelated measures.

Selective Landlord Licensing and new HMO Licensing for properties suitable for sharers introduced by Newham, Camden, Hackney, Tower Hamlets and Islington look, from our perspective, like a 'licence to print money'. Fees range from £500 in Camden for 5 years, to £1,250 in Hackney for a 5-year additional HMO Licence. Landlords, in return for their fees, receive no support, benefits or even a basic inspection of their properties. In the age of austerity, local authorities are desperate for income and are targeting private landlords.

These fees add further to the cost of running a rental business. Being a landlord is a service business but as costs rise, there is an inevitable temptation to recoup costs from elsewhere. Most landlords of apartments in Central London already cover the annual cost of substantial service charges that can range from £2,000 to £10,000, as well as ground rents. All of these eat away at net annual income.

TABLE 7

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

Submarket		Weekly Rent £	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£475	500	£24,700	£49.40
	2 Bed	£640	750	£33,280	£44.37
	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	£340	500	£17,680	£35.36
	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*

The Tenant Fee Ban, due to come into effect in April 2019, will only add to a landlord's cost burden and it will put upward pressure on rents.

It is no surprise that some landlords are considering selling properties following this barrage of new taxes. However, with bank interest rates remaining so low, few are under any pressure to sell and in a slow market with few buyers, much of this stock sits stubbornly on the market.

In October, the Government announced a policy consultation designed to encourage landlords to sell out and help renters onto the first rung of the property ladder. The proposal is that investors should be eligible for tax relief from Capital Gains Tax if they sell to a tenant who is a first-time buyer and has rented the same home for 3 years or more.

On the other hand, the Government proposal for three-year tenancies to give tenants greater security will be welcomed by landlords, who are almost invariably focussed on secure regular income and minimal voids. In fact, the market has moved in this direction. In our experience, the average length of an AST tenancy is now approaching three years although tenants prefer initial 12 month terms to provide greater flexibility, without the need for legislation to nudge it along. In a market where rents are stable and renters show little interest in becoming home owners, there are fewer incentives for tenants to move from one rental property to another.

At the same time, there has been growth in the short-term rental apartment market thanks to both professional and amateur operators who now compete directly with the hotel sector.

The Deregulation Act 2015 introduced a measure designed to curb and regularise this segment of the market. Planning restrictions imposed a maximum 90-night limit on the number of days a landlord can sublet a property in any year, without obtaining a change of use from a dwelling house (C3) to short term rental / hotel (C1). Online booking platforms including Airbnb offer tourists and corporate tenants a short-term alternative to conventional long term rental agreements.

Weekly rates for short term lets far exceed the equivalent rent on a 12-month lease but this activity does create conflict with other owners and residents in apartment blocks. Neighbours resent their buildings being used as unofficial hotels, and are concerned that there is no security vetting of visitors using the building facilities.

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-GFC (Global Financial Crisis) downswing is taken into account (2007-2008), the difference is striking.

TABLE 8

LONG TERM RENTAL GROWTH

	2000 - 2018	2007 - 2018	2008 - 2018
1 Bed	29%	9%	20%
2 Bed	32%	7%	17%
Inflation (CPI)	47%	32%	29%

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*

Central London's property market now performs like housing markets across Central and Northern Europe where renting is the dominant tenure and sales occur less frequently. Despite the increased burden of regulation for landlords, we are pleased to report that the rental market is working well for both landlord and tenant.

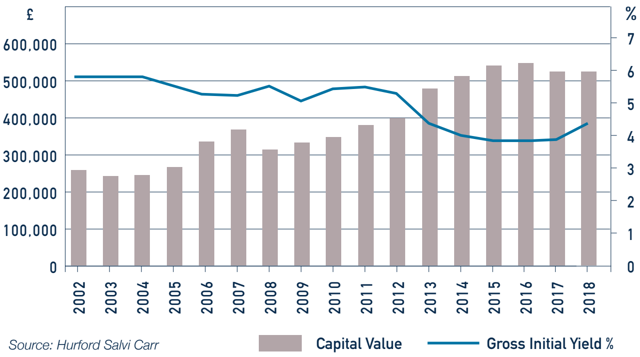
However, the number of new buy-to-let investments has declined as evidenced by the amount of capital raised through Buy to Let mortgages. In London, it was 40% lower in the first half of 2018 than it had been in the first half of 2015 - £3.5 billion down from £5.8 billion. In fact, in 2018, there were more investment properties sold than bought. The slowdown in investor activity was most pronounced in Central London and we expect it to continue that way in 2019.

Banks who are struggling to hit lending targets are now offering buy-to-let Landlords cheaper mortgages than homeowners for the first time with rates as low as 1.14% on discounted variable mortgages. The dramatic shrinking of the buy-to-let market has sparked a rate war among lenders.

BLOOMSBURY WC1 - 2 BEDROOM APARTMENT, LET SEPTEMBER 2018 £1,070 PW

The damage inflicted on the investment market by the present government has been broadly supported by the opposition. At its party conference in September, Labour announced that, if elected, it would look to introduce new taxes aimed at second homes that are not let. Its proposal is to introduce a new levy based on a property's council tax band which would double a council tax bill. The funds raised would be sent to the Treasury, rather than kept at local level.

FIGURE 7
CAPITAL VALUES AND YIELDS FOR ONE BEDROOM APARTMENTS
MIDTOWN, CITY & EAST LONDON

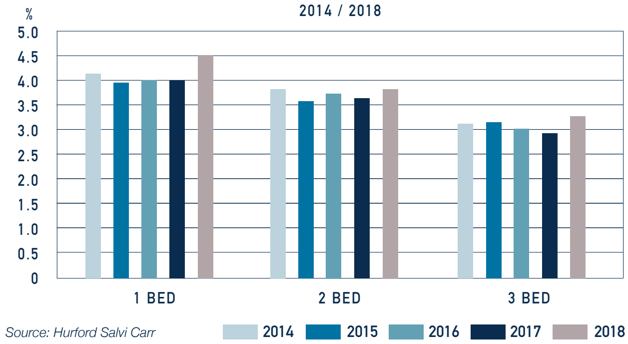


The squeeze on an investor's margins is reflected in net yields, as costs have risen. Our analysis shows gross yields and these have risen over the year as capital values have dipped. The gross yield for a one bed flat is now back at 4.5% and could rise a little further in 2019, preserving the attraction of residential investment. The increased cost burden eats up approximately 3% of the yield reducing the investors return to just 1%-1.5%.

The small number of investors enquiring in 2018 were attracted by improved investment returns but deterred by SDLT. A convergence is underway but yields need to move a little further to really attract investors.

LIMEHOUSE E14 - 2 BEDROOM APARTMENT, LET OCTOBER 2018 £515 PW

FIGURE 8
CHANGE IN YIELDS FOR CITY, MIDTOWN & EAST LONDON
2014 / 2018



Yields are consistently higher for one bed apartments than two beds and returns on two beds are higher than for 3 beds. These differentials do not change much although the gap opened up a little in 2018 because of the different place in the capital value cycle – one beds lost more in capital values this year and gained a little more in rental value.

TABLE 9
GROSS INVESTMENT RETURNS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2012 TO 2018

	2012	2013	2014	2015	2016	2017	2018
Gross Annual Income £	21,840	21,840	21,060	21,580	21,840	21,060	21,840
Capital Value £	405,000	486,000	520,000	550,000	555,000	530,000	485,000
Gross Initial Yield %	5.4	4.5	4.1	3.9	3.9	3.97	4.50

Source: Hurford Salvi Carr   *Gross Yields - Gross to Net is typically depleted by 2.5%*

Have Renters Changed

In the four years that we have collated buyer and tenant profile data, the market has undergone some significant changes with a shift in activity from sales to rentals. We know that some households that would, in other circumstances, have been buyers are now choosing to rent and that renters are staying longer in the sector than previously.

For this year-end report we compared the tenant profiles for 2018 with the average over the period 2015-2018, to highlight any significant variations from the longer term trends.

The biggest departure from trend in terms of the employment sector is in the reduction of renters working in the legal sector. It is difficult for us to explain this change - perhaps Brexit has created more work for UK lawyers and for lawyers on temporary contracts from the EU. It is reassuring and perhaps surprising to see an increase in EU nationals in 2018 compared to the longer trend. This might be explained by a shift from buying to renting.

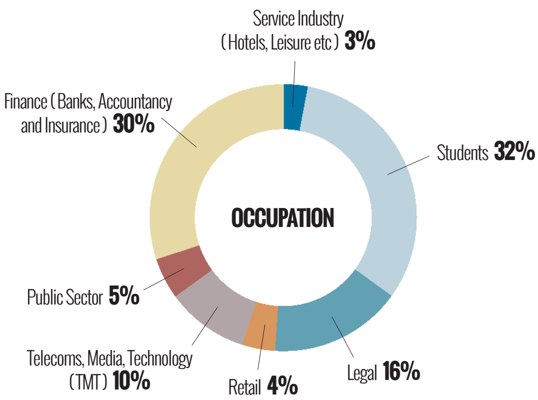
2018 TENANT PROFILES

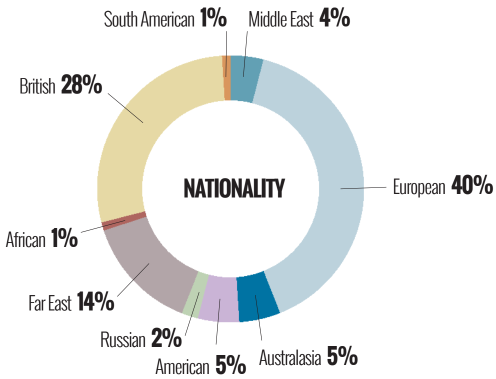
Occupation

Banking and financial is always a key employment sector in our markets, given proximity to Canary Wharf and the City and accounts for 30% of the total. Student renters tend to be those with larger budgets than the average students and range from UK post-grads to affluent overseas under-graduates. There is a concentration of academic institutions with global reputations in and around our area including UCL, King's College and LSE and students have always been an important source of demand.

Nationality

EU nationals made up 40% of renters in 2018 – a reassuringly high proportion. We do not know how many of these might, in other circumstances, have considered buying a home but in the current market, buyers need to be thinking with a minimum of 3 year time horizons. 32% were from outside the UK and EU with Far East being the dominant group, often students. This chart underlines the importance of overseas nationals to the London rental market.



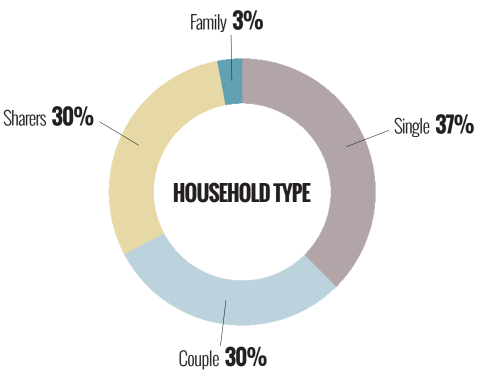


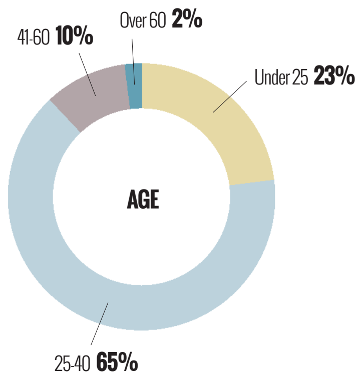
Household Type

The majority (67%) of renters in our markets in 2018 were singles or couples, so it is no wonder that the one bedroom market is so important. A couple can share a one bedroom apartment and life in Central London becomes affordable for a much wider segment of the population. Families are relatively rare and that also reflects the nature of the housing stock.

Age

The dominant age group renting in our markets is 25-40 years old. They account for two thirds of the total in 2018. The under 25s represent the student renters or early-career graduates and over 40s are relatively unusual.





Future Prospects

SALES VOLUMES TO INCREASE

On 29th March 2019 the UK may, or may not, leave the European Union on what has become known as 'Brexit Day'. We can only speculate on how the final outcome will affect the London housing market. In many ways, any negative impact has already been absorbed in the 33 months since the referendum as uncertainty has dominated the headlines. Nevertheless it seems likely that Brexit Day will feel like a watershed moment for the nation and we would expect there to be a national sigh of relief as the deadline passes and the new era begins. No doubt that this period will go down in history as a critical time for the nation's economic and social wellbeing.

Brexit has pre-occupied the nation for two and a half years and the national mood of uncertainty remains the most dominant influence on the behaviour of buyers and sellers. London's housing market is driven by demand, and demand is itself driven by confidence in London, the UK and global economies. It is difficult to remember a period of political uncertainty to match the past 3 years.

Yet, throughout that time, London has continued to be a highly successful global economic power. While we have little idea of how the future UK–EU relationship will play out, we remain confident of London's future as a global city. It will continue to be a leading financial centre; to attract international tech companies; be a magnet for design and the arts; have a hotel sector serving a global clientele; a world-class restaurant scene; high employment rates and a warm welcome for EU nationals.

London will celebrate the opening of its ambitious Crossrail project in 2019, the new Elizabeth Line, which will link Canary Wharf, The City and West End with Heathrow.

It is four years since we first experienced falling transaction numbers in Central London a trend set in motion by changes to Stamp Duty. But now, at the beginning of 2019, there is a new-found equilibrium. A re-setting of prices, however modest, has improved affordability and, perhaps more importantly, it has restored some faith in the housing market. Slowly, buyers are being enticed back, but not Buy to Let investment buyers. At least not in their conventional form. The take up of Buy to let mortgage finance has fallen 40% since 2015. The slowdown in investor activity has been most pronounced in Central London and we expect it to continue that way in 2019.

However, we believe there are small investment funds poised to buy up stock in bulk and at a discount, from house-builders who are losing patience with the back-log of new home completions. In these cases, stock will most likely end up in the rental market producing a longer term return for the investors.

The investor market faces significant barriers to entry including taxes and the endless new anti-landlord legislation from local and central Government.

The combination of reduced Buy to Let activity and discounts for investor funds will put upward pressure on yields, especially as capital values have fallen. We predict that gross rental returns will consolidate at 4.5% in the next 12 months.

London's rental stock has undergone an enormous expansion in the last decade or two but higher SDLT has strangled the Buy to Let market and ultimately it will lead to upward pressure on rents. Rents across Midtown, City and East London have been largely flat for the past 10 years but are likely to rise in 2019.

Rent increases are less likely in the greater London area where new Build to Rent developments are adding significant numbers of new homes to the rental market particularly at Wembley, Stratford, Croydon and Ealing.

The structural shift in the balance of supply and demand is, and will continue to be, a challenge to developers, regulators, funders and property owners.

As the reality of a post-Brexit London becomes clearer, we expect owners who delayed putting homes on the market to reach a decision-point and the traditional April boost to the number of listings for sale, should reappear in 2019.

Even a small improvement to transaction numbers will still leave volumes at their new lower level in 2019 and we expect prices will remain unchanged. Government policy will be a huge influence on the future direction of the sales market whether that is through direct intervention like tinkering with SDLT rates or supporting first time buyers, or indirectly via the final denouement of the Brexit deal.

Ultimately most people still regard residential property as a safe home for accumulated wealth and that in itself makes property an attractive long term investment. The most recent graduate cohort may have delayed home ownership but the desire for home ownership has not been lost.

For now, London's housing market looks and feels very European, dominated by an active and fluid rental market and a low turnover of sales transactions.

CLERKENWELL EC1 - 1 BEDROOM LOFT, SOLD AUGUST 2018 £1,195,000

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