research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 1ST HALF 2019

“Residential investment yields improve”

HURFORD SALVI CARR

Market Overview

RENTS START TO RISE

Rental values edged upwards in the first half of 2019, after an 11 year period of stability. The rise is neither sharp nor steep but, because it comes at a time when sale prices are flat or falling, it means that investment yields (return on investment) for residential property, have significantly improved.

So far, this improvement in returns has not translated into renewed activity amongst buy to let investors. Their appetite was curbed by the introduction of a 3% Stamp Duty levy for 'additional homes' back in April 2016 and it remains a deterrent.

The vast majority of new rental property in London over the past two decades has come to market from buy to let investors. Although investment slowed after April 2016, new rental stock continued to flow to the market as new developments were completed, because so many investors had bought new homes off-plan. It is only in the last 6 months that supply has dropped and we have begun to see an impact on rents. It has not been a dramatic rise (they rarely are) but we expect it to continue.

Rental growth is far less volatile than sales price growth because values adjust each year on renewal and because landlords focus more on minimising voids than raising rents. The gross yield on a typical one bedroom property in our areas has reached 4.7% for the first time since 2013. By the end of the year, we expect yields to be closer to 5%. It is hard to believe that this will not attract some interest from savvy investors.

There is no doubt that the 3% additional home levy, (combined with Stamp Duty relief) has helped to clear the way for first time buyers by discouraging investors. At the same time, there has been a slew of new regulation to protect renters.

It is ironic that these policies, which many see as cynical political moves to attract young voters, have been an additional cause of rising rents. The proposal to introduce three year tenancies will be similarly double-edged. Renters generally prefer the flexibility of a break clause and landlords are normally the party most keen to lock in rental income and avoid the costs of finding a new tenant. In the current market, with capital values flat, there is little to motivate renters to become owners.

For five long years, the sales market has been in stalemate with, on the one hand, buyers convinced they can negotiate discounts on the asking price and, on the other hand, owners unwilling to sell if it means crystallising losses. The resulting impasse has meant that sale transactions across Central London dropped to historic lows and stock levels plummeted in tandem. Prices for one and two bedroom apartments are now 15% below their 2015 highs and larger properties 30% below.

Stamp Duty continues to dampen prospects of price growth and we could reasonably expect a decade of price stagnation unless there is some policy intervention such as Stamp Duty reform. However, we see little reason why the government would choose to do that since suppressing price growth was ostensibly one of the key policy aims and is also a plank of Labour's housing strategy.

Few people expected the question of Brexit (or no Brexit) to remain unresolved past March 29th 2019 – but that is the surprising outcome of a democratic process that has become mired in dispute and disagreement. The new target date is October 31st 2019 and this extension of uncertainty has taken its toll on the housing market in London.

At the beginning of 2019 Brexit and the succession of parliamentary votes, dominated the national consciousness and caused buyers, sellers and even renters to avoid decisions. We sensed a change in May and June, with a growing acceptance that the price re-set is probably coming to an end in a market with few forced sellers and very little stock for sale. Conditions like this prompted some buyers into a decision to act before the opportunity to buy in a slow market disappears and buyer enquiries have increased.

We are not declaring a turning point just yet. Opportunistic buyers tend to focus on properties that have been on the market for some time and make speculative offers. Nevertheless, we can confirm that there were more buyers willing to move closer to asking prices in Q2 2019, in order to secure a property.

ISLINGTON N4 - 2 BEDROOM HOUSE, LET MARCH 2019 £650 PW

Two better months are most welcome but it is too early to call it a sustained upturn and the announcement in June of a Tory leadership election, with the prospect of a new Prime Minister to steer Brexit towards the next deadline, ekes out the uncertainty. At half year, we still do not know whether to expect a General Election, a Referendum, a withdrawal deal or no deal. Confidence is critical in housing markets and, today, decisions are framed by the belief that pricing has found a new normal. We expect prices to hold at their current level for the remainder of 2019.

Many are forecasting a mini-boost to the market following a Brexit resolution in October and it will certainly be tempting for the government to boost the housing market, stimulate the economy and appease a Brexit-weary electorate in its post-Brexit Autumn statement. That will support current pricing but only activity will drive price growth and we appear to be in a new paradigm with lower transaction volumes.

While most buyers and sellers in our markets are highly tuned in to the economic and political backdrop, there are always other imperatives driving housing market decisions. Life-style changes such as household formation, births, education, downsizing, retirement, health and legacies all play a key part in triggering a move or investment.

Economic Overview

MARKETS AWAIT BREXIT DEAL

The Bank of England adjusted its outlook for the UK economy downwards in June, to reflect an increased risk of a 'no deal' Brexit, following the Tory leadership campaign which favours Boris Johnson. This risk factor sits alongside weakening global markets and intensifying trade disputes to dampen the growth outlook.

The UK economy has remained remarkably resilient in recent years, repeatedly confounding pessimists with better than expected figures for GDP growth, employment, output and inflation. Although prolonged Brexit negotiations have caused frustrations, undermined confidence as well as prompting investment in the UK to decline.

LIMEHOUSE E14 - 3 BEDROOM HOUSE, SOLD FEBRUARY 2019 £1,250,000

The Bank's forecast for growth has been reduced to zero for Q2, whereas just a month earlier it had been predicting a marginally healthier 0.2%. It compares with growth of 0.5% in Q1 2019, when the economy benefited from companies buying extra goods as stockpile for the initial Brexit deadline.

The value of sterling fell on the news of the Bank's growth downgrade. Sterling had already weakened on the back of Theresa May's resignation and Boris Johnson emerged as the Conservative leadership favourite (and the Brexit implications that suggests).

UK employment remains strong for now, recording a record high in 2019. The ONS report 32.7 million people in employment at the end of March, while unemployment fell to its lowest level since 1974, at 3.8%, well below the EU average of 6.5%.

It is difficult to unpick what all these factors and risks mean for London in particular. The Greater London Authority (GLA) released its latest forecasts in June. These suggested a weaker 2019 and 2020 before improvement in 2021, with a continuation of income and employment growth throughout the forecast period but at more modest growth rates.

London runs with a higher unemployment rate of 4.3% (April 2019), down from 5.1% a year earlier. The latest employment report by KMPG and REC indicates that there might be some slippage in the unemployment rate ahead as the number of permanent staff appointments fell across London to its lowest level in April since September 2016, the only region to witness a fall.

Whilst the value of sterling, which continues to be a barometer for Brexit risk, was affected by recent developments key equity market indicators have remained resilient. Both the FTSE-100 and FTSE-250 are 10% above levels at the start of the year.

The tide might be turning on the interest rate outlook, following earlier expectations of a rise before the end of the year. Now both the FED and the ECB appear more likely to lower rates and the consensus forecasts for the UK are for rates to remain at 0.75% until the end of the year.

Across the UK, average wages rose by 3.4% in the three months to the end of April, a similar level to March (3.3%). For now wage growth continues to outpace inflation, which is currently close to the target rate of 2.0%, but that margin has started to close.

On the global stage, the IMF report that after peaking at close to 4% in 2017, global growth remained strong at 3.8% in the first half of 2018 but dropped to 3.2% in the second half of the year. It anticipates growth of 3.3% in 2019 with advanced economies growing by 1.8%. These reduced forecasts are put down to tariff hikes and trade tensions between the United States and China, along with a tightening of financial conditions, and higher levels of policy uncertainty across many economies expected to impact growth in 2019.

BLOOMSBURY WC1 - 2 BEDROOM APARTMENT, LET APRIL 2019 £950 PW

Sales Market

PRICES STABILISE

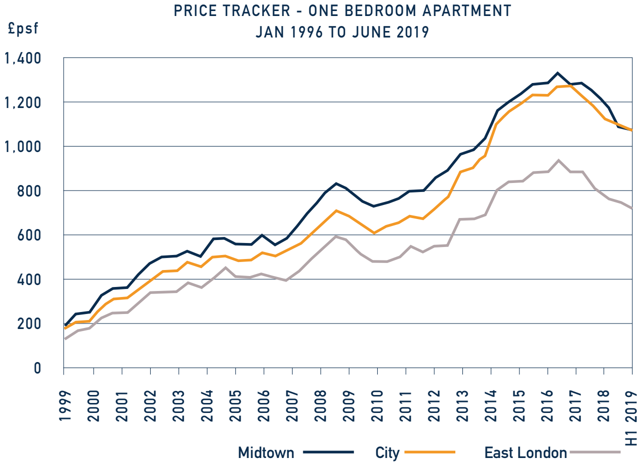
Prices in our markets have stabilised, after five years of downward pressure. There may be further small falls, but broadly, the market has found its level and we expect a period of consolidation with relatively little fluctuation for the rest of 2019. This feels like the bottom of the curve.

The price of a one bedroom apartment fell one percentage point in the first half of 2019, the tail-end of a downturn that began in 2015 and was accelerated in 2016. Prices of two bedroom flats peaked in 2015, at a level that simply proved unsustainable and this segment of the market was first to experience price pressure. Initially, buyers turned their attention to the more affordable one bedroom and they carried on gaining value for another year.

But 2016 introduced new stresses and triggered a prolonged downturn. The causes are well known, the 3% Stamp Duty levy on additional homes in April of that year curtailed demand from investors and was swiftly followed by the EU Referendum in June. Since its 2015 peak, the average price of a two bedroom apartment has fallen by 15%, and a one bedroom, which peaked in 2016, has fallen since then, by 14%. While these are not dramatic falls, they have taken the market back to 2013 prices. This is a difficult fact for many owners to accept who have purchased within the past six years and impacts the motivation to sell

The political wrangling over Brexit negotiations, which culminated in a delay to the leaving date at the end of March this year, has taken its toll on buyers, sellers and renters – leaving many unable, or unwilling, to make big decisions while the nation is mired in uncertainty.

FIGURE 1
PRICE TRACKER - ONE BEDROOM APARTMENT
JAN 1996 TO JUNE 2019



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

In 2019, transaction volumes in Prime London dropped to an historic low and prices were nudged down a little further. Although Brexit is widely blamed for the current weak market, it should not be forgotten that it was changes to Stamp Duty that fundamentally altered the economics of high value housing markets.

The number of sales in Greater London peaked in September 2014, with 125,473 homes changing hands in the previous 12 months. By mid 2019, the equivalent annual total had fallen to 86,916, a drop of more than 30%. In our markets, the peak came a little earlier in June 2014 and the fall from peak has been even greater at over 34%.

While the impact on transaction volumes has been profound and prolonged, it is also reversible, should the government wish to stimulate activity.

TABLE 1
TRANSACTION VOLUMES: FROM PEAK TO TROUGH

	Midtown, City and East London
Date of peak annual transaction volume	June 2014
Number of peak annual transactions	7,055
10 year average annual transaction volume	5,289
Current annual transaction volume (mid 2019)	4,625
Current versus peak (%)	-34.4%

Source: dataloft, Land Registry
Midtown, City & East London : WC1, WC2, EC1, EC2, EC3, EC4, E1, E2, E14, N1

Low sales volumes and low stock levels have become the new norm. It takes motivated buyers and sellers to create momentum. Forced sellers are rare in our markets where buyers are well funded and, in any event, interest rates remain low. A stake in Central London remains a scarce resource and not relinquished lightly unless the price is attractive.

Those who envisaged an opportunity to buy cheap while confidence was dented after the Brexit extension, were disappointed to find that owners were not ready to accept low offers.

Homeowner's finances are far more manageable than they were before the 2008 banking crisis as borrowers have used low interest rates to pay down their debts and this points to the current stalemate in the sales market.

Home repossessions in the UK totalling 4,580 in 2018 were at their lowest level since 1980 as low interest rates and a strong employment in London ensured that mortgage payments remained affordable.

By the summer of 2019, the expectations of buyers and sellers were coming into line and a property listed at the correct price, by a vendor open to advice, was more likely to sell than at any time in the last 4 years.

SHOREDITCH N1 - 2 BEDROOM DUPLEX APARTMENT, SOLD APRIL 2019 £795,000

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
2019 H1	-1.0%	480,000	-5,000

Source: Hurford Salvi Carr

Our monitor of one bedroom apartments, averaged over all our markets, (table 2) shows just how little movement in prices there has been in 2019. In the first six months of the year, values dipped by £5,000 or 1%, in contrast to 2018, when £45,000 was razed from the average price of a one bedroom, equating to 8.5% of value.

The cost of buying a property in our markets is more affordable in mid 2019 than it has been for five years. The perception that London prices are on a relentless upwards curve has finally been disproven.

London housing markets are underwritten by the performance of its economy and, in particular, the scale and strength of employment and pay conditions in the city. One of its greatest successes has been attracting multi-nationals to locate their European headquarters in London.

A recent Deloitte study found that 201 Fortune Global 500 companies have a headquarters in Europe, and 55% of them chose to locate in London (87) and the Wider South East (24). No other city comes close. Geneva has 7, Amsterdam, Dusseldorf and Brussels, 5 each.

TABLE 3
PRICES & PRICE CHANGES FOR 1,2 & 3 BEDROOM APARTMENTS IN THE RESALE MARKET AT END OF H1 2019

		2018 £	H1 2019 £	£ per sq ft	Change % 2019	Change % from 2015
Midtown	1 Bed	550,000	550,000	1,100	0%	-15%
	2 Bed	850,000	850,000	1,133	0%	-15%
	3 Bed	1,750,000	1,650,000	1,100	-6%	-37%
City	1 Bed	585,000	575,000	1,150	-2%	-9%
	2 Bed	800,000	775,000	1,033	-3%	-8%
	3 Bed	1,500,000	1,425,000	950	-5%	-25%
East London	1 Bed	400,000	390,000	780	-3%	-13%
	2 Bed	540,000	525,000	700	-3%	-16%
	3 Bed	925,000	925,000	617	0%	-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*

BLOOMSBURY WC1 - SPACIOUS 1 BEDROOM APARTMENT, SOLD MAY 2019 £745,000

CITY EC4 - 2 BEDROOM APARTMENT WITH PARKING, SOLD FEBRUARY 2019 £1,050,000

Larger properties have experienced much bigger price corrections than the rest of the market. Apartments and houses with three or more bedrooms, are now 37% below their peak in Midtown and 25% below in other parts of our market and are still losing value this year. Only in East London, where average prices are lower, did larger properties stabilise this year. In this part of London, a 3 bedroom property is likely to be under £1 million, making the burden of Stamp Duty less onerous.

Our discreet marketing service, whereby properties are withheld from the portals, remains popular and effective. Buyers appreciate the individual approach and vendors maintain a degree of privacy. There needs to be compromise on both sides to successfully broker a deal but owners are just as likely to withdraw from a sale as buyers, if buyers procrastinate.

The Stamp Duty Effect

Across our markets, Stamp Duty Land Tax and in particular the additional 3% surcharge for second home owners and Buy to Let investors continues to deter buyers. Anyone coming to London for a 3-5 year work assignment will probably believe it is more cost effective to rent in the capital, especially when the cost of service charges that include on site residents facilities are borne by the landlord.

While Stamp Duty rates came down for properties under £937,500 in December 2014 this was a short lived reprieve with the introduction of the 3% surcharge that effects so many buyers in London.

TABLE 4
STAMP DUTY PAYABLE AT VARIOUS PURCHASE PRICES
2019

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

Taking the example of a 2 bedroom apartment in Midtown, with a purchase price of £850,000, the Stamp Duty payable would be equivalent to one year's rent on a first home but if it is a second home, the Stamp Duty is equivalent to 18 months rent.

For higher priced homes, the Stamp Duty escalates. If we take the example of a 3 bedroom apartment in the City, with a purchase price of around £1.5 million, the Stamp Duty is equivalent to 2 years rent and if it is a second home, the ratio approaches 3 years of rent.

TABLE 5
COMPARING COSTS OF STAMP DUTY AND ANNUAL RENT

	Price	SDLT	SDLT with 3%	Annual Rent
Midtown 2 Bed	£850,000	£32,500	£50,000	£34,320
City 3 Bed	£1,425,000	£93,750	£138,750	£49,000

Source: Hurford Salvi Carr

The motivation to buy has also waned as the prospect of long term capital growth is uncertain.

Historically, even a short-term resident would have considered buying into the London market, in anticipation of long-term capital growth. An owner who bought when our records began in 1994, would have seen their capital grow by around 500%.

Someone who seized the opportunity to buy in 2008, in the immediate aftermath of the Global Financial Crisis, would have seen their asset value increase by between 40% and 67% in the decade since then. If it was also a rental investment, it would have attracted around £200,000 of gross income as well as capital value growth.

However, for anyone coming into the market more recently, that level of growth is unattainable - often the cause of long debates between parents and their young adult off-spring.

TABLE 6
LONG RUN PRICE CHANGES
FOR A 1 BEDROOM APARTMENT IN THE RESALE MARKET

Submarket	2007 - 2019 H1	2008 - 2019 H1	2014 - 2019 H1
Midtown	29%	42%	-10%
City	52%	67%	-7%
East London	21%	40%	-15%

Source: Hurford Salvi Carr

WHITECHAPEL E1 - FREEHOLD HOUSE, SOLD MARCH 2019 £1,200,000, SDLT £99,750

Talking about his plans for a first budget should he become Prime Minister, Boris Johnson describes Stamp Duty as a "problem" and said tax cuts could get the "locked up" market moving. "I think particularly in London there is clearly a problem with Stamp Duty and it needs to be addressed" Mr Johnson told The Telegraph.

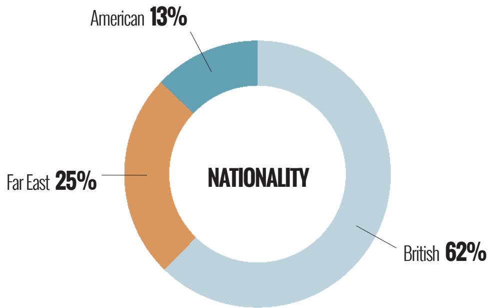
BUYER PROFILES MID 2019

Nationality

Almost two thirds of buyers in our markets were British citizens in the first half of 2019. We did not sell any properties to EU nationals and, in a low transaction market, the proportion of buyers from the Far East rose to a quarter. This does not reflect an increase in the numbers, rather an increase in the dependence of the market on Far Eastern buyers, particularly buyers from China.

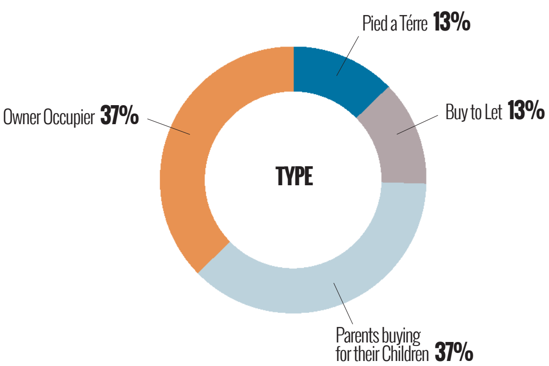
However, we note that it is increasingly difficult for buyers from China and Hong Kong to transfer money out of their country as their government is restricting rules on overseas investment in property.

The total loss of EU buyers is unsurprising given the level of uncertainty around Brexit. On average, in the period 2015-2018, EU nationals made up 16% of our market.



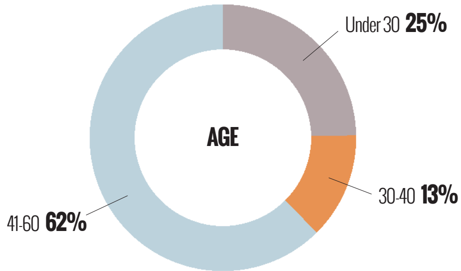
Household Type

The proportion of purchases where parents and adult children join forces rose to 37% in H1 2019 – a dramatic increase on previous years. In the period 2015-2018, this buyer type represented an average of 8% of all sales. Buy to let purchases held up at 13% but that is significantly down on the average which was 21% in 2015-2018.



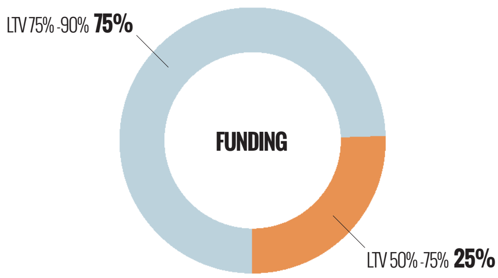
Age

There has been a shift towards older buyers in our markets this year with 62% aged over 40. On average, over the period 2015-2018, the proportion of buyers over 40 was 44% with a much higher proportion in their 30s.



Funding

The typical buyer in our market this year has funded their purchase with debt rather than equity. We recorded no cash buyers in the first half of 2019 and all buyers used debt for at least half the purchase price, reflecting historically low interest rates on offer from banks and the shift from investors to owner occupiers.



New Homes

FEWER HOMES IN THE PIPELINE

Construction of homes in London has fallen to its lowest level in a decade.

It is no secret that developer appetite has waned, particularly in prime central London where house prices have been under downward pressure over the last few years. Testimony to that waning appetite, the value of development land has continued to fall. The latest March 2019 data from Knight Frank, showed a further -8% decline in Prime Central London land values over the last year and -20% since the market peak in 2015.

Similarly, housing starts across London peaked in 2015 (at 24,300 new homes a year) and has since fallen -30% to current levels (17,000 new homes a year) according to official DCLG statistics to the end of 2018. This pullback in new housing starts yet again highlights the impact of Stamp Duty on demand, with development levels directly linked to sales volumes and pricing. Stamp Duty has taken its toll across the London market.

Government figures show that construction of only 2,940 homes were started in London in the first three months of the year, down 50% on the same quarter of 2018.

The GLA stands by its projections of housing need at 66,000 new homes per annum even as private sector developers are pulling back from the capital. Clearly current development levels are only a fraction of that stated target.

Help to Buy data continues to show a strong uptake of the scheme across London. Data for the Q4 to end December 2018 recorded 1,667 loans, the largest volume to date and equivalent to 50% of London's new build sales in that quarter.

With affordability stretched and the difficulties of saving for a deposit, it is clear to see why Help to Buy has been a success. Although anecdotal evidence from some developers suggests that many help to buy loans haven't been critical in helping first time buyers onto the housing ladder but instead have helped new buyers afford better quality homes.

The shortage of new homes in the pipeline is helping to support pricing and as the current cycle of homes nearing completion with impressive specifications, facilities and finishes buyers are recognising the opportunity that buying into these new lifestyle developments afford. City locations that once were described as fringe including Kings Cross, Old Street, Aldgate, Southwark and Hackney Wick are now highly regarded, well served and well connected residential districts.

INVESTIGATION INTO THE SALE OF LEASEHOLD PROPERTIES

The Competition and Markets Authority (CMA) has formally launched an investigation into the sale of leasehold properties. It will examine two key issues:

- Potential mis-selling: whether buyers were given enough information to fully understand the ground rent costs and obligations they were taking on.
- Potential unfair terms: whether fees were excessive for such things as administration, service charges and permission for alterations etc.

Concerns came to the fore when it emerged that some leaseholders were tied into ground rents that doubled every ten years and were liable for charges to get consent for home improvements.

The CMA will consult with businesses across the sector including housebuilders, lenders and freeholders as well as with homeowners.

THE MAKERS, NILE STREET N1 - COMPLETION FROM SUMMER 2019

Lettings Market

ANTI-LANDLORD AGENDA RELENTLESS

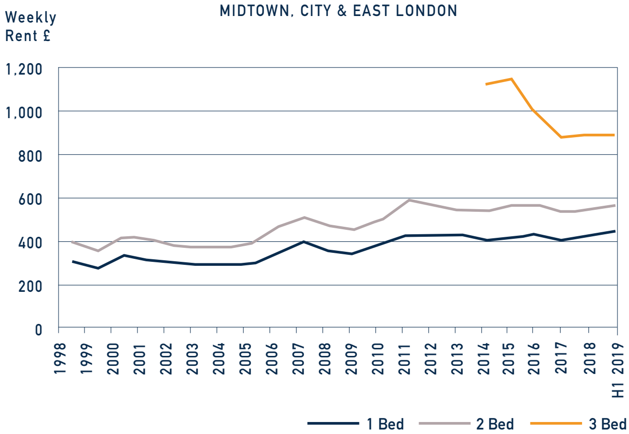
The rental value of a two bedroom apartment rose by 4% in the first half of 2019, after a prolonged period of virtually no change stretching back to 2011. One bedroom apartments also rose in value, albeit by a more modest 2%. Only larger properties remained at the same level.

We expect this gentle upward pressure to persist through the remainder of the year because the supply of property to rent is not being topped up by new stock. Investment buyers are not currently active in our markets. Neither is there evidence of existing landlords selling up. In this market they are typically low geared and in a position to re-finance when necessary. Few are choosing to sell at a time when rents are rising and capital values have fallen.

OLD STREET EC1 - 3 BEDROOM APARTMENT, LET JUNE 2019 £1,000 PW

At the start of 2019, demand for rental was surprisingly robust which helped to nudge rents upwards. Businesses continued to bring staff into the UK despite Brexit, although their future remains highly uncertain until the withdrawal agreement has been signed.

FIGURE 2
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*

In fact, the extended uncertainty has reinforced the preference for renting rather than buying and we noted that more tenants sought to renew leases beyond their initial term.

Much as in the sales market, the value of larger properties has been under more pressure. Rents for these properties remained static while the rest of the market has risen. It is a simple matter of supply and demand – large apartments are less in demand and supply is plentiful. The rent per sq ft for a three bedroom apartment in East London is half the rate of a smaller unit. In City and Midtown the discount is closer to a third and, at current growth rates, the gap will narrow in all markets.

TABLE 7
WEEKLY RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON AT END H1 2019

Submarket		2016 £	2017 £	2018 £	H1 2019 £	% Change 2018 - 2019 H1
Midtown	1 Bed	475	450	475	485	2
	2 Bed	660	600	640	660	3
	3 Bed	1,300	1,100	1,100	1,100	0
City	1 Bed	430	450	450	465	3
	2 Bed	560	560	560	580	4
	3 Bed	950	925	950	950	0
East London	1 Bed	360	320	340	350	3
	2 Bed	450	425	425	440	4
	3 Bed	675	575	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*

In March, the Mayor of London, Sadiq Khan, pledged to cap rents as part of his 2020 re-election campaign. Our records of long term rental value show a surprisingly stable rental growth profile. Almost 40% of London's population lives in the private rented sector and tenant friendly policies are seen as vote-winners.

TABLE 8
ANNUAL RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON H1 2019

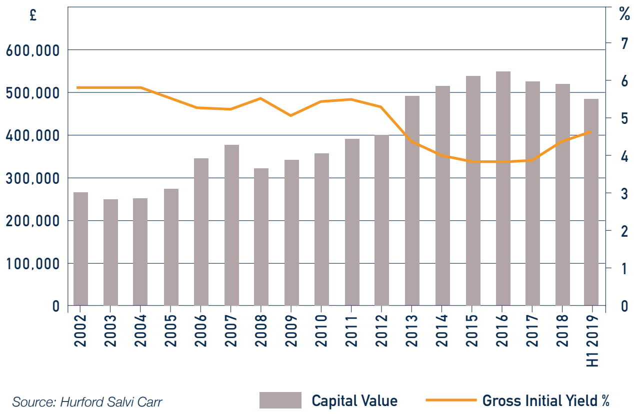
Submarket		Weekly Rent £	Sq ft	Rent p.a.	Rent psf
Midtown	1 Bed	£485	500	£25,220	£50.44
	2 Bed	£660	750	£34,320	£45.76
	3 Bed	£1,100	1,500	£57,200	£38.13
City	1 Bed	£465	500	£24,180	£48.36
	2 Bed	£580	750	£30,160	£40.21
	3 Bed	£950	1,500	£49,400	£32.93
East London	1 Bed	£350	500	£18,200	£36.40
	2 Bed	£440	750	£22,880	£30.51
	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*

In our markets, rents are around one third higher than they were in the year 2000 – an average annual growth rate of just under 2%. Inflation over that period has been just under 48%, or an average of 2.1% per annum. The current annual inflation rate is 2.0% (May 2019). As an investment return, the combination of capital value and rental growth makes property look attractive but as policy-makers add to the burden of costs, it is no wonder that landlords have begun to question their commitment.

As a result, we expect rents to rise further in 2019, as the supply of rental property continues to fall while demand shows no sign of abating.

FIGURE 3
CAPITAL VALUES AND YIELDS FOR ONE BEDROOM APARTMENTS
MIDTOWN, CITY & EAST LONDON



Source: Hurford Salvi Carr

DOCKLANDS E14 - 2 BEDROOM APARTMENT, LET MAY 2019 £450 PW

Policy Intervention

On June 1st, the Tenants Fee Ban became law – one of the numerous pieces of legislation the government has managed to enact in the past three years. This is just one part of the 'Anti-landlord Agenda' which has eaten away at investor confidence and, with some irony, put upward pressure on rents. The list is long and includes : Right to Rent checks; Anti-money laundering checks; electrical tests; additional HMO licencing; selective licencing; a new housing complaints resolution service and code of practice.

In March the Labour party announced a policy on new 'indefinite tenancies' for private tenants based on the German model, where the average length of tenancy is reported to be 11 years. While Labour is not in a position to push this policy through at present, it has said it will consult with landlord and tenant groups on defining the grounds for termination of a tenancy ahead of the next general election. This supports Labour's broader policy on rent controls.

The current conservative government, faced with the prospect of fighting local elections in May without an agreed Brexit deal, came out with a proposal to abolish Section 21 notices. A Section 21 notice enables a landlord to evict a tenant on certain agreed grounds.

The abolition of Section 21 would, in effect, create indefinite tenancies, mirroring Labour policy and demonstrating the view of politicians that an 'anti-landlord agenda' is a vote winner. We are in no doubt that this hasty announcement was intended as a 'good news story' aimed at younger voters at a time of enormous political uncertainty and with little consideration for the impact on the private rental sector. On 27th June the Prime Minister Theresa May said that the Government would look to introduce legislation later this year and we could now see a ban on Section 21 evictions in place by the spring of 2020.

In another controversial announcement the Housing Secretary James Brokenshire suggested the Government would look to make it easier for tenants to 'passport' a deposit directly between landlords when moving from one property to the next.

London's economy relies on a highly qualified and footloose workforce who choose to live in the private rental sector and are willing to pay a fair rent for a good service. The private rental sector has matured and expanded over the past two or three decades, as demand has increased. The standard of rental property available in London has improved enormously. This market is critical to the future economic success of London.

While there may be a need to regulate in the parts of the market that were formerly provided for by social housing, the unintended consequences for what has become the mainstream market, are of concern.

CLERKENWELL EC1 - 3 BEDROOM APARTMENT, LET FEBRUARY 2019 £850 PW

Short Term Rental Market

Another trend eating into the supply of good quality homes for rent is short term rentals. This segment of the rental market is growing and, because it has emerged so fast, it is largely unregulated. It is reported that 80,000 rooms or home are listed on Airbnb in London and that 24% of listings are from owners with 5 or more properties.

FLEET STREET EC4 - SHORT LET APARTMENTS, MAY 2019

In 2015, the GLA introduced a ceiling of 90 days a year on short term rentals. After that, there needs to be a planning permission for change of use. However, a report from the BBC suggested that only six planning consents had been granted across the 33 London boroughs since the new rules were put in place. In other words, much of the provision in this market is 'under the radar'. Short term rentals offer the possibility of extended stays without the committment of a fixed term contract and boosts the London economy through flexible business stays and tourism.

The Mayor of London together with the London boroughs of Camden, Islington, Hackney, Tower Hamlets, Westminster, Kensington and Chelsea, has called on the government to introduce a new registration system for anyone wanting to rent out a property for less than 90 days a year, in an attempt to establish who is operating in this sector. In June a Government report by Opinion Research Services on selective licensing included a call to introduce a national landlords register. While we support the need for greater understanding, our concern is that a landlord register will create yet another opportunity for cash-strapped local authorities to generate revenue from the introduction of new fees and additional regulation for the rental sector.

Income Returns Improve

The investment yield on a one bedroom apartment has been edging upwards since 2015, primarily driven by falls in capital values. This year, with the additional impetus of rising rents, yields have reached 4.7%, just under a full percentage point higher than in 2015 – and an improvement of more than 20%.

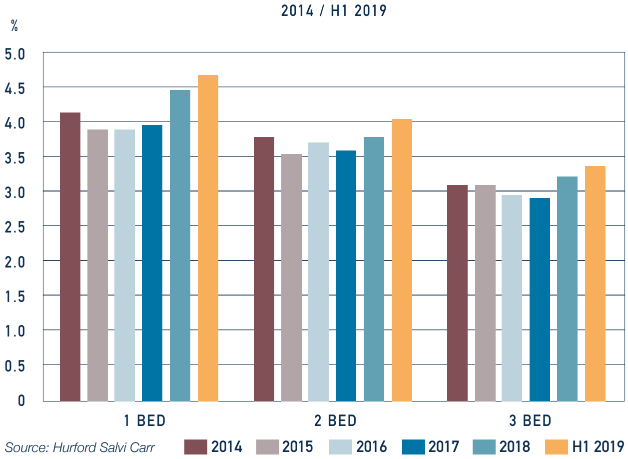
TABLE 9
LONG TERM RENTAL GROWTH

	2000 - 2019 H1	2007 - 2019 H1	2008 - 2019 H1	2014 - 2019 H1
1 Bed	34%	13%	24%	7%
2 Bed	37%	11%	22%	4%
3 Bed	N/A	N/A	N/A	-22%
Inflation (CPI)				

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 yield on a two bedroom apartment is now 4.1%, improving by almost 8% in the first six months of the year and breaching the 4% threshold for the first time since 2013. With the bank base rate still languishing at 0.75%, the differential between returns from cash and gross returns from residential property has widened, and helps to off-set the impact of the tenant fee ban and withdrawal of tax relief on net yields.

FIGURE 4
CHANGE IN YIELDS FOR CITY, MIDTOWN & EAST LONDON
2014 / H1 2019



Source: Hurford Salvi Carr

TABLE 10
GROSS INVESTMENT RETURNS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2012 TO 2019 H1

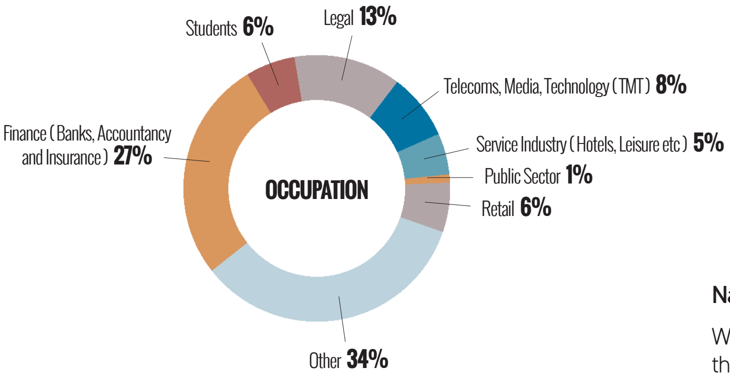
	2012	2013	2014	2015	2016	2017	2018	2019 H1
Gross Annual Income £	21,840	21,840	21,060	21,580	21,840	21,060	21,840	22,620
Capital Value £	405,000	486,000	520,000	550,000	555,000	530,000	485,000	480,000
Gross Initial Yield %	5.4	4.5	4.1	3.9	3.9	3.97	4.50	4.71

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

TENANT PROFILES MID 2019

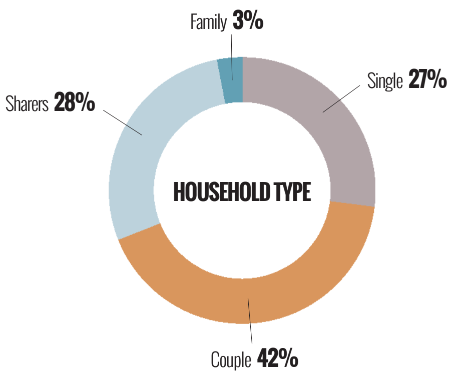
Occupation

Banking and finance are key employment sectors in our markets, given proximity to Canary Wharf and the City and so far this year over 40% of tenants we dealt with worked in these sectors. There is always a good spread of sectors in our markets with legal and technology jobs accounting for 20% and 8% respectively. Student renters will make up a bigger proportion by the year end but they generally move in September/October, so tend to appear in H2 figures.



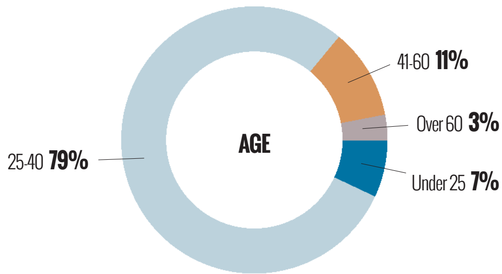
Household Type

Couples are the most popular household set-up in our markets, with 42% of the total. Singles and sharers accounted for the balance in almost equal proportions. Again, the household type figures tend to look different over the whole year when student lets are incorporated and we would expect to see a greater proportion of sharers. In the period 2015-2018, 33% of renter households were sharers. Families are relatively rare and that also reflects the nature of the housing stock with apartments far more common than houses.



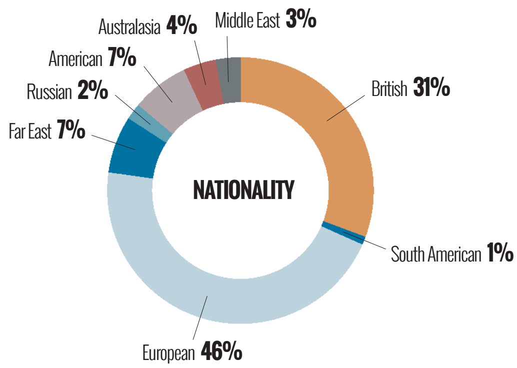
Age

The dominant age group renting in our markets is 25-40 years old. They account for four fifths of the total in H1 2019. Younger renters are more common in the autumn and for the whole year, the distribution will be less skewed towards one age band.



Nationality

We noted that EU nationals had slipped out of the sales market but they remain a dominant component of the rental market and so far this year, they have accounted for 46% of all renters. Given the shadow of Brexit and lack of capital value growth, renting is a more appealing choice. 31% were from UK and less than a quarter from other parts of the world beyond Europe. This balance is likely to shift in the full year figures when letting to overseas students is taken into account.



Future Prospects

HOUSING POLICIES TO DOMINATE

It is hard to look to the future of the London housing market, without dwelling on the recent past. After a dramatic collapse in housing transactions in the past 5 years prices stabilised in the first half of 2019 and we expect them to hold at current levels. Buyers and sellers understand and are prepared to trade.

We have entered the next phase of the property cycle and we do not see this as the beginning of the next boom, rather the end of the last decline. We need a sustained improvement in transaction numbers before we can confidently predict an upturn.

Unless there is a distinct change in attitudes towards property owners, the outlook for our markets will continue to be blighted by policies from politicians of all persuasions, to discourage investors, favour first time buyers and to raise revenue through taxation. These policies have serious unintended consequences.

Each new tax grab damages the housing market. Price falls of between 15% and 30% are the legacy of a series of property tax changes beginning with George Osborne's reform of Stamp Duty that hit properties above £937,500 in December 2014.

Figures from HM Revenue and Customs confirmed that Stamp Duty receipts fell by £968 million in 2017/2018 to £11.9 billion - proving that the unintended consequences extend to the national exchequer.

The burden on investors arising from Stamp Duty and loss of income tax reliefs for landlords is already playing out in rising rents. We expect rental growth to continue in the months ahead.

The tenant fee ban, which came into effect in June, adds to landlords' costs and will exert further upward pressure on rents. Unfortunately we expect our next Prime Minister and his Government to continue to devise new ways of currying favour with those living in the private rental sector at the expense of homeowners and investors.

We would not rule out a further increase in taxes for overseas buyers which would make London less attractive to international capital and open up an opportunity for other European cities to poach international investors.

The major commentators are now aligned with our published views that central London values peaked in the summer of 2014 and have fallen back to those levels. We stand by our prediction that we are in the midst of what is destined to become a decade of zero growth in London house prices.

There is a growing number of prospective buyers biding their time, waiting for clarity on the future direction of the post-Brexit market, following three years of unprecedented uncertainty. Whether a post-Brexit government provides that confidence, remains to be seen.

Few homeowners in our markets are forced sellers and they do not sell in a slow market. Many have used low interest rates to pay down any debts. For these reasons, we expect the current stalemate to persist until there is greater clarity.

In the second half of 2019 we expect prices to remain largely unchanged (whatever the outcome of Brexit). If the UK leaves the EU on October 31st, with a withdrawal deal in place, we would anticipate a strong start to 2020, with restored confidence and sense of relief. Any other result will do little to end the current economic uncertainty.

Rents, on the other hand are expected to continue on the moderate growth trajectory experienced in the first half of the year. Landlords will look to recover the additional costs incurred as a result of the tenant fee ban.

While any resolution of Brexit is almost certain to trigger some renewed market activity, Stamp Duty costs will continue to be a disincentive to buyers in central London and it remains the dead hand weighing on our markets.

Housing policy will continue playing a major role in the performance of residential property. Proposals proliferate from politicians in and out of power seeking to control price growth; encourage home ownership; tip the balance in favour of first time buyers; increase the rate of construction and so on.

As the size of private rented sector has doubled over the past 10 years the Government have announced that they looking to introduce Licensing for residential property professionals which will include a the appointment of a new regulator to oversee the residential sales and letting sectors, in a move that is being driven by providing additional protection for consumers. This new legislation is likely to be introduced in 2021 and we understand will have no regard as to what is best for owners or providers of accommodation.

While such proposals may not yet, or ever, be implemented, the mere fact that they are publically discussed means that they have some influence on confidence and behaviour and, as we move towards the next election, we expect the flow of new ideas on housing to carry on.

Labour commissioned George Monbiot to report on land use and land value and the report, 'Land for the Many' recommended a land value tax – a subject that is aired periodically but, so far, has not been taken up by a party in power. The report also suggested a progressive property tax to replace the council tax, payable by owners, not occupiers. It would attract a significantly higher rate for second or empty homes.

Other ideas mooted in the report include extending capital gains tax to main residences; withdrawing single person discounts on council tax, to avoid over-consumption of housing; compulsory sale orders for land left vacant or derelict and 'jury service' for planning whereby members of the public, chosen at random, would adjudicate on planning decisions.

Policies implemented in other countries can also influence UK politicians and the mood in the housing market. Local politicians in Berlin have backed a five year rent freeze in the city which is expected to become law in January 2020.

We enter the second half of 2019 with genuine optimism that the recent upturn in sales enquiries, offers and sales agreed will continue. At the same time the property industry continues to come to terms with latest onslaught of new legislation in the private rental market that as widely predicted by the industry has resulted in upward pressures on rent levels for tenants.

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