research

from Hurford Salvi Carr

MIDTOWN, CITY AND EAST LONDON

RESIDENTIAL 2022

“

Central London

sales values pegged

at 2013 levels.

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HURFORD SALVI CARR

Market Overview

RENTS INCREASE BY 12%

2022 turned out to be an extraordinary year for the UK. The nation celebrated 70 years on the throne with Queen Elizabeth II in June and mourned her death in October, just days after she had greeted her 15th Prime Minister, Liz Truss and only weeks before the new King, Charles III, prepared to meet the second Prime Minister of his reign, Rishi Sunak. At the end of the year Jeremy Hunt had the heavy responsibility of being our fourth Chancellor of the year.

Meanwhile the politics of eastern Europe had repercussions across the globe as Russia's actions in Ukraine caused spiralling energy costs, grain shortages and a new wave of refugee movement across Europe. Inflation reached a 30 year high in the UK and by December, the Bank of England had raised interest rates nine times in a year, taking them to 3.5% and ending a 14 year era of cheap borrowing for home buyers as the UK went into recession.

The appointment of Rishi Sunak, with his more orthodox approach to Treasury management, proved to be the calming influence required by the financial markets, quelling the chaos unleashed by the short-tenure Downing Street team and their mini fiscal event in October.

BLOOMSBURY WC1 - 2 BEDROOM FREEHOLD HOUSE, SOLD NOVEMBER 2022, £1,595,000

In stark contrast, house prices in our markets ended the year with no net change. The fallout from turmoil in the financial and currency markets offset any gains logged in the summer months.

Rents, on the other hand, rose steeply in the face of an acute shortage of stock, gaining 12% in 12 months and ending the year 20% higher than their 2019 pre-pandemic levels. The scale of rental growth, against the backdrop of a cost of living crisis, has attracted plenty of media attention and reinforced the call for even more regulation in the private rental sector. The terrible unintended outcome is that investors are now exiting the market, just when they are needed most and we see little appetite from new investors to become landlords.

SHOREDITCH N1 – 1 BEDROOM LOFT, LET AUGUST 2022, £2,600 PER MONTH

An absence of buy to let or overseas investors and pied a terre buyers left room for renters to become first time buyers in the first 9 months of 2022, until the impact of higher interest rates dampened demand in the final 3 months of the year. For many would be buyers the level of service charges at many apartment blocks proved a major concern at a time where utility costs and cost of living increases had already impacted on their lives.

Although mortgage rates are, and will undoubtedly remain, far below the rates remembered by those who bought property in the 1980s and 90s, they have tripled this year and it is the relative cost of monthly repayments that will impact heavily on the financial calculations of today's buyers. The high proportion of mortgage debt on fixed rates prevents a cliff edge but ensures that there will be a steady flow of re-mortgaging on higher rates over the next 2 to 3 years. New borrowers need to hastily recalibrate their affordability calculations.

The cost of borrowing has less impact in our markets than most because of the high proportion of cash or equity rich buyers. For that reason, the spectre of forced sellers, redemptions and negative equity is not a significant issue in our markets - with the possible exception of East London where there have been more first time buyers and uptake of Help to Buy equity loans.

With buyers facing higher borrowing costs and owners unwilling to sell at prices that remain pegged at 2013 levels, we expect lower transaction volumes in 2023 with a gentle pick-up as inflation subsides later in the year. The London housing market has faced numerous setbacks in recent years and proved remarkably resilient. We expect prices in our markets to remain stable in the year ahead because of those low volumes. We appreciate that this contradicts the narrative in parts of the UK which experienced a strong post-pandemic boom, where a price correction seems more likely.

Economic Overview

INTEREST RATES RISE TO 3.5%

Higher interest rates are here to stay
Interest rate markets behaved like choppy seas during 2022 although they seemed poised to meet calmer waters by the year end – albeit at a sustained higher level. Bond yields and swap rates – both key indicators of long term interest rates – receded virtually back to their pre-mini-budget levels. Short term interest rates however, moved to reflect the reality of the prevailing inflationary environment.

The Bank of England raised the bank rate in December by 0.75%, the largest single increase in the Bank Rate since 1989, which took it to 3.5%, the highest it had been for 14 years and the ninth rise in a year.

Whilst interest rates are expected to continue to rise early in 2023, the Bank of England has strongly signalled that rates may not have to rise as high as the markets were expecting in the midst of the Growth Plan turmoil. Consensus economic forecasts indeed suggest that the average rate for next year will be 4.1% and year end rate also 4.1%.

For UK residential markets, the interest rate is a key factor in driving demand because of its impact on affordability for mortgage debt but also for the relative merits of leaving capital on account.

Whilst many borrowers will be protected for a time with fixed rates (84% of all existing outstanding mortgage lending was on a fixed rate by the end of Q1 2022) there is of course a rolling schedule of borrowers due to re-mortgage who will face markedly higher rates as they do so.

TABLE 1
INTEREST RATES ON MORTGAGE DEBT
Q3 2021 V Q3 2022

MORTGAGE RATES	YEAR AGO (OCTOBER 2021)	CURRENT (OCTOBER 2022)
5 year fixed (95% LTV)	3.2%	6.1%
5 year fixed (75% LTV)	1.3%	5.6%
Revert to rate	3.6%	5.4%
Average lending rate	1.6%	3.1%

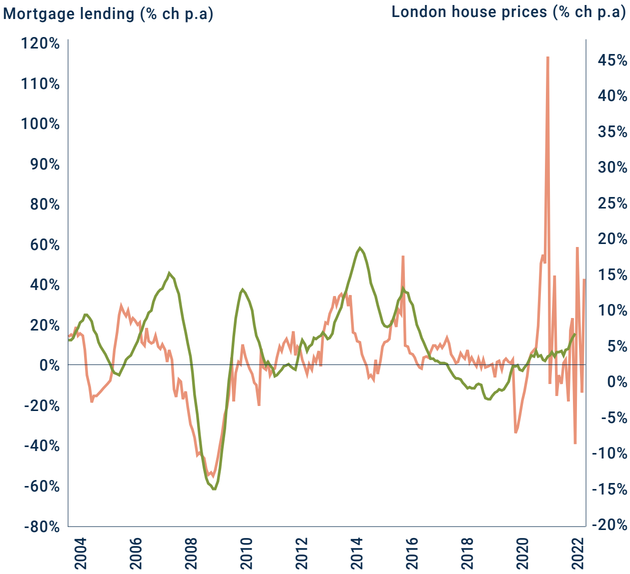
Source: Hurford Salvi Carr

Even more affected will be first time buyers who typically have a smaller deposit and no existing housing equity as a cushion. As first-time buyer activity slows, this does flow through to other parts of the London housing market with a lag. Prime central London markets will be more immune given the higher proportion of cash buyers and much lower reliance on mortgage debt.

October data showed mortgage approval volumes drop to their lowest level since the Covid induced low of January 2020. Despite falling volumes, the value of mortgage lending continued to rise in October, up 2% on the month before.

Falling mortgage volumes is a direct impact of the Growth Plan and the consequent soaring of interest rates. It could have caused a much steeper decline in transaction numbers but for the likely high proportion of mortgages already being processed ahead of the interest rate shock. Mortgage approval rates are expected to continue to trend lower in the first half of 2023 reflecting weakening mortgage demand.

FIGURE 1
LONDON HOUSE PRICES
LINKED TO OVERALL MORTGAGE LENDING



Source: Dataloft, Bank of England

Inflation expected to peak in Q4 2022
The view from the Office of Budgetary Responsibility in the Autumn was that inflation should peak at 11.4% in the final quarter of 2022. It reached 11.1% in October and dipped to 10.7% in November, suggesting that the economy is very close to an inflation peak.

SHOREDITCH EC2 – 1 BEDROOM LOFT, SOLD JULY 2022, £1,100,000

Forecasts for 2023 suggest that the rate of inflation could average 7.4% over the year but settle back to 4.1% by the year end. Most commentators expect inflation to subside quickly in 2023 as long as pressures ease in the UK labour markets.

Consumer led slowdown

At the heart of the current economic slowdown is the pressure on consumers from a range of angles – rising costs across the board and the ensuing impact on disposable household income. Figures released by the OBR for the November budget remind us that this is the largest hit to household disposable income in more than 6 decades.

Parts of London had a strong October half-term in footfall retail numbers, with the recent opening of the Elizabeth Line providing a bright spot boosting footfall numbers in and around Oxford Street. Parts of London remained much quieter than pre-Covid highlighting the direct impact of hybrid working on London retail locations.

Consensus forecasts do point to inflation peaking soon. European inflation appears to have recently peaked and whilst one month of data is by no means necessarily conclusive and Europe in part has different inflationary pressures, starting to see inflation subside for our European neighbours and the expectation the UK will do likewise soon, would help shore up optimism for the economic outlook.

The forecast for the housing market is for a slowdown. Parts of the London market - particularly prime central London - which have not seen recent price rises, are likely to be more resilient. These markets have, for some time, been primed to improve once the right set of economic conditions fires up that spark.

TABLE 2
CONSENSUS FORECASTS

	2022	2023	2024	2025	2026
GDP	4.2%	0.7%	1.4%	2.0%	1.8%
UK house prices	10.7%	-2.1%	-3.2%	1.1%	2.2%

Source: Hurford Salvi Carr

Following the disastrous mini budget on 23rd September the pound rebounded from a 37 year low against the dollar of 1.08 to 1.21 by mid December. At the same time the FTSE recovered from a low of 6,826 in October to end the year at close to its January 2022 high of 7,672. The measures that the new Chancellor and Prime Minster have implemented to calm the markets appear to be working despite large scale industrial action in December.

CLERKENWELL EC1 – 2 BEDROOM FLAT, LET OCTOBER 2022, £4,300 PER MONTH

The fall in the number looking for work has helped to push the unemployment rate to its lowest for nearly 50 years. The jobless rate fell to 3.5% in the three months to August, according to the Office for National Statistics (ONS). The number of job vacancies fell again, although the level still remains high with many firms struggling to recruit. The ONS data showed that while wages were rising they were still failing to keep up with rising prices.

An inquiry by a House of Lords committee in December reported that the 565,000 workers who left the jobs market since the start of the pandemic found that early retirement among those aged between 50 and 64 was the main driver of the trend. Early retirement as a lifestyle choice was found to have been a major factor in fewer people looking for work and was a major factor in the supply of labour to the economy. This trend has been evident in our markets where buy to let investors have been selling rental properties to help fund their retirements where landlords are often aged between 50 and 64.

The Treasury received a record £17.5billion from SDLT in 12 months to August 2022. First time buyers now only pay SDLT on homes over £425,000, up from £300,000. First time buyers' relief is available on properties up to £625,000, up from £500,000.

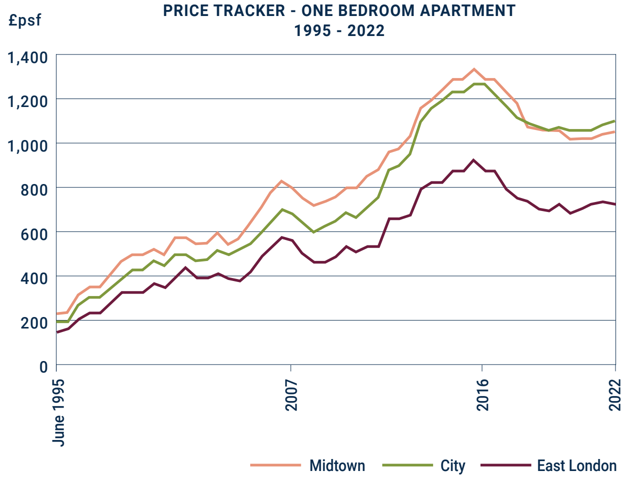
Sales Market

DEMAND FALLS AS RATES RISE

2022 was a year of two halves. In the early months, prices crept upwards, as demand outpaced supply but, after the debacle of the mini-budget and six successive interest rate rises, demand ebbed and prices settled back to end the year pretty much where they began. Two key trends remained to uphold demand, these were: renters losing patience with rising rents and parents passing on wealth to the next generation.

Owners in our markets will normally decide to withdraw a property from the market and retain it as an investment, rather than accept a reduced price – very rarely do we encounter forced sellers. Overall, prices have been broadly flat in 2022, with a slight uptick experienced by mid-year soon offset by a slight dip in the Autumn, following the mini budget. In these circumstances the volume of sales contracts and prices are shored up by the sheer lack of stock available to buy.

FIGURE 2
PRICE TRACKER - ONE BEDROOM APARTMENT
1995 - 2022



Data based on the value of a 500 sq ft one bed apartment in the re-sale market

Source: Hurford Salvi Carr

LIMEHOUSE E14 – 2 BEDROOM FLAT, SOLD NOVEMBER 2022, £875,000

The shortage of homes for sale in Central London has been exacerbated by thousands of flats across London becoming unsaleable while fire safety issues are resolved. It will be six years in July since the Grenfell fire and still many leaseholders do not have a confirmed date for the fire safety works to commence in their apartment blocks. The unacceptable delay by the original developers and failure of the government to step in, has caused a whole segment of the market to stagnate.

Given the strength of the rental market right now, any motivation to sell is further eroded because owners can command an attractive rental income while they review their plans.

On the other hand, from the perspective of the renter, the case for owning has become more compelling as rents have risen. As long as rents were relatively stable, many renters were happy to trade the security and predictability of owning, for the flexibility and freedom of renting but the magnitude of recent rent rises has persuaded a new wave of renters to look again at buying. A simple calculation confirms that monthly mortgage payments, even with higher interest rates, are attractive compared to current monthly rents.

First time buyers, albeit wealthy ones, have been a dominant buyer type across City, Midtown and East London in 2022. That was not the case in the first half of the year but, as rents have continued to rise, we have noticed a surge of young well-paid professionals entering the market who have, until now, been long term renters.

The most popular property type for these buyers is a 2 bedroom, 2 bathroom apartment with a balcony or roof terrace, priced at between £700,000 and £900,000.

However, the reality doesn't always meet expectations. We have found that service charge levels have become a barrier to would-be buyers; a cost they had not appreciated as renters. Even where they had allocated a figure in their calculations, it was normally around £5 per sq ft or between £3,000 and £5,000, and in purpose built blocks the majority are now running well above that level. Costs have risen due to higher utility bills, maintenance, fire safety requirements and annual insurance costs.

Another barrier to securing a sale has been the presence of tenants in occupation. Arranging viewings and ensuring a high standard of presentation are both problematic in these cases. Even in owner occupied apartments, poorly maintained common parts will discourage buyers – first impressions are highly influential in buying decisions.

Prices fell each year from 2017 to 2022 but since then have stabilised at a level equivalent to mid 2013. In effect, that is almost a decade of no price growth. At these prices we are not surprised to see a steady flow of new buyers but, unfortunately, there is very little stock because owners are not motivated to sell. Indeed, if the owner no longer needs a property in these areas, they are far more likely to offer it for rental, especially as rents are rising so steeply.

TABLE 3
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	-2.1%	475,000	-10,000
2020	-3.2%	460,000	-15,000
2021	1.1%	465,000	5,000
2022	1.1%	470,000	5,000

Source: Hurford Salvi Carr

The price differentials between our markets have stayed broadly in line over the past year with the price of one bedroom flats in Midtown or City, equating to a two bed in East London. Values on a square foot basis are broadly the same across Midtown and City at around £1,000 - £1,200 and at least 50% higher than per square foot values in East London.

Although price per square foot is not widely used in the UK, it is familiar to many overseas and investor buyers as a way to compare different markets. It also makes it easier to account for differences in the floorspace of an apartment where the number of bedrooms gives no sense of room sizes. Room sizes have become more important with hybrid working because of the need to carve out space for a desk or computer set-up.

CLERKENWELL EC1 – 3 BEDROOM FREEHOLD HOUSE, SOLD AUGUST 2022, £1,500,000

Table 5 looks at price growth over a series of time periods and shows clearly that the era of rapid capital growth in the late 90s and early 2000s has not returned. Clerkenwell and Midtown, which includes Holborn, Bloomsbury and King's Cross, underwent substantial material change in that period, with widespread renewal and regeneration of their traditional building stock as well as new construction on sites in between. In East London the most significant change occurred after the Olympics in 2012, although the process had begun earlier.

TABLE 4
PRICES & PRICE CHANGES FOR 1,2 & 3 BEDROOM APARTMENTS IN THE RESALE MARKET AT YEAR END

		2019 £	2020 £	2021 £	2022 £	£ per sq ft	Change % 2021-2022 YE
Midtown	1 Bed	550,000	525,000	525,000	530,000	1,060	1%
	2 Bed	850,000	850,000	850,000	875,000	1,167	3%
	3 Bed	1,650,000	1,700,000	1,800,000	1,750,000	1,167	-3%
City	1 Bed	560,000	530,000	530,000	530,000	1,060	0%
	2 Bed	765,000	765,000	765,000	790,000	1,053	3%
	3 Bed	1,400,000	1,450,000	1,550,000	1,500,000	1,000	-3%
East London	1 Bed	390,000	375,000	385,000	390,000	780	1%
	2 Bed	525,000	525,000	535,000	540,000	720	1%
	3 Bed	900,000	900,000	975,000	975,000	650	0%

1 bed is 500 sq ft, 2 bed is 750 sq ft with 2 baths, 3 bed is 1,500 sq ft
Source: Hurford Salvi Carr

A one bedrrom apartment in our markets can be purchased for the same price as it would have been a decade ago. An owner who purchased 6 or 7 years ago, will be nursing a capital loss. As with all investments, values can go down as well as up. The difference with residential investments, at least in our markets, is that the demand for rental homes rarely falls - and today it is stronger than ever. That same owner who bought at today's prices in 2013, could have collected more than £250,000 in rent over that time.

TABLE 5
LONG RUN PRICE CHANGES FOR A ONE BEDROOM APARTMENT IN THE RESALE MARKET

Submarket	1994-2022	2000-2022	2007-2022	2008-2022	2015-2022
Midtown	453%	110%	27%	39%	-18%
City	530%	154%	56%	72%	-10%
East London	460%	114%	23%	43%	-17%

Source: Hurford Salvi Carr

Construction activity declined in 2022. The number of new starts dropped over the course of the year and, in the end, Build to Rent developments accounted for 40% of all new completions across London. The combination of rising interest rates and the new homes premium in Central London pushed affordability beyond the reach of many UK based buyers - although pricing remains attractive for overseas investors. Current market conditions will inevitably dampen development activity in a market that already suffers from viability and planning constraints.

Despite the challenges of the market, there has continued to be significant delivery of new homes in Canary Wharf and wider East London. This area has been a focus for new development in recent years, reflecting the opportunity presented by rising land values and available sites and driven by infrastructure improvement and in particular the 2012 Olympics. The Canary Wharf post code, E14, accounted for 8% of all new starts and 7% of total completions since 2015. In fact, almost one in four homes built in London since 2015 has been in Newham, Tower Hamlets or Greenwich.

Reduced development activity creates opportunity for other sectors to enter the market, like the build to rent, or institutional rental sector. At the same time, work has started on more new council homes in London than in any year since 1979. In 2021/22, construction started on 4,946 new council homes under the Mayor's 'Building Council Homes for London' grant funded programme.

FIRE SAFETY UPDATE

In March of this year, 48 major housebuilders signed up to the Government's pledge to fund the remediation work on blocks with fire safety issues that they had built over the past 30 years. They were expected to sign legal contracts with the Department for Levelling Up, Housing and Communities (DLUHC) in the summer - but that deadline has been missed. The housebuilders are unhappy with the terms of the agreement and have requested a significant redraft. This is causing further delays to organising essential works.

People living in blocks requiring remedial works have accused housebuilders of "delaying tactics" and called on the Government to force them to make their buildings safe. Across the country, leaseholders report that works are yet to begin or have stalled, more than eight months after the country's biggest housebuilders signed the Government pledge.

The housing secretary, Michael Gove, said roughly £3bn would be needed from developers to pay for additional cladding remediation. Developers who signed up to the pledge also agreed to return any funds they claimed from the £5.1bn Building Safety Fund, and to cease claiming from it.

The government has also launched a scheme that will identify who is paying to fix the buildings they are responsible for and who is not. This scheme came into law on 1 September as part of the Building Safety Act. Housebuilders that refuse will be prevented from getting planning permission for new developments or securing building control sign-off. This will effectively prevent uncooperative developers from building and selling new homes.

The reality is that banks are unwilling to lend where no EWS1 (External Wall System) certificate is required or available. This has been acknowledged as a problem by the government. In December, the RICS (Royal Institution of Chartered Surveyors) issued new guidance for valuing blocks with cladding issues. The intention is to provide clarity and confidence by making it easier for potential buyers to raise a mortgage and thereby easier for leaseholders to sell.

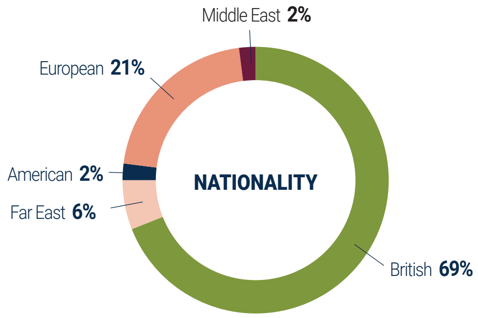
By the end of December some of the country's largest banks said they will consider mortgage applications for some flats with dangerous cladding from January, provoking a sigh of relief from thousands of people stuck in properties they have not been able to sell or remortgage. Lenders including Barclays, HSBC, Lloyds, Nationwide Building Society, NatWest and Santander, said they would consider fresh mortgage applications from 9 January 2023, after receiving long-awaited guidance from the Royal Institution of Chartered Surveyors (RICS) on how to value affected properties. Owners will need to prove that the dangerous materials will either be removed by developers or covered by leaseholder protections or a specific government scheme.

The new guidance asks valuers to take into account any agreed remediation funding and timelines when forming an opinion on the value of properties in blocks with cladding. It remains to be seen whether this will have any impact on lenders' willingness to lend, or buyers' willingness to buy into a block requiring remedial works.

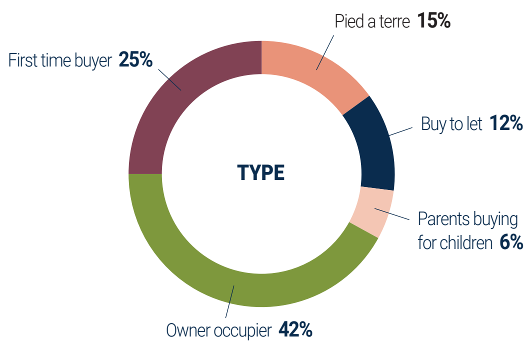
BUYER PROFILES 2022

Nationality
The dominance of British buyers in our markets in 2022 is exactly in line with the long term average at around 70%. There is variation though, between the sub-markets and also between the nationality groups. Europeans made up 16% of buyers on average between 2015 and 2022 but in the last year they accounted for a much larger 21%.

In our Aldgate office, which covers the City, Spitalfields and Wapping, half of the buyers in 2022 were European and only 38% British. The Far East is a much more significant group in Aldgate too, and also in East London, where there has been much higher volumes of new build. We were, of course, not surprised by the absence of Russian buyers this year. They have never been a significant group in our markets, preferring more traditional high value areas around Knightsbridge and Belgravia. Our markets have always been more reliant on domestic purchasers, particularly in the second hand market.

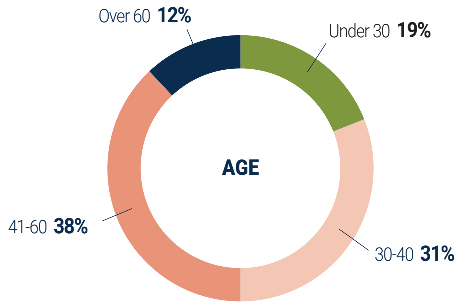


Type
When we compare buyer types in 2022 to the longer term average between 2015 and 2022, there are some significant differences. This year there were more pied a terre buyers than normal (15% v 8%) and more first time buyers (25% v 20%). The category that saw the most significant drop was buy to let investors who normally account for 17% of buyers but were only 12% in 2022.

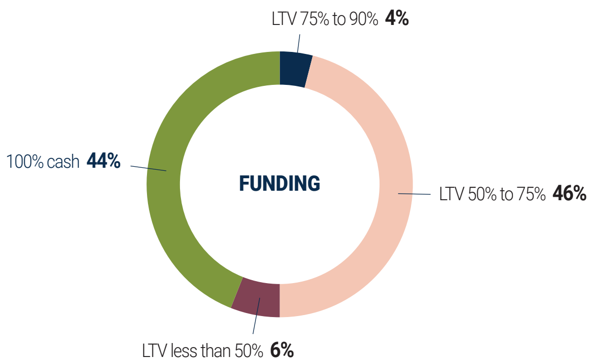


Age
The proportion of buyers over 60 is above trend this year accounting for 12% of all buyers – compared to an average of 7% in the period 2015-2022. It is the 30-somethings who have been less active this year. They normally make up just under 40% of buyers but this year were down at 31%.

With so many people having the option of working from home now, more young families have chosen to make their home in the leafier suburbs and we suspect this accounts for the change. Whether it persists as a trend will depend on the future of hybrid working.



Funding
Almost half of buyers in 2022 were what we would describe as 'cash buyers', in other words, they were not using a mortgage to fund the purchase. Of those that did use a mortgage, the majority came with equity of between 25% and 50% and there were very few sales transacted in our markets with any less than a 25% deposit.



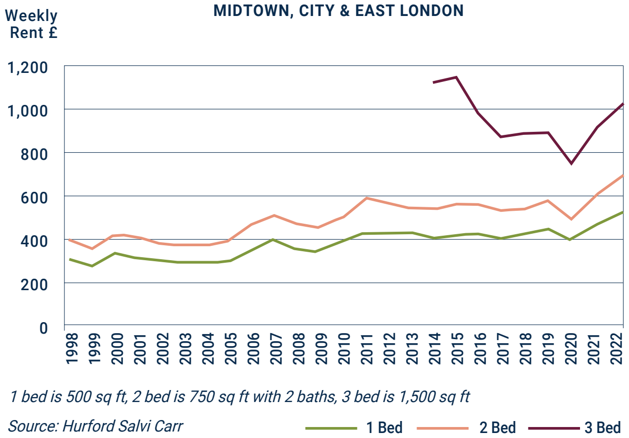
Lettings Market

SUPPLY SHORTAGE

The pace of rental growth over the past 18 months has been extraordinary and unexpected. Prices only grow at rates like these when there is a severe imbalance between supply and demand. Some investors may be viewing their spiralling returns with delight but their customers, the renters, are suffering and it is not a healthy situation.

In many ways, this imbalance is hard to explain. We do not believe there are more renters in London today than there were in 2019 and while there is undoubtedly evidence of some landlords exiting the market, it is not a strong enough trend in our markets to account for the severity of the imbalance.

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



1 bed is 500 sq ft, 2 bed is 750 sq ft with 2 baths, 3 bed is 1,500 sq ft

Source: Hurford Salvi Carr

As is usually the case, there is no one simple explanation. We have identified a number of factors we believe have contributed to the pressure on supply:

- Students who deferred their university places in 2020, returned in 2021/22 and effectively expanded the cohort.
- The speed at which renters returned to the city in summer 2021 created competition for certain properties and a sense of urgency.
- Renters who had moved in from lower cost areas during the pandemic often secured low rents for longer periods and have not moved back out.
- The short let market revived and owners who had lost rent during Covid, were tempted by the higher returns available from Airbnb or corporate letting agencies.
- Household sizes shrank as the need for space to work from home made sharing more difficult.
- HMO licencing has also led to shrinking household sizes by rendering the 'box room' unlettable as a bedroom.
- Couples are more likely to want a spare bedroom to act as an office space
- Workers on short term placements and overseas assignments returned to the city and added to the intensity of demand.
- New development activity has declined as construction costs have risen and planning has become increasingly difficult.

TABLE 6
WEEKLY RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON AT YEAR END

Submarket		£ 2018	£ 2019	£ 2020	£ 2021	£ 2022	% Change 2021-2022	% Change 2019-2022
Midtown	1 Bed	475	500	450	550	600	9	20
	2 Bed	640	680	575	700	775	11	14
	3 Bed	1,100	1,100	875	1100	1200	9	9
City	1 Bed	450	490	390	510	550	8	12
	2 Bed	560	600	500	650	750	15	25
	3 Bed	950	975	800	1000	1100	10	13
East London	1 Bed	340	350	325	350	400	14	14
	2 Bed	425	440	400	450	525	17	19
	3 Bed	575	575	540	600	700	17	22

1 bed is 500 sq ft, 2 bed is 750 sq ft with 2 baths, 3 bed is 1,500 sq ft
Source: Hurford Salvi Carr

These come on top of the long hiatus in social housing and the heavy burden of Stamp Duty imposed on investors in December 2014. Policy interventions often have unintended consequences and the current debate about rent controls is of major concern. If rent freezes are introduced by this or a future government, there is no doubt that it would push more landlords to exit the market.

Any further loss of stock will inevitably be difficult for renters and push more power into the hands of landlords. Already we see far greater scrutiny of a renter's ability to cover the rent and more demands for upfront rental payments, in some cases, for the whole lease term. Visa requirements for overseas students and work permits only add to the burden of scrutiny.

We have said many times in previous reports, that rental markets are highly responsive and adjust to market conditions very fast. When rents rise above the level a renter wants to pay, they can and often do, elect to move to a lower cost area, or a cheaper property. This is particularly characteristic of young, footloose renters in urban areas. We do expect the current overheated conditions to subside over the next year or two and for the market to regain its equilibrium.

TABLE 7
ANNUAL RENTS FOR 1, 2 & 3 BEDROOM APARTMENTS
IN MIDTOWN, CITY & EAST LONDON AT YEAR END

Submarket		Weekly Rent £	Sq ft	Total Rent payable p.a. £	Rent psf £
Midtown	1 Bed	£600	500	£31,200	£62
	2 Bed	£775	750	£40,300	£54
	3 Bed	£1,200	1,500	£62,400	£42
City	1 Bed	£550	500	£28,600	£57
	2 Bed	£750	750	£39,000	£52
	3 Bed	£1,100	1,500	£57,200	£38
East London	1 Bed	£400	500	£20,800	£42
	2 Bed	£525	750	£27,300	£36
	3 Bed	£700	1,500	£36,400	£24

1 bed is 500 sq ft, 2 bed is 750 sq ft with 2 baths, 3 bed is 1,500 sq ft
Source: Hurford Salvi Carr

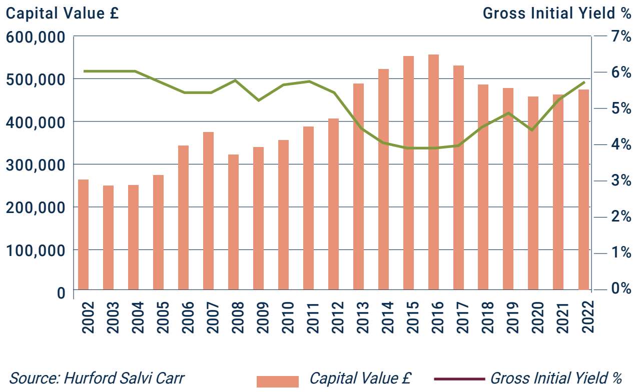
Already we are seeing young renters in well-paid jobs deciding to look at the alternative of home ownership because their rents have risen so steeply. In the years that rents and prices have been relatively stable, renting is an attractive option because of the flexibility it offers but when the cost of renting begins to look distorted, the relative merits shift – even when interest rates have risen. The psychology is that paying a mortgage, even with interest rate rises, is more appealing than paying a high rent.

BLOOMSBURY WC1 – 3 BEDROOM MANSION FLAT, LET SEPTEMBER 2022, £6,000 PER MONTH

The figures in Table 7 show what has happened to rents in each of our submarkets and for apartments of different sizes. At the end of 2021, rents were broadly back at their pre-pandemic levels, or just above. By the end of 2022, they had gained some 20%. Midtown is still the most expensive market but East London and City have grown faster, especially for 2 and 3 bedroom homes.

The average annual rent for a one bedroom apartment is around £25,000 per annum. A single occupier, would need an income

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

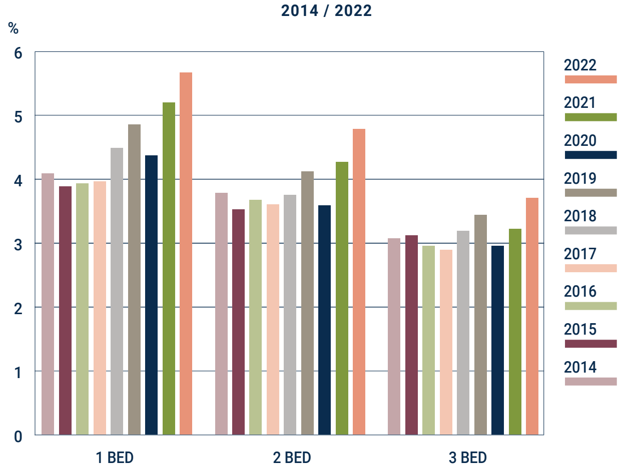


Source: Hurford Salvi Carr

of £75,000 to cover the rent and comply with normal referencing criteria of 30% gross income cover. Couples sharing a single bedroom apartment are in a much stronger position but renters in these markets are often affluent overseas students who pay six months up-front and treat the cost as a capital investment in their education.

Sharer households are in a different position but with hybrid working, sharing has become increasingly problematic. This is a significant impetus to the return to work and a boost to cafes and co-working spaces!

FIGURE 5
CHANGE IN YIELDS FOR CITY, MIDTOWN & EAST LONDON
2014 / 2022



Source: Hurford Salvi Carr

TABLE 8
LONG TERM RENTAL GROWTH

	2000 - 2022	2007 - 2022	2008 - 2022	2014 - 2022	2020 - 2022
1 Bed	58%	34%	47%	27%	32%
2 Bed	67%	36%	49%	27%	38%
3 Bed	N/A	N/A	N/A	-9%	36%

1 bed is 500 sq ft, 2 bed is 750 sq ft with 2 baths, 3 bed is 1,500 sq ft
Source: Hurford Salvi Carr

TABLE 9
GROSS INVESTMENT RETURNS FOR ONE BEDROOM APARTMENTS
AVERAGE OF MIDTOWN, CITY AND EAST LONDON 2014 TO 2022

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Gross Annual Income £	21,060	21,580	21,840	21,060	21,840	23,140	20,280	24,336	26,760
Capital Value £	520,000	550,000	555,000	530,000	485,000	475,000	460,000	465,000	470,000
Gross Initial Yield %	4.1%	3.9%	3.9%	4.0%	4.5%	4.9%	4.4%	5.2%	5.7%

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

RENTERS' REFORM BILL

The government has confirmed its commitment to introducing the Renters' Reform Bill in this parliamentary session, including implementing a single system of periodic tenancies and abolishing section 21, which currently allows landlords to terminate tenancies without demonstration of a cause.

On 16 June 2022, the Department for Levelling Up, Housing and Communities issued a white paper, setting out radical proposals to reform the rental system in order to create a 'fairer private rental sector' for tenants. The proposals reflected manifesto pledges from 2019.

The Government accepts that landlords should be able to take action against tenants who do not pay their rent or fail to comply with the terms of their tenancy agreement. So, whilst the plan is for no-fault evictions to be abolished, there will also be an overhaul of the current grounds for evicting tenants who breach tenancy agreements to support landlords.

Confirmation of the reforms is expected in 2023, well before the next general election (expected in 2024). If made law, the proposals will represent the most substantial changes to regulation in the private rented sector in over 30 years.

The most significant change is the abolition of section 21 notices. The bill would ban assured tenancies and assured shorthold tenancies and replace them with a single system of periodic tenancies – meaning there is no end date specified in the rental contract. Landlords will only be allowed to evict a tenant in 'reasonable circumstances', which have yet to be defined. It is anticipated that properties let to students will be covered by this change in the law, although purpose-built student accommodation will be exempt.

To ensure that landlords are not repeatedly left with vacant properties at short notice, a tenant wishing to move out, will need to give two months' notice.

New mandatory grounds for possession will be introduced for landlords who want to sell the rented property or move into it themselves, although not within the first six months of the tenancy. There will also be new mandatory grounds for repeated serious rent arrears, and also new provisions to ensure that tenants who are behind with their rent have a fair chance of paying off the arrears without losing their home.

Rent review clauses will be abolished and landlords will only be allowed to raise rents once a year and must give two months' notice of any rent increase.

Where a tenant has paid rent in advance, the landlord will have to repay any outstanding amount when the tenancy ends. The level of rent which landlords can require in advance will also be limited.

Under the proposals, a single, Government-appointed, ombudsman will have jurisdiction over all private landlords in England to enable disputes to be settled more quickly at lower cost and without going to court.

Tenants will be entitled under law to request that a pet share their home. The landlord will be obliged to consider such requests and will not be allowed to unreasonably withhold consent. A landlord's refusal can be challenged, but there is not yet any detail on how this will work. A landlord will be able to require the tenant to insure against damage to the property caused by the pet but as yet there is no detail on how landlords should respond if their own superior long lease prohibits pets.

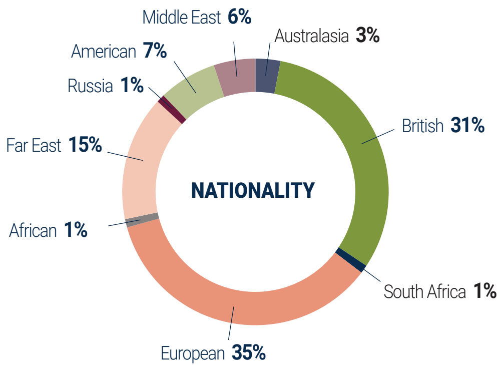
Other provisions proposed are that there can no longer be a blanket ban on renting to families with children, or those in receipt of benefits. The bill also requires all private rented homes to meet the 'Decent Homes Standard'.

RENTER PROFILES 2022

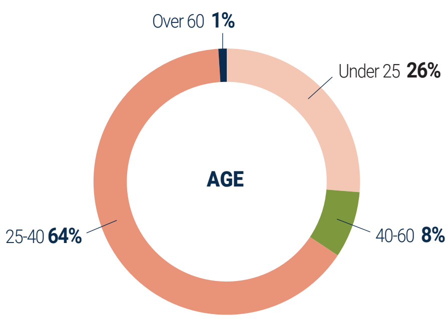
Nationality
Renters are from a much broader mix of nationalities than buyers in our markets. While two thirds of buyers are British, they account for less than one third of renters. Europeans make up another third as they have since we began collecting this data in 2015. Renters from the Far East withdrew from the market during Covid but have returned to their pre-Covid levels of around 15% while the final 15% originate mostly from USA, Middle East and Australia.

The return of overseas students has been an important feature of the market this year and most universities have reported steep rises in registrations from overseas.

In the year ending September 2022, the total number of sponsored study visas granted (including dependants) was 592,710, more than double (+108%) the number in 2019, the last full year before the pandemic, and 39% higher than the previous year.

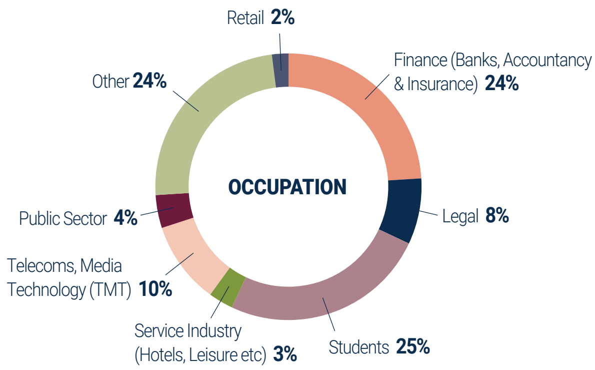


Age
The vast majority of renters in our markets are aged between 25 and 40 years old. They account for 65% of all renters over the whole year. Younger renters arriving for university or to take up graduate employment in the Autumn, made up a quarter overall but a much higher share in the second half of the year.



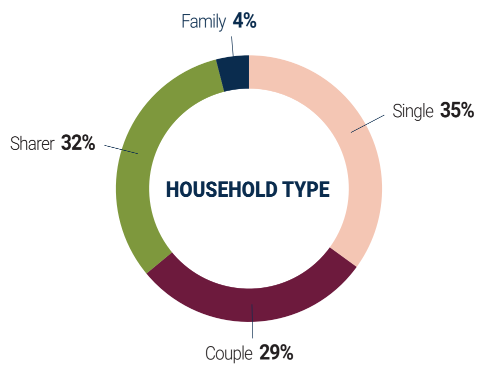
Occupation
Banking and financial has always been a key employment sector in central London and it continues to account for a quarter of all renters in our markets. Inevitably, it is stronger around the City and Aldgate.

The tech sector is also an important driver of demand in the City and Islington/Shoreditch. Although it represents only 10% overall, it is the employment sector for 18% of renters in Islington/Shoreditch and 16% in the City – where there is a cluster of tech related offices around Broadgate and also in Midtown. Of course, this sector is one of the most likely to be affected by hybrid or home-working so it is interesting to see this distinct clustering of residential as well as commercial occupation.



Household Type
The composition of household types varies very little over time on our markets - singles and sharers make up around one third each, while couples account for just under 30% and very few (under 5%) are families.

However, there are significant differences between our offices. Singles accounted for close to 40% of renters in City and Islington/Shoreditch compared with only 17% in East London. Sharer households and couples were disproportionately high in East London and lower in the City.



Future Prospects

GENERAL ELECTION ON THE HORIZON

We are expecting lower transaction volumes in 2023 in response to higher interest rates. We also believe that we are entering another period of stagnation because owners are simply not motivated to sell at current prices. The combination of reduced demand and reduced supply can have only one logical outcome – reduced transactions.

Conflicting pressures are likely to increase next year. We expect buyers to become more cautious in the light of economic uncertainty, while owners will surely dig in their heels – especially as current prices sit below their original purchase price for anyone who bought since 2014. With an attractive rental market, there is little incentive to sell for anyone with no immediate need to release capital.

A wider global recession looks increasingly likely in 2023 and the wave of strikes at home is adding to the pressure on wages. There is a chance that, if inflation is not controlled and interest rates stabilise, then a longer term economic downturn could transpire.

In the City, Midtown and East London we do not expect to see distressed sellers and therefore we anticipate that prices will remain broadly unchanged. There may be a modest decline in values of between -1% and -3% over the next 12 months, as the cost of living increases play out across the wider economy. That will be led by those who need or choose to sell at this time but, as explained, we do not expect high volumes.

We expect more landlords to exit the market in 2023 because of very real concerns about the impact of the Renters' Reform Bill. It became evident in 2022 that an unusual proportion of homes for sale were occupied by renters. Landlord exits have become an established trend despite rents growing at the fastest rate in many years. The two are, of course, inextricably linked but it does seem to play into the hands of the institutional investors who are stepping in to deliver rental home at scale, or to buy stock that is being rejected by the traditional private rented sector.

We are in no doubt that the shortage of rental homes in City, Midtown and East London will continue to drive rental growth in 2023, albeit at a slower pace than over the last 12 months.

With strong demand and a shortage of new supply of rented accommodation, we expect rents to rise by a further 5% in 2023, on top of the 12% rise in 2022, pushing rents to 25% above their 2019 pre-pandemic levels.

It is inevitable that some tenants will struggle to pay these increases but, as ever in a dynamic and fluid rental market, renters can choose to move to a lower cost location, or a smaller home in order to reduce their overheads. This will eventually act as a dampener on rental growth and a natural control on the supply demand balance. There remains in our market a cohort of renters who moved in to central London during Covid when rents dropped and many of them will probably move back out over the next 12 months reducing pressure on demand.

Demand for short term accommodation looks likely to increase in 2023 with the strength of the Dollar against Sterling helping the tourism and hospitality sectors – which can only be positive for the London economy.

As we get closer to a General Election in 2024, we fully expect housing to be a key battleground for the main political parties with policies designed to address issues of supply and cost in order to attract key voter groups. In London renters are a large voter group but at national level it is first time buyers who will probably be the focus of attention.

We expect to see policy support for an institutional rental sector at national and local level. The Build to Rent sector is working hard to lobby government on the benefits of delivering long term professionally managed rental communities and there is no better time for them to be heard if small private landlords continue to leave the sector. It is probably more politically expedient to support a professionalised sector than a fragmented sector with a reputation sadly tainted by a small proportion of 'rogue landlords'. Certainly the lobbyists will focus their attention on the 'rogue' group.

OLD STREET EC1 – 2 BEDROOM FLAT, LET AUGUST 2022, £3,000 PER MONTH

Our markets will mirror the wider malaise in UK housing markets, even though most owners are not highly exposed to mortgage debt. The higher cost of servicing debt will squeeze all sectors of the economy. Although the UK has lived with higher levels of interest rates in the past the impact for homeowners with fixed rate mortgages coming to an end will now be significant with double digit inflation.

There is an expectation that as we move into the second half of 2023, that inflation will fall which in turn will reduce pressure on interest rates. House prices will remain an attractive prospect for buyers in central London during this period.

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