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MARKET REPORT

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PRIME CENTRAL LONDON

The Prime Central London (PCL) market has now witnessed a decline for fifteen consecutive quarters which is longer than the decline witnessed post the collapse of Lehmans (6 quarters) or between 1989 and 1992 (11 quarters). Values are down by 18.2% (source Savills PCL flat index) across the board but this varies significantly depending on the nature of the asset. Higher value properties appealing to an international market are faring comparatively poorly to smaller units that appeal to a domestic market. As an example, five bedroom houses in Belgravia, appear to be approximately 21% below the level witnessed in 2014, whereas one bedroom flats in the Paddington Basin (lower value and an area that has increased in popularity) are showing modest growth over the same period. The value margin between refurbished properties and those requiring work remains wide on account of the increased transaction costs faced by developers and increased choice for potential purchasers.

The decline witnessed so far has called many estate agents to cite that there are signs that "the market is bottoming out" and that now may be the time to buy. There are certainly signs that the market is adjusting. Lonres record both an increase in price reductions and a reduction in the number of properties that have been withdrawn from the market, indicating that vendors' expectations are beginning to become more aligned with the state of the market. The rate of decline also appears to be slowing with Savills recording a decline of 4.3% over the last 12 months versus 7.3% over the previous 12 months.

A more bearish view is that further decline is inevitable and when the market does recover it will do so at a more modest rate than many would anticipate. Whilst the decline has been longer than in previous downturns, the rate of decline is still yet to hit the levels witnessed in 2009 (22.6%) or 1989-1992 (28.7%). The incentive to sell (London is seen as a good long term bet and the costs of holding the asset is low) is more limited and the market therefore remains illiquid.

Prior to recovering, the market must further adjust to a number of headwinds. Firstly, London witnessed very significant price growth between 2009 and 2014, when in certain areas, capital values doubled owing to both domestic and international demand fuelled by quantitative easing. Whilst we have witnessed a significant decline, the reality is that in most areas prices are only back to the levels witnessed a couple of years prior to the market

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turning, albeit we would once again stress that the rate of decline varies significantly depending on the nature of the relevant property and the location. London is unquestionably a vibrant and interesting place to either live or have a home but despite the decline witnessed over the last four years, remains expensive in a global context. Whilst it has declined in its ranking, Christies cite London property as now still only being less expensive than Hong Kong and New York.

The price growth witnessed in London between 2009-2014 was out of kilter with the rest of the country, including the South East and according to the ONS there has been a 27% increase over the last five years of people in their 30s leaving London in order to gain better value elsewhere. Better communications and changing working patterns have also enabled many to work in London but live further afield.

New and significant barriers to entry have been put into place, including high rates of SDLT (the liability for a £5m second home being £663,750) and measures taxing both offshore individuals and companies (ATED & CGT) which are curtailing demand from international purchasers. Whilst there has been a decline in capital values, rents have also generally declined over the last four years and gross yields remain at between 2-3%, the same level witnessed in 2013 (i.e. just prior to the market turning). This coupled with higher taxation on purchase, increased regulation, the phased abolition of mortgage interest rate relief and the prospect of interest rate rises is curtailing demand from investors.

In summary, the signs that the market is adjusting should be regarded positively, as should the decline witnessed to date with some areas showing good value. Nevertheless, we are of the opinion that it is likely that there will be further, more modest, price falls with PCL prior to the market gradually recovering. Aside from unexpected political turmoil or further adverse amendments to property taxation, we forecast this to begin in 2020 at which point the market is likely to have seen a price correction more akin to the last two downturns.

As we have been forecasting for some time, the market in outer London is now struggling and witnessing price falls that are more significant than those currently being recorded in PCL. Again, this varies significantly depending on the nature of the property and the location (an example being North and East London outperforming South and West London). Over the last three months Knight Frank record a decline of 0.5% for PCL versus 1.6% for Prime Outer London. In contrast, the same indices that record 18.2% decline for PCL flats, record only approximately 6% from the peak of the market with respect to outer areas. It is our opinion that many outer areas now appear expensive and the market is adjusting to reflect this. Outer areas predominantly appeal to a domestic market and we do not consider that they will witness as significant a price correction as PCL. Nevertheless, we do think that this market has further to fall owing to the comparatively limited decline witnessed to date. These areas are also generally more reliant on mortgage funding and we are of the opinion that the phased abolition of mortgage interest rate relief could have a greater impact on the market outside PCL.

RENTAL MARKET

In terms of the rental market, there has been a significant supply side imbalance in London over recent years arising from investors purchasing new build stock; potential vendors electing to let their properties instead rather than sell at a discount and a significant surge in purchases by investors prior to the introduction of the 3% SDLT surcharge in April 2016. Nevertheless, decreased demand from investors is now causing the rental market to re-align, particularly in the Super Prime market where there is good demand from High Net Worth individuals electing to rent rather than buy in the current market. Lonres cite an 11% drop year on year to Q1 2018 of the number of available properties to rent which has resulted in rental growth of 2.1% over the same period. Whilst there are a number of headwinds facing the rental market, including a potential Brexit exodus, we think that this is currently, and will be, balanced by a reduction in supply over the coming years.