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MARKET REPORT

NOVEMBER 2017

PRIME CENTRAL LONDON

The consensus over the first part of 2017 amongst those active within the Prime Central London (PCL) market was that it was either bottoming out or that there were green shoots of recovery appears, with the benefit of hindsight, to have amounted to a false dawn. Within the environment of Brexit uncertainty and a weak government in the wake of the General Election, the market has continued to decline. ***Our observation six months ago that "£1,750 per sq. ft. is the new £2,000 per sq. ft." would now appear generous and should be revised to £1,650 per sq. ft.***

It does, however, seem to us that the rate of decline is slowing and there has been a slight increase in activity, albeit transaction levels remain very low in a historical context. Lonres report that the average discount from asking prices is also down from 9.1% to 8.5% indicating that asking prices may be becoming more realistic in the wake of the decline in the market witnessed over the last three years.

Whilst these statistics perhaps illustrate that the rate of decline is slowing, the market remains very illiquid. Garringtons report that 63% of the properties available for sale in Mayfair and St James's have been on the market for over twelve months. An illiquid market, where guide prices are often inflated, can lead to occasional sales that are significantly in excess of Market Value. This is because purchasers have limited information on which to base a decision. In the current market it is very helpful when undertaking a valuation to speak to agents "on the ground".

The lack of activity derives from the lack of incentive to buy or sell. Vendors are faced with the fact that their property is worth considerably less than it was three years ago; their asset is comparatively inexpensive to hold (whilst there has been a small interest rate rise, 0.5% is very low and the Bank of England has indicated that future rises are likely to be both gradual and modest), they are likely to be of the opinion that Central London property is a "good bet" in the long term and high levels of Stamp Duty Land Tax (SDLT) mean that it is expensive for them to buy another property if they elect to sell.

From the purchaser's perspective, the lack of incentive to commit is also prevalent; there is Brexit uncertainty including the Bank of England warning that 75,000 jobs in the financial services could be lost over the next five years and thus indicating that prices could fall further. The gradual reduction of Mortgage Interest Rate Relief and increased regulation is curtailing demand from investors, with many seeking improved value and yields in the regions. The introduction of more stringent Anti Money Laundering regulations is also impacting certain purchasers and most notably, buyers are faced with

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onerous levels of SDLT on acquisition. The favourable taxation environment for property owned by individuals domiciled overseas or offshore companies has also been removed completely.

We have repeatedly stressed that it is our opinion that the high levels of taxation faced by the PCL market is one of the main culprits in constraining demand (albeit we concede that a £2m house in Central London has witnessed a fall of double the stamp duty liability which would indicate that it is not the only factor). ***The hope that the Chancellor may seek to amend SDLT rates is subsiding, particularly as he elected to remove SDLT for first time buyers up to £300,000 but did not amend the upper tiers where SDLT can reach an iniquitous 15%***.

It is our opinion that the quite significant variance in the rate of decline within PCL is on account of the taxation implications. Higher value flats and houses that are situated in areas which have traditionally been favoured by overseas purchasers (demand from whom, despite favourable currency fluctuations, is very limited because of taxation arising from SDLT, ATED and CGT) have performed comparatively poorly versus lower value properties in locations that have generally appealed to a more domestic market.

We feel that some historically high value areas such as Knightsbridge and Belgravia are showing good value. Belgravia houses are a very good example, 58 South Eaton Place recently sold for £3,150,000 equating to £1,651 per sq. ft. (which is fairly typical at present) whereas two houses in Elgin Crescent in Notting Hill have recently exchanged for over £2,300 per sq. ft. Some of the older riverside developments are also showing good value owing to the general state of the market and very high levels of supply arising from newly completed schemes along both sides of the river.

Overall, up to the end of Q3 2017, Savills report PCL seeing a decline of 6.8% over the year. Knight Frank record 3.6%. Savills' statistical indices show that overall the market has declined by 16% from the peak witnessed in August 2014. We agree that as an average this is accurate but believe the decline varies from 5%-30% depending on the nature of the property and the location. The same indices show a decline of 22% during the previous crash witnessed between the end of 2007 and the beginning of 2009. ***Whilst the current decline has been much more gradual, we are beginning to be in the realms of a "post Lehman" price correction***.

In the next few years, as Brexit uncertainty lifts, PCL will appear good value in a historical context in our opinion. In the interim, unless there is an unexpected impetus to sell, we do not think that prices will fall much further within the mainstream PCL market. We are of the opinion, however, that the new build market has further to fall owing to high levels of supply and the fact that developers have thus far been reluctant to cut prices to schemes that are ongoing. This is presumably partially so as not to antagonise those that acquired properties in the same scheme a year or two ago at higher values. Once the sales agreed on an off plan basis have been completed, we may see a more realistic approach taken in an effort to off load their remaining stock, with a consequent knock on effect on those units which are perceived as second hand.

SHORT LEASES

Whilst the differential between unmodernised and refurbished properties (which can be greater than

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£1,000 per sq. ft.) remains significant on account of, amongst other factors, high transaction costs faced by developers, we are seeing a greater degree of certainty within the short lease market. Whilst the decision in Trustees of the Sloane Stanley Estate v Mundy with respect to relativity (the value of the existing lease as a proportion of freehold) resulted in landlords' agents reviewing their graphs of relativity in a downwards direction (thus increasing Marriage Value and the premium), these new graphs have not so far been widely tested and we believe Landlords may be reluctant to do so because of political pressure. Purchasers of short leases are once again beginning to have a clearer idea of the likely lease extension premium which is enabling them to pay slightly higher prices than were being witnessed 12 months ago. Such buyers should, however, be aware that at least one major PCL Landlord is exploring a further deferment rate appeal which could upset this market once again.

OUTER LONDON

Turning further afield, outside of Prime Central London the market has performed better but within the Greater London area, the market has still declined as a whole. Once again, this varies significantly in terms of the value and the location, with higher value houses performing comparatively poorly and some areas significantly outperforming. We have noted a general increased demand, particularly amongst younger buyers, to move to North and East London which have outperformed South and West London. Stoke Newington values, for example, sit at roughly double those recorded in 2007.

In contrast to Savills' recorded 6.8% annual decline with respect to PCL, Outer London recorded a decline of 4.8%. Whilst the Outer London market has a higher concentration of lower value houses and has more of a domestic audience, we are witnessing a ripple effect spreading to outer lying areas. Whilst we have been forecasting this for some time, the decline in outer lying areas is a relatively recent phenomenon and in general terms has been approximately 5% from the peak of the market, in contrast to the 16% recorded in PCL. Whilst we do not consider that outer lying areas will witness as significant a price correction as the centre, 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 will 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. Demand is also stronger for smaller flats with Savills citing an annual decline of 1.9% for one bedroom properties versus 4.8% for three bedroom properties. Like PCL capital values, rents are largely below the levels witnessed five years ago, with the exception of one bedroom flats. Whilst there are a number of headwinds facing the rental market, including a potential Brexit exodus, we think that this will be balanced by a reduction in supply over the coming years.