Residential Quarterly | Winter 2017/2018

Research - Market View

Economic Outlook

Some details have finally begun to emerge on what has been agreed with regards to Brexit negotiations. The UK will pay approximately £40bn in a 'divorce bill', UK workers in the EU and EU workers in the UK will keep their rights for a maximum of five years after the UK leaves the EU, and both sides have agreed not to erect a hard border between Northern and Southern Ireland and support the 'all island economy and the protection of the 1998 agreement'. This progress has meant negotiations can now begin on a trade agreement between the UK and the EU.

The National Institute for Economic and Social Research estimates that the UK economy grew by 0.5% in Q4 2017, and forecasts that growth over the whole of 2017 was 1.6%. This shows that momentum has increased as the year has progressed but it is still below what was seen at the end of 2016.

The ICAEW Business Confidence Monitor which looks at UK sentiment reported a score of -3.4 in Q4 2017 which is an increase from Q3 2017 (-8.0) and higher than the -8.7 recorded a year ago, it is still negative. This means business confidence has been negative for five out of the last six quarters with likely causes being inflation reaching 3.0% in December, the interest rate rise and the continuing lack of clarity on Brexit. Additionally, rising costs for businesses (apprenticeship levy, business rates, living wage), coupled with the weak exchange rate, may still impact the domestic market, both by increasing costs for domestic firms and making imports more expensive. In 2017 inflation has been above the Bank of England's target rate (2.0%) for most of the year declining to 3.0% in December. The BCC expected it to outpace earnings until 2019 which will erode real wages and is likely to result in lower consumer spending. This is particularly worrying considering consumer spending is a key driver of economic growth for the UK.

The official bank rate remains at 0.5%. The rate remains very low by historic standards, but it will increase mortgage rates for some households, as well as increasing savings rates for others. Financial markets are indicating two more interest rate increases over the next three years, taking the official rate to 1.0%.

The FTSE 100 has registered another set of strong growth figures for Q4 2017. This follows a trend of having experienced generally positive growth since the EU Referendum, although there continue to be periods of volatility. As for productivity and unemployment, unemployment remains very low whilst for productivity, the ONS measure of output per worker increased by 0.9% compared to the previous quarter, representing the biggest increase since Q2 2011. This increase however was a result of a reduction in the number of hours worked rather than an actual acceleration in the growth of output.

In the Autumn Budget, Philip Hammond announced a Stamp Duty Land Tax relief for First Time Buyers (FTBs) in England, Wales (until 1st April 2018 when Land Transactions Tax goes into effect) and Northern Ireland to purchase a residential property for £500,000 or less and provided the purchaser intends to occupy the property as their only or main residence. The FTB purchaser must not, either alone or with others, have previously acquired a major interest in a dwelling or an equivalent interest in land situated anywhere in the world. If the property is purchased jointly, all the purchasers must meet these conditions.

3.0%

December 2017 inflation was at 3.0% down from 3.1% in November 2017

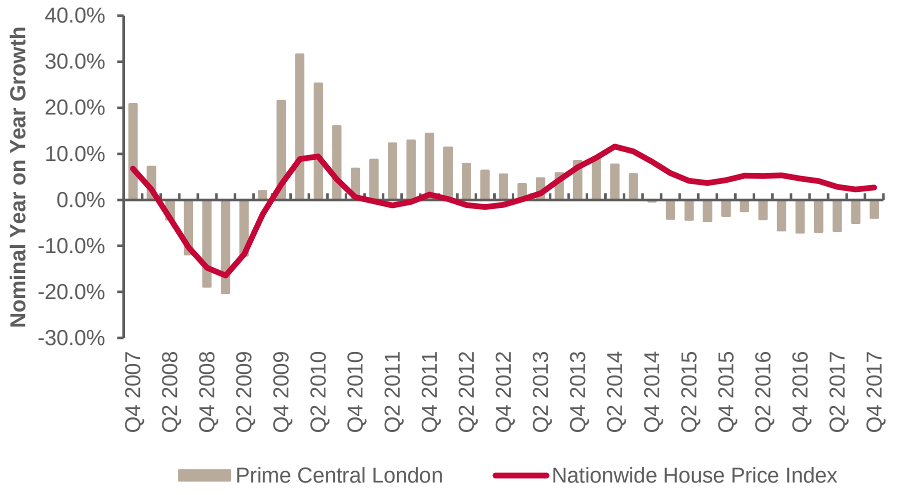
PMI Services up from 53.8 & PMI Manufacturing down from 58.2
Source: HIS Markit/CIPS

Real average weekly earnings (total pay) fell by 0.2% in the three months to October 2017, compared to the equivalent period in 2016.
Source: ONS

Property market pricing

According to the Nationwide House Price Index, UK property prices grew 2.7% in the year to Q4 2017. YoY growth over the same period shows that on a regional basis the best performer has been the West Midlands (5.3%) closely followed by the South West (4.8%) and the East Midlands (4.6%). London, which has historically experienced the strongest growth rates in the UK, was the worst performing region in 2017 with negative growth of 0.5%. This is the second consecutive quarter in which London has had the lowest year on year growth rate. Other regions below the national average are Northern Ireland (2.0%), Outer Metropolitan London (1.2%), Scotland (2.6%), East Anglia (2.2%), Yorkshire and the Humber (1.8%), and the North (0.1%).

Figure 1
UK house price growth vs Prime Central London (PCL)



Source: *Nationwide House Price Index, Volterra*

UK property prices grew 2.7% Y-o-Y to Q4 2017

UK residential sales transactions

Table 1. Number of registered properties sold by all property type for 2016 and 2017

Region	All Property 2016	All Property 2017
East Midlands	68,454	67,903
East of England	89,760	86,888
Greater London	85,271	83,464
North East	30,930	33,877
North West	94,925	99,674
Scotland	100,437	104,015
South East	130,028	128,009
South West	87,221	87,468
Wales	37,910	40,422
West Midlands	70,777	72,952
Yorkshire and Humber	70,620	73,614

Source: *Dataloft, Land Registry 2016 data as at 20th January 2017 and 2017 data as at 9th January 2018; Registers of Scotland as at 1st February 2018*

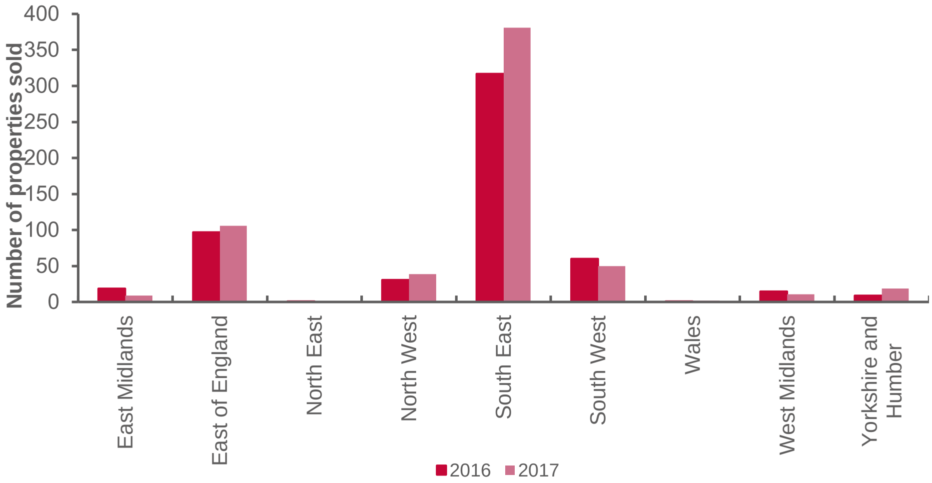
National house prices are now 19% above November 2007, according to Land Registry

Country house highlights

The majority of homes sold over £2 million in 2017 were in the South East and East of England with both seeing Y-o-Y growth of 20.0% and 9.0% respectively. An interesting contradiction when taking into account the wider markets (see Table 1) where both regions saw overall decline in transactions. A slight surprise was in the South West, a common second home locale, which experienced a 17.0% decline in 2017 compared to the previous year. Whilst Yorkshire & Humber and the North West both saw growth in 2017 compared to a year previous with 111.0% and 26.0% growth respectively, albeit at low levels of transactions.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in 2016 and 2017



Source: *Dataloft, Land Registry 2016 data as at 20th January 2017 and 2017 data as at 9th January 2018*

"Even with continued restriction in house price growth during Q4 2017, the residential market remains active with the number of new buyers rising and anecdotal reports of increased activity from around the country. Over the past quarter, the effects of higher rates of stamp duty, political and economic uncertainty have continued to temper prices in the residential market particularly in London and around the M25, although realistic pricing and flexibility by all parties is key to achieving a successful sale."

Guy Robinson

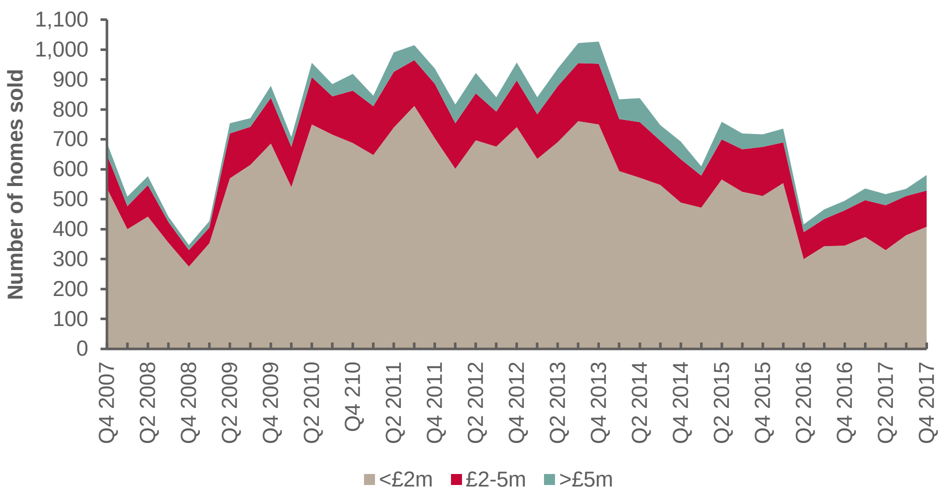
Head of Residential Agency

Prime Central London residential sales market

Overall, transaction levels have been gradually increasing during 2017 however the Y-o-Y growth of 3.1% in PCL is interesting in that whilst the largest quantity of transactions is in the sub £2m bracket, the growth levels have been experienced in the £2m-£5m and £5m+ brackets (20.7% and 19.1% respectively) which tend to be more sensitive.

Figure 3

Historic number of sales in PCL

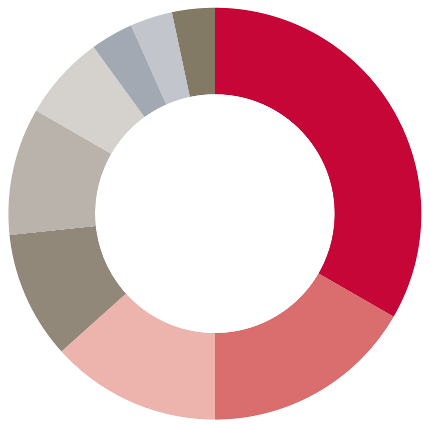


Source: *Dataloft, Lonres.com, Strutt & Parker as at 9th January 2018*

While our agents reported that new buyer registrations were up during the second quarter of 2017, the Stamp Duty Land Tax (SDLT) for second homebuyers along with a progressively harsher tax system for higher priced properties is continuing to be reported as having a severe impact on PCL house prices.

However, even with the SDLT challenges, the continued weakness in Sterling following Brexit has attracted overseas purchasers and assisted the higher value market sector activity to a degree.

Figure 4
Known PCL buyer nationalities for Q4 2017 (excluding UK domestic market)



Source: *Strutt & Parker*

"December 2017 concluded the year with increased trading evidence suggesting confidence is returning; with the levelling equilibrium between buyer affordability and vendor expectations in prime central London. This bodes well for committed parties wishing to move in 2018 as sensibly priced properties will be available for those looking to capitalise on the lull before a Brexit process conclusion is due to be reached in 2019."

Charlie Willis

Head of London Residential Agency

Prime Central London residential new homes

Across Greater London there were just over 27,000 units that began construction in 2017, a 12.6% increase compared to 2016, according to Molior. In addition, there were 22,562 units completed across Greater London in 2017, a 7.6% decrease on last year. However when looking at the PCL figures there was an increase in starts (65.9%), under construction (32.7%) and completions (22.6%) when compared to 2016.

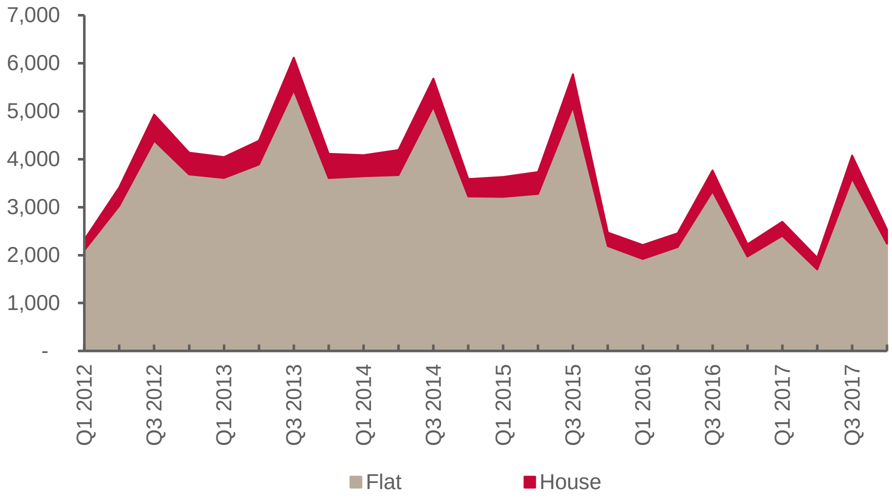
Figure 5
Construction status of new homes in PCL

Source: *Molior, Strutt & Parker as at 29th January; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster*

Prime Central London lettings market

The take-up of new rental tenancies across PCL increased by 5.5% in 2017 compared to the same period last year. However, this positive increase is down 23.7% on the five-year average for the overall year.

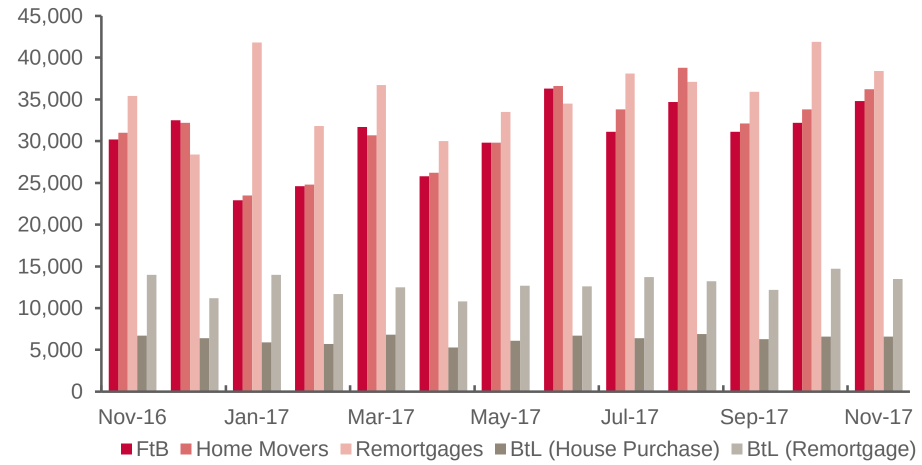
Figure 6
New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 9th January 2018*

The buy-to-let (BtL) house purchase mortgage market has seen a minor decline for November 2017 compared to the same period in 2016, according to UK Finance, as the housing market activity continues to see a moderate shift towards first-time buyers (FtB).

Figure 7
Number of New Residential Loans (monthly)



Source: *UK Finance – Mortgage Trends Update 16th January 2018*

"Changes in taxation and other rising costs in the buy-to-let space pushed some Landlords out of the market in 2017. In PCL, former vendors becoming Landlords because they cannot secure the premium price they want on the sales market have boosted rental stock. These properties let quickly and easily, as they are in turn key condition and are snapped up by increasingly discerning tenants. We expect the price at the super prime end of the market to remain strong. New build properties command a premium, while older rental stock becomes more difficult to let, so there we may see those rents soften slightly."

Kate Eales

Head of Residential Lettings

UK Average Rent: £907pcm
Source: HomeLet

Outlook & forecast

Previously it was believed that much of the downward pressure on PCL house prices due to taxation changes and Brexit had already been experienced, however, prices continued to fall during 2017 and are now 16% below their previous peak. Total transaction levels, particularly in the higher priced brackets, have picked up. Substantial economic and political uncertainty remains and it looks unlikely that this will change any time soon.

Now there have been some initial agreements reached on Brexit attention can move towards trade negotiations. The route Britain takes with these issues will have huge implications on the nature of Brexit and for this reason it is still too early to say whether there will be a soft Brexit, hard Brexit or ultimately a 'no deal' Brexit.

Transactions, despite showing signs of picking up, remain low by historic standards. PCL prices fell -3.9% in 2017. This was close to our downside risk scenario of -5%. Realistic pricing and the attractiveness of Sterling will continue to be key factors affecting market activity levels in the higher price sectors. We expect this stagnation in prices to persist during 2018 with the possibility of further negative growth as globally and domestically the economy and political environments remain volatile. From 2019 onwards it is extremely difficult to forecast this market with any certainty but we would expect some bounce back once more stability has returned.

"Whilst political and economic conditions remain uncertain, we have seen house price growth in PCL decline; however we have also seen an uplift in the number of transactions, specifically at the higher end over the last half of 2017 and therefore show no growth in 2018 as our best case scenario. And with the current Brexit negotiations underway, we continue to maintain that from 2019 onwards it is extremely difficult to forecast the housing market with any certainly, but we would expect some bounce back and a return to growth once more political stability has returned."

Vanessa Hale

Research

Table 2. Residential price forecast Q4 2017

Sales	2018	2019	2020	2021	2022	5 Year to 2022
Prime Central London ***Best case***	0.0%	4.0%	5.0%	6.0%	6.0%	23.0%
Prime Central London ***Downside risk***	-5.0%	0.0%	1.0%	2.0%	2.0%	0.0%
UK	2.5%	2.5%	4.0%	4.0%	4.0%	18.0%
Lettings	**2018**	**2019**	**2020**	**2021**	**2022**	**5 Year to 2022**
Prime Central London	0.5%	1.5%	2.0%	2.5%	2.5%	9.0%

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Methodology

As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q4 2017 in light of changes since Q4 2016. Data may also be compared on a rolling month on month basis. When referring to the PCL market it includes those markets which Strutt & Parker operate in (Knightsbridge, Belgravia, Kensington, Chelsea, Notting Hill & Fulham) and as such is reflective of London's most prime markets. Economic views are attributed to Strutt & Parker's retained economic advisors, Volterra. Additionally, Lonres.com data is used to assess the London sales and lettings market. The behavioural data is collected from our activity in PCL markets: our proprietary "behavioural data" is not representative of the UK as a whole. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.