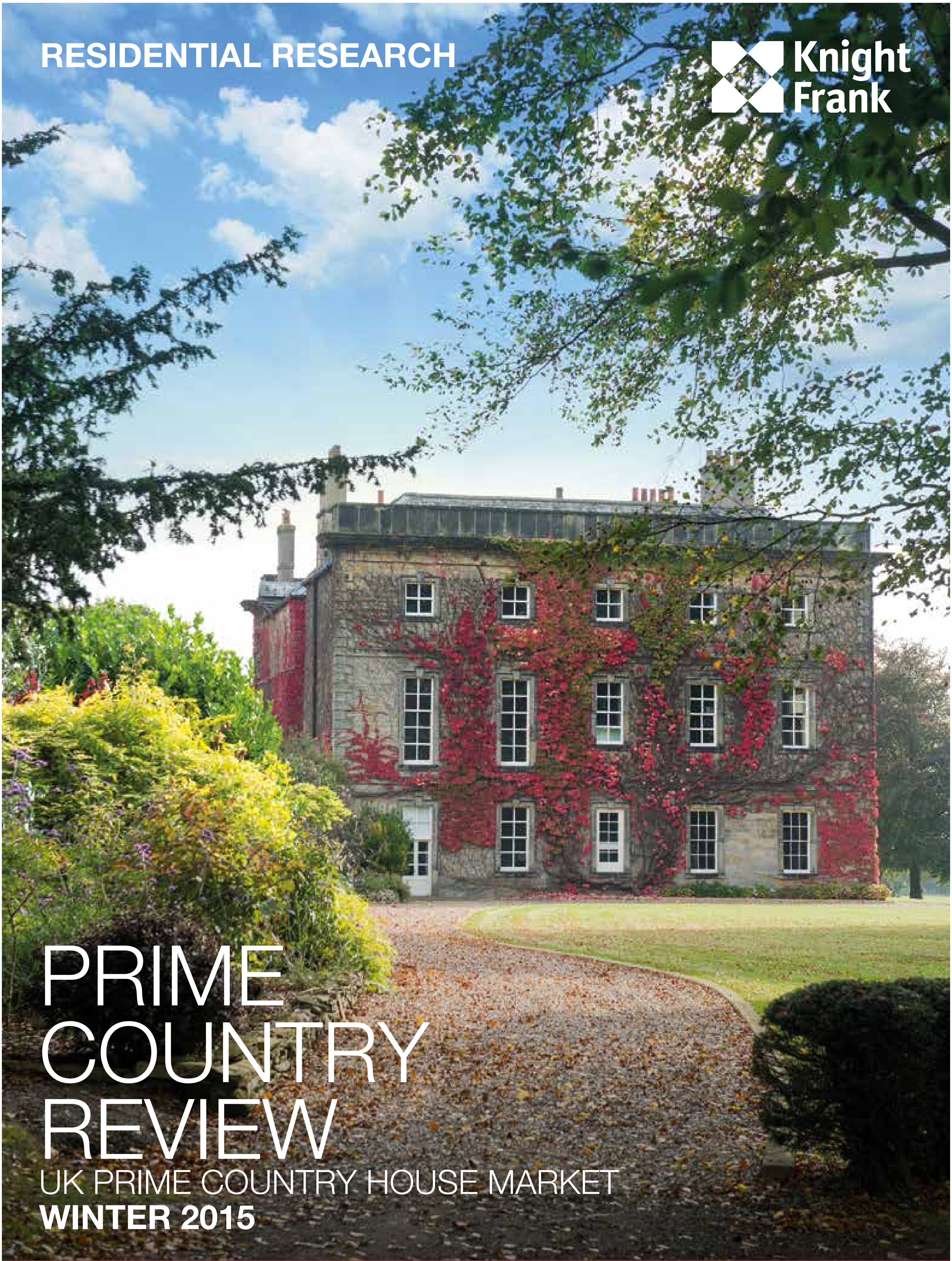


RESIDENTIAL RESEARCH

Knight Frank

PRIME COUNTRY REVIEW

UK PRIME COUNTRY HOUSE MARKET

WINTER 2015

MARKET UPDATE | RISE OF URBAN PRIME | PROPERTY TAX UPDATE

KEY FINDINGS

Prime country house prices rose by 2.7% on average over the year **to September**

Stamp duty reform, announced in December 2014, **continues to weigh on activity and price growth at the top end of the market**

In Scotland the level of LBTT for sales between £750,000 and £2 million is on average 55% **higher than the equivalent Stamp Duty payable across the rest of the UK**

Price growth in prime town and city markets including **Oxford, Bath and Bristol** has been relatively robust

Farmland values remained steady in Q3 2015 **as the market enters a period of equilibrium**

OLIVER KNIGHT
Senior Analyst

"While the general trend has been for more subdued growth, there are a number of prime markets around the UK that have outperformed."

ADJUSTING TO THE NEW NORMAL

Price growth in the prime country house market slowed in 2015, Oliver Knight examines the data

The annual change in prime property values over the year to September was 2.7% on average, down from a high of 5.2% last year.

Before the General Election in May, fears about a possible mansion tax and other unknowns associated with a potential change of government had meant that a number of prime buyers adopted a wait and see approach, preferring to sit on the sidelines until there was greater clarity surrounding the outcome.

That said, the expected market upswing after the Conservative Party victory did not materialise.

But while the general trend has been for more subdued growth, some prime markets around the UK have outperformed.

Such markets have been benefitting from local economic growth and job creation as well as improvements to infrastructure.

Many are also less affected by the recent changes to stamp duty, as prices on the whole fall below the higher threshold.

However, the top end of the country house market is still adjusting to the stamp duty reform announced in the Autumn Statement of December 2014.

A number of prime buyers now find themselves with a larger stamp duty liability as a result and this remains a barrier to price growth and activity as individuals become more circumspect about moving.

In Scotland, the introduction of the Land & Buildings Transaction Tax (LBTT) in April has had a similar dampening impact on the prime market. The level of LBTT for sales between £750,000 and £2 million is on average 55% higher than the equivalent Stamp Duty payable across the rest of the UK.

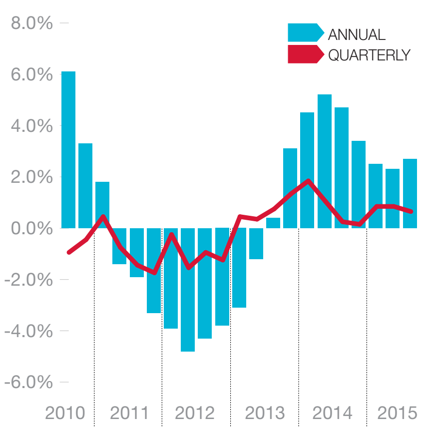
In England and Wales, the market below £1.5m has been less affected by these tax concerns with prices up by nearly 4% annually. In Scotland, activity has focused on the sub-£750,000 market.

Bright spots

Despite the challenges facing homes at the top end of the market, there are a number of locations where activity and prices have outperformed.

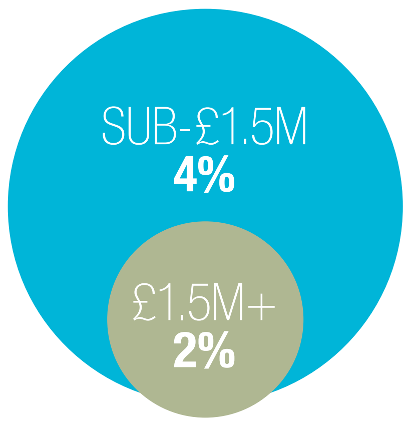
As we examine in more detail on pages 3 and 4, access to good schooling, amenities and transport links are among the factors which have driven demand in these markets. Outperformance is predicted to continue, underpinned by record-low interest rates and ongoing economic growth.

FIGURE 1
Prime country price growth



Source: Knight Frank Research

FIGURE 2
Annual price change by price bracket
Q3 2015



Source: Knight Frank Research

THE RISE OF URBAN PRIME

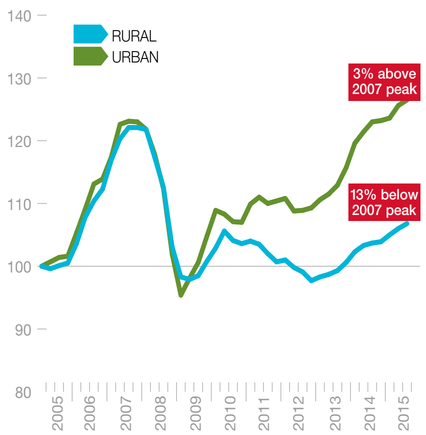
The trend towards living in a thriving town or city market has accelerated since the financial crisis, leading to the continued rise of prime urban markets

According to our indices, prime property values for homes located in town and city markets have risen by 26% since 2005 and are now 3% above their 2007 peak. In comparison, more rural properties have risen in value by 7% since 2005 and remain 13% below peak levels.

FIGURE 3

Urban properties outperform

Prime urban v prime rural property price growth (nominal)



Source: Knight Frank Research

Over the past year this outperformance has continued. This has been particularly evident in prime cities with strong commuting links to London, notably locations such as Oxford, Bath, Bristol and Winchester among others.

Economic boost

These cities have a high concentration of prime housing stock, as well as excellent transport links back to the capital.

Good schools are another big driver of prime urban markets.

In recent years, a return to economic growth has given a number of these towns and cities an additional lift with an improving business environment helping contribute towards higher demand for housing as people relocate to an area for work, or look to move up the ladder locally.

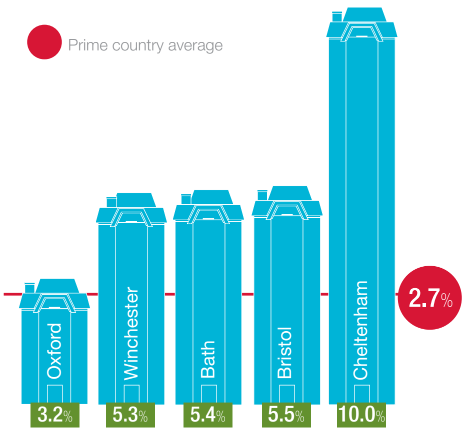
Indeed, a recent report from the British Bankers' Association noted that banking jobs are shifting from London to some smaller regional locations, with particularly strong growth in Tunbridge Wells, South Gloucestershire, Chelmsford and North Tyneside – all of which outperformed London in terms of employment growth over the last year.

Regional office take-up by businesses provides another useful measure of local job creation. Total take-up across ten regional cities monitored by Knight Frank – including Bristol, Birmingham and Leeds – was 4.78m sq ft over the first nine months of 2015, 2% higher than the comparable period last year and an 18% increase on 2013.

FIGURE 4

City outperformance

Annual change in prime property values (Q3 2015)



Source: Knight Frank Research

The maps on page 4, which show transactions in the top 10% of the market by value in 2005 and 2014, highlight how the trend towards urbanisation has evolved over time with activity coalescing in and around large towns and cities.

In 2005 there was quite an equal distribution of prime sales across the country, but by 2014 there had been changes across the Midlands, North West and Yorkshire as transactions clustered more around urban centres.

A closer look at the data shows that while the volume of sales fell by 13% across the country between 2005 and 2014, in key town and city markets sales volumes at the top end of the market increased by an average 25%.

The markets immediately surrounding London, in the South East and the Cotswolds saw the strongest growth in activity, buoyed by the fact that these markets have always been strong historically.

Looking forward

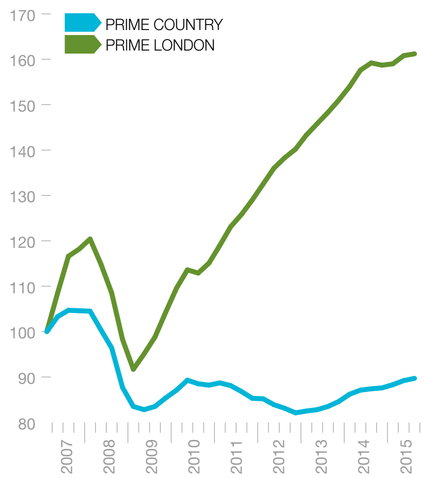
The trend for urban living is expected to continue. As the economy continues to recover and house prices outside of London show further growth, the trend for more London buyers to move will gain more traction and this will boost the ripple effect of house price growth from the capital.

Infrastructure improvements, such as faster road or rail connections or the creation of new transport hubs will enhance the appeal of these areas further still, but may also have the effect of opening up the more rural markets once again.

FIGURE 5

Prime London v Prime Country

Nominal price change (100 = Q1 2007)



Source: Knight Frank Research

Using data from the Land Registry, we can track the locations in England and Wales where prime sales occur.

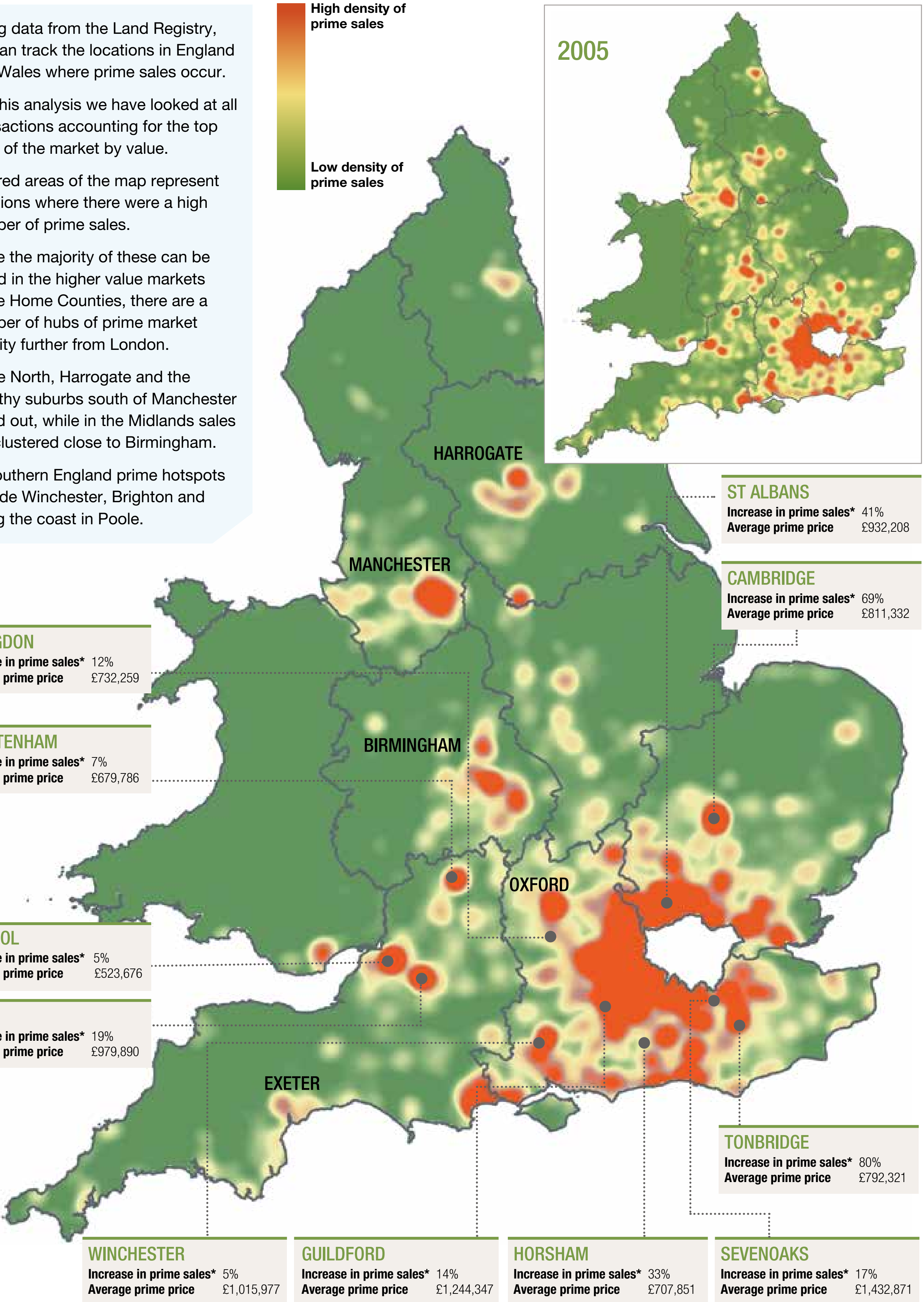
For this analysis we have looked at all transactions accounting for the top 10% of the market by value.

The red areas of the map represent locations where there were a high number of prime sales.

While the majority of these can be found in the higher value markets in the Home Counties, there are a number of hubs of prime market activity further from London.

In the North, Harrogate and the wealthy suburbs south of Manchester stand out, while in the Midlands sales are clustered close to Birmingham.

In Southern England prime hotspots include Winchester, Brighton and along the coast in Poole.



* (2005-2014) **NB:** The average prime property price refers to the average sale price of homes in the top 10% of each market in 2014

Source: Knight Frank Research / Land Registry

PRIME TAX UPDATE

There has been a succession of tax changes affecting high-value property over the last few years, both in England and Wales and in Scotland

Stamp Duty – England and Wales

Despite the fact nearly a year has passed since the Chancellor raised stamp duty for properties worth more than £1.1 million, the upper end of the prime country market continues to be held back by tax considerations.

The number of £1m sales completed in England and Wales (excluding London) in the first eight months of 2015 has fallen by 7% year-on-year. Sales above £2m are 22% lower.

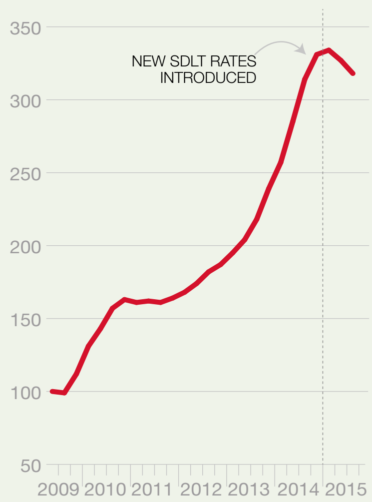
Agents note that as a result of higher purchase costs some buyers and vendors have been deciding to stay put and improve rather than move.

While it is expected that the prime country market will eventually absorb the new rates – especially as more Londoners look to take advantage of the relative price differential between property in London and the country – there is likely to be an ongoing period of adjustment during which transactions will remain subdued.

As can be seen in the chart, annual stamp duty revenue for residential property has fallen since the introduction of the new rates. The OBR has already revised its forecasts for stamp duty revenue down in the coming years –although it is questionable whether even these reduced forecasts will be met.

Receipts have become increasing reliant on the top end of the housing market, where activity has been most subdued post stamp duty reform, while the cut in stamp duty for the majority of the housing market has failed to stimulate any significant additional market activity.

FIGURE 6
Annual Stamp Duty Revenue



Source: HMRC

LBTT – Scotland

The number of sales with a value above £1m has fallen by 52% year-on-year between April and September, highlighting the impact that higher purchase taxes have had on this section of the market.

Across Scotland there were 35 such sales completed between April and September compared to 74 last year.

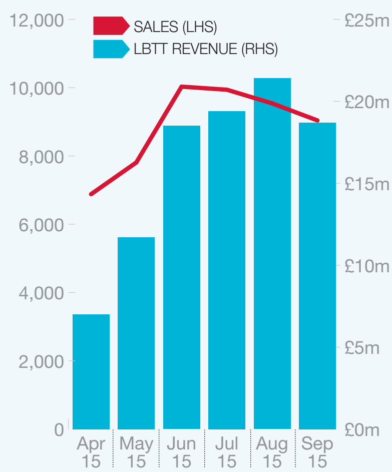
Revenue Scotland has collected around £96m in receipts between April and September and – while it is still too early to draw any firm conclusions – the initial indication is that revenues are unlikely to raise the £235m originally forecast over the 2015/16 tax year.

Negotiations between buyer and vendor have become more protracted and in some instances this has led to prices being adjusted downwards to account for the higher charge.

In fact, Scottish country house prices fell by 0.7% between July and September, the first time that prime prices have fallen on a quarterly basis in over two years. Annual price growth in the Scottish country house market slowed to 0.6% over the year to September 2015.

In the medium term, activity across the prime market in Scotland is likely to moderate slightly as the market continues to adjust to the higher rates of LBTT. The Holyrood elections scheduled for next May and a consultation on council tax reform also have the potential to cause some uncertainty in the market.

FIGURE 7
Monthly LBTT sales and receipts



Source: Revenue Scotland

FARMLAND MARKET UPDATE

Farmland values remain steady in Q3 2015 as the market enters a period of equilibrium

The average value of bare agricultural land in England rose by just 0.5% between July and September, according to the latest results from the Knight Frank Farmland Index.

Although this represents the eleventh consecutive quarter of growth and means values now stand at a record £8,306/acre, it also marks the beginning of a period of potential price stability.

Over the past five years farmland (+48%) has outperformed many other asset classes, including gold (-10%), and has even kept pace with London's luxury residential market (+43%).

This strong performance brought new buyers into the market, including a wide range of investors from both the UK and abroad.

However, potential purchasers, particularly farmers, have gradually become more considered in their approach to acquisitions since the beginning of 2015. This is partly due to a prolonged period of low commodity prices, but also reflects the perception that the market was reaching a peak.

Availability of farmland has also increased. So far this year around 20% more land has been advertised publicly compared with 2014.

As a result, what we are experiencing now is a market that is much more in equilibrium in terms of the balance between supply and demand.

Prices are unlikely to fall or rise to any great extent over the next few years because buyer demand remains strong, albeit cautious. Supply, while up on the previous year, is also low in historic terms and the market is unlikely to be saturated.

A sudden upwards shift in interest rates could put some pressure on more farmers to sell up, but the indications from the Bank of England seem to point to a gradual rising of rates starting in the second half of 2016.

Price variability on a local, as well as a regional level, is also likely to grow as a dominant theme of the market.

Extremely high prices will continue to be paid for large blocks of top quality land where a number of buyers are in the running. Where interest is more limited, vendors will need to temper their expectations.

ANDREW SHIRLEY
Head of Rural Research, Knight Frank

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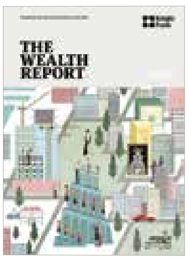

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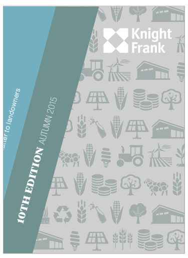

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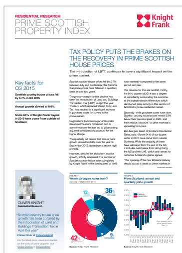

Prime Scottish Index - Q3 2015

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Front cover image: Brandsby Hall, near York.
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