POST BUDGET 2010

MARKET OUTLOOK RESIDENTIAL

Knight Frank

The emergency budget and the housing market

The most obvious point to take from George Osborne's first budget was the seriousness of intent. It was a more hard-hitting statement than had been expected, with the objective of reducing the UK's budget deficit from 11% of GDP to 2% by 2015. No other country is planning public spending cuts of anything like the size required to meet the new government's deficit targets.

The impact of the fiscal retrenchment is significant, representing 6.3% of GDP over a five-year period, and the risk this poses for the UK economy is significant, especially as the country is barely moving out of recession.

The budget wasn't all about spending cuts, taxpayers will need to bear some of the pain due to the severity of the problems the country is facing. By virtue of the heavily trailed advance warnings from the government, Capital Gains Tax (CGT) was always going to be the main story from this budget. In reality the rise to 28% for higher rate tax payers is a nonissue for the housing market.

The rise came into play overnight, meaning that there was no opportunity for a sudden sell-off of second homes or investment properties. The new rate effectively takes us back to a level last seen under the pre-2008 rules, when taper relief enabled a 40% headline rate of CGT to be reduced to 24%. With higher-rate CGT at 28% the argument for property investment still looks strong, and capital gains still compare very favourably with income tax at 40% or even 50%.

While the budget confirmed that the new 5% higher rate of Stamp Duty would be introduced for residential property purchases from April 2011, there was a tacit acceptance that Stamp Duty rates are beginning to hit levels where purchasers are being encouraged to exploit more creative opportunities for avoidance.

The government announced that they would examine whether changes to the rules on stamp duty land tax on high value property transactions are needed to prevent a reduction in tax take.

Wealth taxes back in the spotlight

As set out in the coalition agreement, the government announced that it will review the taxation of non-domiciled individuals. This review will assess "whether changes can be made to the current rules to ensure that non-domiciled individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK." The ultimate impact of this review will be difficult to pre-judge, as there is a sharp divergence of opinion regarding 'non-doms' between the Conservatives and the Lib-Dems.

The budget also announced that the government is looking to take "action to tackle unacceptable bank bonuses." The announcement confirmed that the Independent Commission on Banking will "look at structural and non-structural measures to reform the banking system and promote competition". In addition, the government confirmed that it would consult on a "remuneration disclosure scheme… [and would] explore the costs and benefits of a Financial Activities Tax on profits and remuneration."

There is potential from both of the above to weaken demand for prime property, especially in London. The evidence from the past two years is that raising taxes on wealthy UK residents does tend to encourage people to look overseas for alternative residency options – so far most have not actually taken up the opportunity – but the government would be wrong to assume that there would be no risk of a flight of wealthy people if these reviews were clumsily handled. The rather clean approach taken with CGT , with the avoidance of the need to reintroduce taper and indexation, suggests that we may well be seeing the beginning of a welcome return to tax simplification.

The housing market was thought to be at significant risk from measures in this budget. In reality, the changes announced seemed to be carefully considered, and the certainty created by the announcement will serve to underpin the market.

It was noticeable that the budget contained strong GDP growth forecasts for 2011 and 2012. The inference from this is that the Bank of England will be encouraged to maintain a very loose monetary policy well into 2011, if not longer.

This requirement to offset fiscal tightening through monetary policy, suggests that interest rates at their current levels could well be maintained for longer than was previously thought likely. This will underpin house prices and also contribute to ongoing low supply in the market as potentially distressed owners are protected by low mortgage payments.

With the imposition of the new 20% VAT rate being delayed until January 2011, the risk that this change might add to inflationary pressures is reduced considerably.

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POST BUDGET 2010

MARKET OUTLOOK COMMERCIAL

Knight Frank

A good budget for business, but repercussions for some markets

In broad terms, the budget was well received by business. As expected the emphasis was on spending cuts, which are to form 77% of the total deficit reduction programme, and not on rising taxation. The latter has been reflected for business by the lower than anticipated change to CGT and cuts in the rate of corporation tax.

The forthcoming spending cuts programme will place enormous pressure on the public sector, both centrally and locally. Councils may be required to balance their books, and could well direct attention towards the planning system to deliver growth and secure much needed revenue through planning related gain. No doubt conscious of the potential impact on the regional economies in particular of cutting an estimated 600,000 public sector jobs, the Government's stated intention to abolish regional spatial planning and encourage a localist agenda was somewhat counter-balanced in the Budget for areas outside the South East.

The Government is to publish a White Paper on tackling regional economic differences and will commit to a number of major regional infrastructure projects including the upgrade of the Tyne and Wear Metro, the extension of the Manchester Metrolink and the redevelopment of Birmingham New Street station. The Government will create a Regional Growth Fund to support projects in the regions that deliver returns for the Treasury and create jobs over the next two years, although full details are yet to be revealed. There are also savings in employers' NI contributions for small start-ups outside London and the South East.

Notable in its absence from protected infrastructure projects, given its Greater London location, was Crossrail, leaving its future still unclear. The knock-on effect of the introduction of the Bank Levy, from which only smaller banks and building societies will be exempt, is also more likely to impact on the UK's largest financial centre than its regional counterparts. Additionally, not all of that 25% reduction in the public sector will hit the regions, and central Government is a significant occupier of London office space.

Environmental issues were given a relative back seat. Support remains for a Green Investment Bank and the aviation tax system will be reviewed, including a potential switch from a per passenger to a per plane duty. Specific reference was made to sharp fluctuations in oil prices and the need for pump prices to be stabilised. Little was made of the potential role of clean technology and carbon reduction projects in driving economic growth, but the Budget did offer a number of opportunities for the creation of the industries and jobs of the future, not least through the reaffirmation of the Green Investment Bank and the introduction of the Regional Growth Fund.

Tough times ahead for the regions

Generally, however, there appears to be an awareness that the severity of the cuts to come will likely hit the regions hardest, which is not good news for commercial property. Most property markets outside the South East are already struggling and have shown little sign of recovering since the recession. Rising public sector unemployment and vacated office space will depress rents across all sectors and add to the (in many cases, already significant) oversupply of stock.

More immediately, the biggest impact both for property and for the economy is likely to come from the substantial increase in VAT. The temporary change in VAT made by the previous government demonstrated the potential inflationary impact of VAT rises. If inflation is driven up, will the MPC be compelled to increase interest rates? This in turn would have serious repercussions for residential and commercial mortgages, bank lending and consumer spending. The latter is already directly under threat from the VAT increase, and the retail sector is the most vulnerable to this budget. Some listed retailers have already seen their share prices fall on the back of the Budget announcement.

On balance, however, what is deemed good news for business is also good news for commercial property. Having been all too aware of the potential severity of this budget, most private industry will have considered this budget to have struck an appropriate balance between taking sufficient action to protect Britain's credit rating while not having attacked the very sector on which the Government will be relying to produce its income and to underpin its projected economic growth.

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