RESIDENTIAL RESEARCH

Knight Frank

LONDON RESIDENTIAL REVIEW

SUMMER 2018

THE DECLINING IMPACT OF STAMP DUTY | THE EFFECT OF LANDLORD TAXES ON SUPPLY IN THE SALES MARKET | THE INTEREST RATE PUZZLE

KEY FINDINGS

4.9%
The difference between old and new rates of stamp duty as a percentage of the exchange price on a £1.7m second home

1/3
The proportion of prime central London markets that reported an annual price rise in the year to June

+2.1%
The average annual rise in prices in Notting Hill in the year to June 2018

-9%
The peak to trough decline in prime central London residential pricing

TOM BILL
Head of London Residential Research

"Sentiment has become a more important driver of demand, which makes the future direction of the market less predictable."

PRIME LONDON SALES MARKET INSIGHT

Prices have adjusted to higher rates of stamp duty but political uncertainty is a rising influence on the market, says Tom Bill

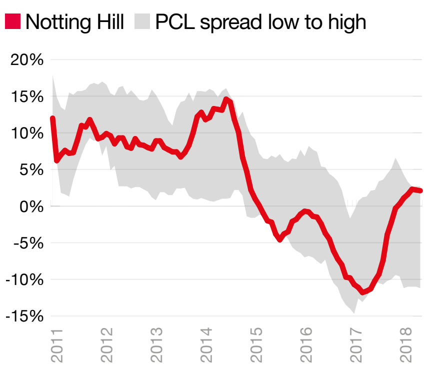
By June this year, prime central London prices had fallen 9% from the last market peak in August 2015. In prime outer London, the decline from the previous high point, which came a year later, was 6%.

The extent of the declines suggests prices in both markets are bottoming out and have adjusted for the last two stamp duty increases, which were in December 2014 and April 2016.

Based on a sample of several hundred £1m-plus sales in prime central and outer London in the first six months of this year, the average difference between old and new stamp duty charges as a percentage of the exchange price was 1.97%, rising to 4.97% when a notional 3% surcharge for second homes and landlords is added.

For example, the extra stamp duty for a £1.7m home is £83,750 or 4.9% of the sale price. Meanwhile, average prices for £1m to £2m homes fell 9.3% in the two years to June.

FIGURE 1
Notting Hill climbs to the top in PCL
Annual price growth in Notting Hill vs PCL spread



Source: Knight Frank Research

Despite this adjustment, trading conditions remain subdued by historical standards, which indicates other forces are at play.

First, while prices have adjusted arithmetically, higher upfront costs are likely to dampen activity for a period of time.

Second and more significantly, political uncertainty is having a more marked influence.

As Brexit talks continue against a fluid UK political backdrop, questions will surround the stability of the government and the political outlook of any potential new prime minister.

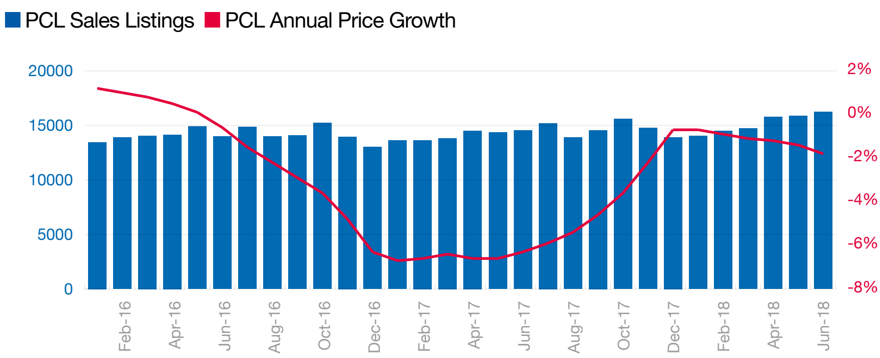
In this way, sentiment has become a more important driver of demand, which makes the future direction of the market less predictable. Underlining how individual markets have become more idiosyncratic, one third of PCL areas reported annual price growth in June whereas two-thirds reported a decline.

The area with the highest rise was Notting Hill (2.1%). One key driver of activity in W11 has been needs-driven buyers such as those moving for schooling or family reasons. As a result, it has gone from one of the weakest to one of the strongest for annual price growth over the last year, as figure 1 shows.

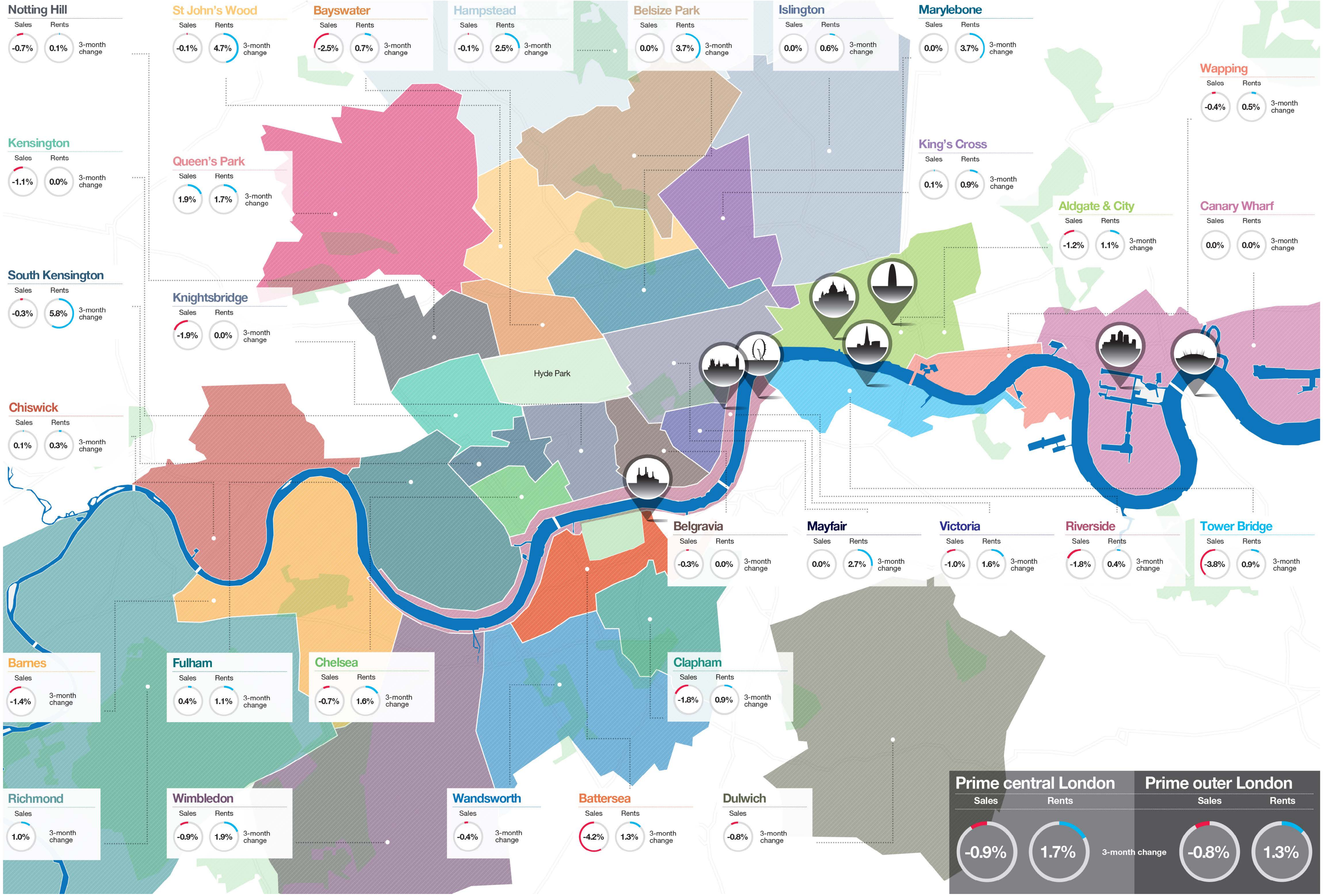
Buyers are scrutinising the market for value but sales volumes and pricing data continued to show a broad bottoming out pattern in the second quarter of the year.

One factor that is weighing on pricing is an uptick in supply, which is creeping higher as more landlords attempt to sell due to recent tax changes. It remains to be seen whether some vendors will revert back to the lettings market if pricing expectations are not met.

FIGURE 2
Recent higher levels of supply is putting downwards pressure on price growth
Supply levels in prime central London versus annual price growth



Source: Knight Frank Research / Rightmove


Notting Hill
Sales Rents
-0.7% 0.1% 3-month change
St John's Wood
Sales Rents
-0.1% 4.7% 3-month change
Bayswater
Sales Rents
-2.5% 0.7% 3-month change
Hampstead
Sales Rents
-0.1% 2.5% 3-month change
Belsize Park
Sales Rents
0.0% 3.7% 3-month change
Islington
Sales Rents
0.0% 0.6% 3-month change
Marylebone
Sales Rents
0.0% 3.7% 3-month change
Wapping
Sales Rents
-0.4% 0.5% 3-month change
Kensington
Sales Rents
-1.1% 0.0% 3-month change
Queen's Park
Sales Rents
1.9% 1.7% 3-month change
King's Cross
Sales Rents
0.1% 0.9% 3-month change
Aldgate & City
Sales Rents
-1.2% 1.1% 3-month change
Canary Wharf
Sales Rents
0.0% 0.0% 3-month change
South Kensington
Sales Rents
-0.3% 5.8% 3-month change
Knightsbridge
Sales Rents
-1.9% 0.0% 3-month change
Hyde Park
Chiswick
Sales Rents
0.1% 0.3% 3-month change
Belgravia
Sales Rents
-0.3% 0.0% 3-month change
Mayfair
Sales Rents
0.0% 2.7% 3-month change
Victoria
Sales Rents
-1.0% 1.6% 3-month change
Riverside
Sales Rents
-1.8% 0.4% 3-month change
Tower Bridge
Sales Rents
-3.8% 0.9% 3-month change
Barnes
Sales
-1.4% 3-month change
Fulham
Sales Rents
0.4% 1.1% 3-month change
Chelsea
Sales Rents
-0.7% 1.6% 3-month change
Clapham
Sales Rents
-1.8% 0.9% 3-month change
Richmond
Sales
1.0% 3-month change
Wimbledon
Sales Rents
-0.9% 1.9% 3-month change
Wandsworth
Sales
-0.4% 3-month change
Battersea
Sales Rents
-4.2% 1.3% 3-month change
Dulwich
Sales
-0.8% 3-month change
Prime central London
Sales Rents
-0.9% 1.7%
3-month change
Prime outer London
Sales Rents
-0.8% 1.3%

KEY FINDINGS

28

The number of months since annual rental value growth was last postive in prime central London, after +0.8% annual growth was recorded in June

-16%

The decline in the number of lettings listings in prime central London in the year to June 2018 versus the previous 12 months

29%

Increase in the number of £5,000+ per week lettings deals in the year to May 2018 versus the previous 12 months

70%

Number of Knight Frank market appraisals in South Kensington attended by sales and lettings, compared to under 10% a year ago

PRIME LONDON LETTINGS MARKET INSIGHT

Annual rental value growth has turned positive but tax changes mean landlords are keeping their options open, says Tom Bill

In June this year, annual rental value growth (+0.8%) returned to prime central London for the first time since February 2016.

It followed a 28-month run of declines that bottomed out at -5.2% in November 2016.

Higher rates of stamp duty was the reason the supply of rental properties grew, with more vendors opting to let their property as the impact of higher stamp duty weighed on price growth in the sales market.

Tax was also the reason the trend began to reverse. A series of levies affecting landlords means more owners have explored a sale in recent months and there were 16% fewer lettings listings in prime central London in the year to June 2018 than the previous 12-month period.

The result is that a succession of government tax changes has had a marked impact on the supply dynamics in the prime London lettings market.

The latest government plan for minimum three-year tenancies may add to the burden on landlords because fewer lenders allow three-year agreements, some have argued.

However, while rental value growth has returned, it would be premature to conclude that falling supply will continue to put upwards pressure on rental values in a sustained manner.

There is anecdotal evidence of landlords returning to the lettings market after their pricing expectations were not met in the sales market, a trend that would be exacerbated should more landlords attempt a sale and thereby increase supply levels.

In this way, the lettings market will self-correct as landlords decide whether it makes more financial sense to sell or let. This, in turn, will play a key role in determining future supply levels and rental value growth.

In an indication that downwards pressure on supply levels may not continue in a consistent or predictable way, the number of lettings listings in prime central was 15% lower in June this year compared to the same month last year. That compared to an equivalent decline of 25% in January, Rightmove data shows. This suggests the trend for more landlords to try and sell up may be slowing.

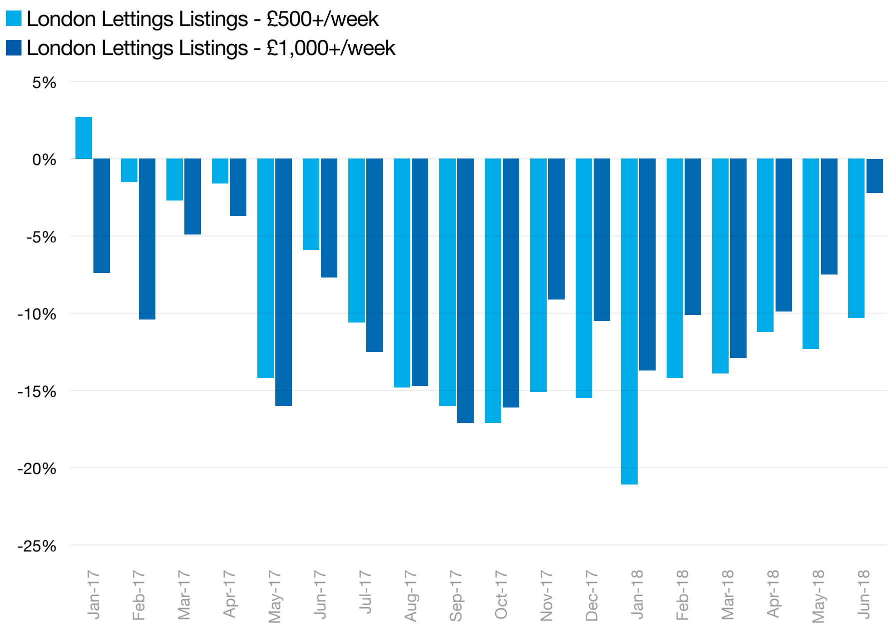
This overall mood of indecision among property owners is reflected by the fact that more are listing their property for rent and sale simultaneously. Knight Frank's South Kensington lettings office is invited to attend about 70% of market appraisals together with the sales team, compared to a rate of less than 10% a year ago as property owners explore both the sales and lettings options.

By price bracket, the number of tenancies agreed in the super-prime (£5,000+ per week) market continued to grow at the fastest rate. There were 29% more deals in the year to May 2018 than the previous 12-month period. This was due to higher rates of stamp duty at the higher-value end of the sales market, in addition to uncertainty surrounding Brexit and the trajectory of price growth.

FIGURE 3

Year-on-year declines in lettings listings have begun to recede

Year-on-year % change in the number of lettings listings in PCL and POL at £500+ and £1,000+/week



Source: Knight Frank Research / Rightmove

MACROVIEW THE INTEREST RATE PUZZLE

The economic and political backdrop to the prime London market was marked by a mood of uncertainty in the second quarter of the year.

The erratic flow of economic data meant many market watchers pencilled in an interest rate rise one week before having to reach for their erasers the next. This mood of indecision was captured by a Bank of England survey that asks people whether they think rates will rise or fall over the following 12 months.

In June this year, a quarter of respondents replied “no idea”, which was the highest figure since the poll began in 1999.

Lenders have responded by pushing their 10-year fixed rate products harder, some of which include deals with a penalty-free option to break after five years, which is one way to hedge against short-term uncertainty.

However, few doubt that a rise is coming in 2018 and the chances appeared to grow in June when Bank of England chief economist Andy Haldane signalled he would back a rise in the second half of the year and the pound duly strengthened.

In a wider sign of how the era of loose monetary policy is coming to an end, European Central Bank president Mario Draghi also said its asset purchase programme would end in December.

For property investors, in a world where central banks are doing less of the heavy lifting by holding rates low, it means finding returns will become more of a skill.

While monetary policy normalises, the political backdrop remains uncertain. The recent ministerial departures have raised the stakes at Westminster and the longer-term ramifications of deeper cross-party alliances on the subject of Brexit remain to be seen.

However, the shifting nature of geopolitics could also help change the calculations on both sides of the negotiating table in the second half of the year.

The fact that US President Donald Trump has threatened to impose tariffs on European car manufacturers may mean the growing global risks from protectionism are brought into starker relief and a path of compromise becomes more inviting.

The other area where the debate is shifting is immigration. The new administration in Italy has been described as the first populist government in Western Europe since the Second World War and its tougher stance on immigration has reopened a debate within the EU. This debate includes freedom of movement, one of the four pillars of single market membership.

As the UK moves towards its departure date from the European Union of March 2019, it appears unlikely that negotiations will proceed in a way that is impervious to such external events.

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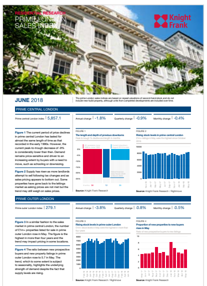
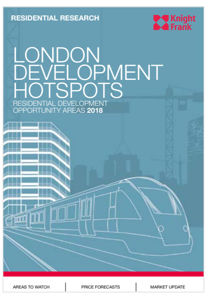
The Wealth Report 2018


Prime London Sales Index June 2018

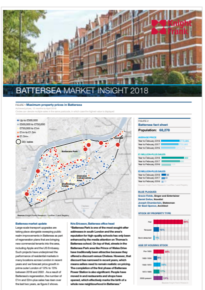

Prime London Lettings Index June 2018

Super-Prime Sales Insight 2018

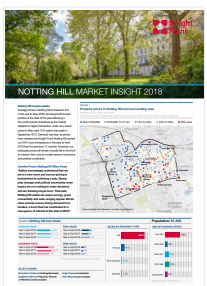


London Hotspots

St John's Wood market insight 2018



Battersea market insight 2018



Notting Hill market insight 2018