Residential Quarterly | Spring 2017

Research - Market View

Economic Outlook

There have been several key events in UK politics recently. Most notably, Prime Minister Theresa May activated Article 50 starting the process of the UK exiting the EU. Additionally, she has called for a General Election to be held on 8th June 2017 which has been approved by MPs, continuing political upheaval over the short term.

Looking throughout Western Europe there are signs of discontent amongst the working and middle classes. Resulting in a rejection of constitutional reform in Italy, rising popularity for right wing parties in Austria and Germany and the increasing support for both far right and hard-left candidates in France. Throughout 2017 there are several election dates abroad that may impact upon the market. Although they may not directly affect the domestic UK market they will indicate the direction of world politics and which the world economy may take, having potential knock on impacts in the UK. The outcomes of these elections are likely to have an impact upon Brexit negotiations.

Despite uncertainty, the UK economic fundamentals appear to be broadly positive, albeit with some caution. The ONS estimates that around 2.0% GDP growth was achieved in 2016. This was slightly less than the 2.2% increase predicted by the IMF at the start of 2016 but nevertheless considerably more positive than many expected following the EU Referendum.

The OBR predicts an outlook of 2.0% for economic growth in the UK in 2017. Her Majesty's Treasury (HMT) publishes views from several independent forecasters and the consensus is for GDP to grow by 1.7% during 2017. However, the range of opinions goes from 1.1% to 2.6% and is still relatively large. That said the spread is substantially less than the previous HMT estimates which ranged from -1.3% to 2.5%. Most commentators are now not expecting a recession or a significant slowdown during 2017.

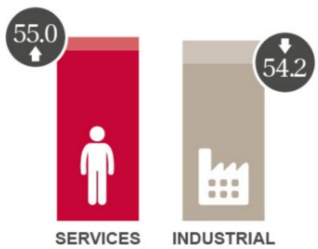
The British Chamber of Commerce's Quarterly Economic Survey for Q1 2017 reports solid growth and generally good business confidence. The optimism is cautious, however, with inflation and rising business costs (such as apprenticeship levy, business rates and living wage) identified as risks which may squeeze prices in the future.

The Consumer Price Index (CPI) growth had been low throughout 2016, however by November it was 1.2% and has increased in 2017. Inflation is now at 2.2%, slightly above the Bank of England's target rate of 2.0%. However, the Bank of England, after cutting the UK base rate to 0.25%, has stated it will tolerate some inflation over the short-medium term. In terms of retail sales, since February 2016 the quantity bought has decreased by 1.9%, the amount spent decreased by 0.7% and average store price increased by 1.2%.

Despite a brief slump in the wake of Brexit, the FTSE 100 was on an upward trend during 2016, finishing the year with growth of almost 20%. Since the turn of the year the FTSE 100 has grown by circa 4.0%.

2%

2016 GDP expected at 2%



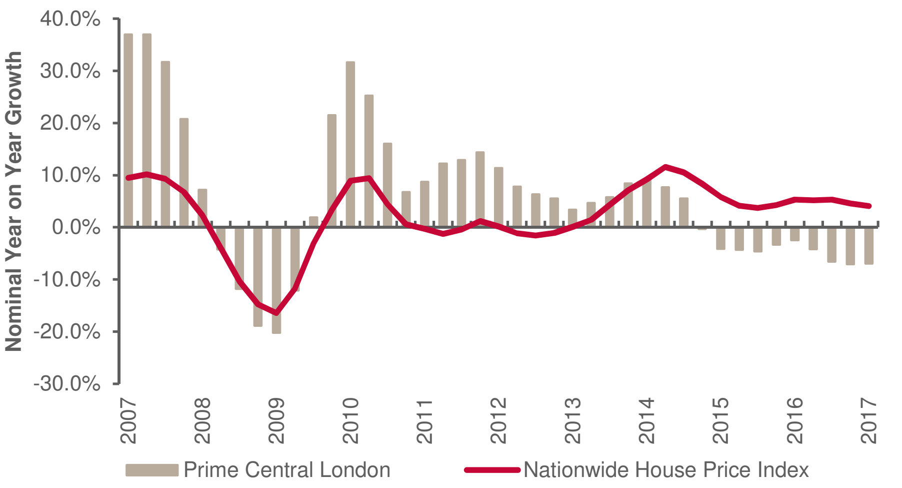
PMI Services up from 53.3 & PMI Industrial down from 56.1

Unemployment fell by 45,000 to 1.6million people (falling marginally to 4.7%)

Property market pricing

National house prices rose 4.1% in the year to Q1 2017. London has historically been the primary driver of national house price growth but during 2016 the region was outperformed by the Outer South East, East Anglia and the South West. Prime Central London (PCL) however tells a different story. Prices across PCL fell by approximately 7.0% in 2016, leaving values around 13.0% down from the 2014 peak. There has, however, been a slight upturn in purchaser activity and realistically priced, good quality stock is selling reasonably well.

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



Source: *Nationwide House Price Index, Volterra*

UK property prices grew 4.1% Y-o-Y in Q1 2017

UK residential sales transactions

Table 1. Number of registered properties sold by property type for Q1 2017

Region	Detached	Semi-Detached	Terraced	Flats
East Midlands	2,157	2,221	1,766	415
East of England	2,596	2,355	2,491	1,338
Greater London	413	1,339	2,534	3,712
North East	518	1,084	1,194	334
North West	1,672	3,229	3,420	939
Scotland	4,418	3,455	4,544	7,510
South East	3,264	3,219	3,682	2,624
South West	2,634	1,987	2,551	1,483
Wales	1,144	1,138	1,381	253
West Midlands	1,692	2,377	2,158	712
Yorkshire and Humber	1,446	2,506	2,327	589

Source: *Dataloft, Land Registry as at 7th April 2017; Registers of Scotland as at 2nd May 2017*

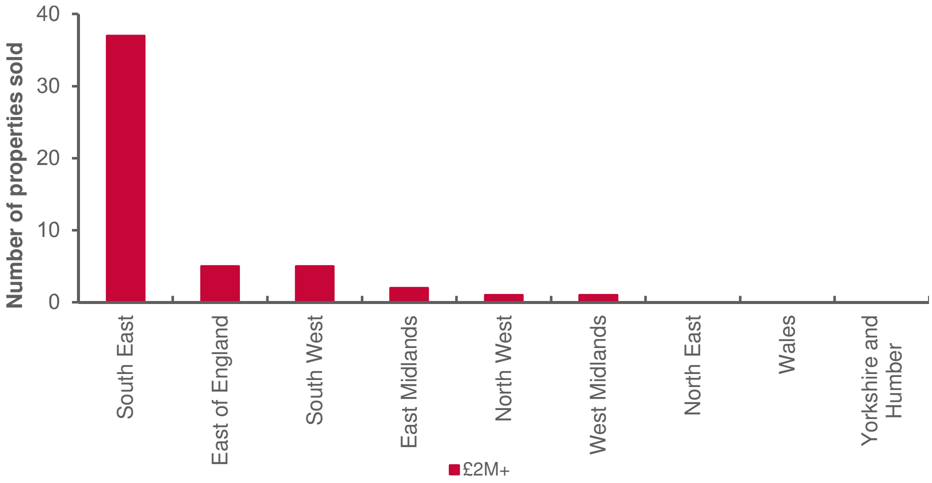
Greater London prices are now 60% above the 2007 peak

Country house highlights

The combination of geopolitical events and higher purchase costs as a result of the stamp duty land tax (SDLT) increases over the past few years have impacted the country house market. Through our analysis, however, we know that the market continues to attract buyers who are employed in finance (30.0%), property (13.0%) or agriculture (12.0%) and who seek their primary home (76.0%). Due to the house price halo effect, the sale of £2M+ homes outside of Greater London is currently the strongest in the South East.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in Q1 2017



***Source:** Dataloft, Land Registry as at 7th April 2017*

"In the regions we are seeing higher transaction levels than this time last year and prices are holding up. The main drag on the market is the time it is taking for transactions to go through – currently around 12 weeks on average. More legislation and an increased number of hoops to jump through is elongating the process."

Guy Robinson

Partner

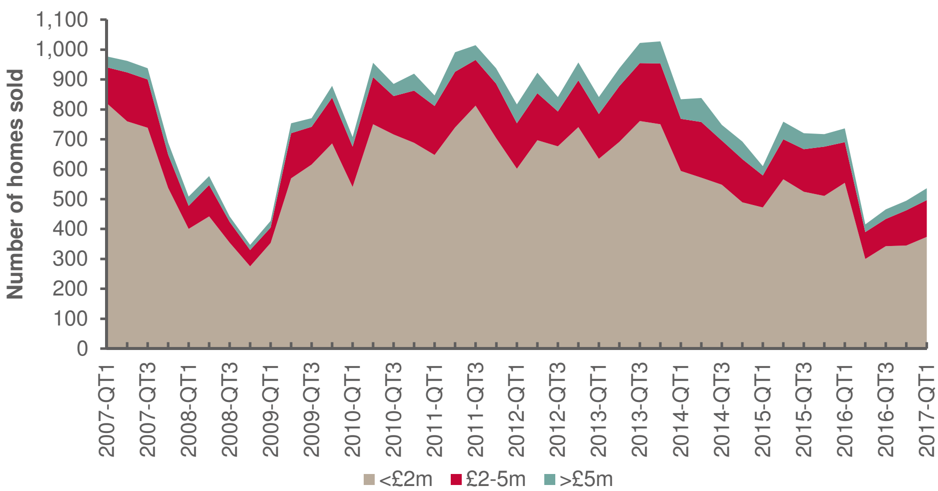
Head of Regional Residential Agency

Prime Central London residential sales market

Transactions in the sub £2M market in PCL saw a decline of 32.0% when comparing Q1 2017 to Q1 2016, however the entire PCL market is now only down 27.0% for the same time period and follows three consecutive quarters of increased transactions. These muted transaction levels in PCL still remain a cause for concern as the longer transaction levels remain low, the bigger the risk of further price deflation.

Figure 3

Historic number of sales in PCL



***Source:** Dataloft, Lonres.com, Strutt & Parker as at 7th April 2017*

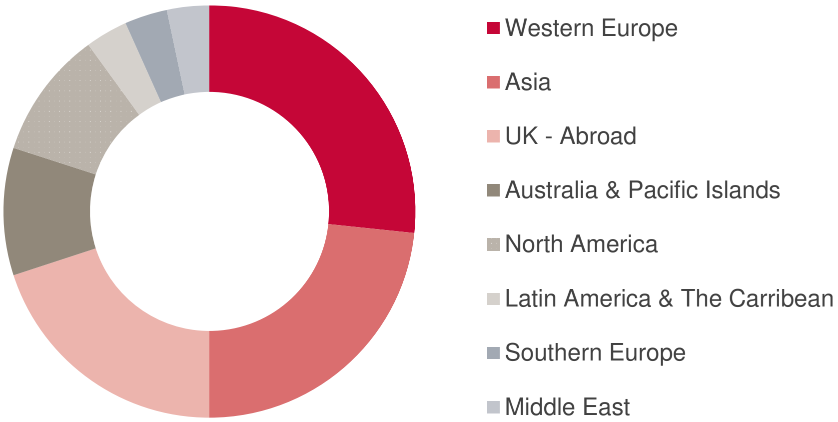
It is believed that the market may have already experienced the bulk of price falls. In addition, the recent weakness in sterling has played a part in attracting overseas purchasers and given a spur to higher value market sector activity. However, we continue to see the dominance of UK domestic buyers in the PCL market, with UK expat money seeking homes in the country over £2M, likely taking advantage of the US dollar strength against the UK pound.

"We have seen a positive change in buyer sentiment and an uplift in transaction levels in the first quarter of 2017 compared to the end of last year. Values have now softened by up to 10% and buyers realise there are good opportunities out there. Meanwhile sellers are beginning to understand the importance of realistic pricing. Stamp Duty which was a concern for many buyers last year, is no longer causing such an issue and the market has absorbed this extra taxation."

Charlie Willis

Partner
Head of London Residential Agency

Figure 4
Known PCL buyer nationalities for Q1 2017 (excluding UK domestic market)

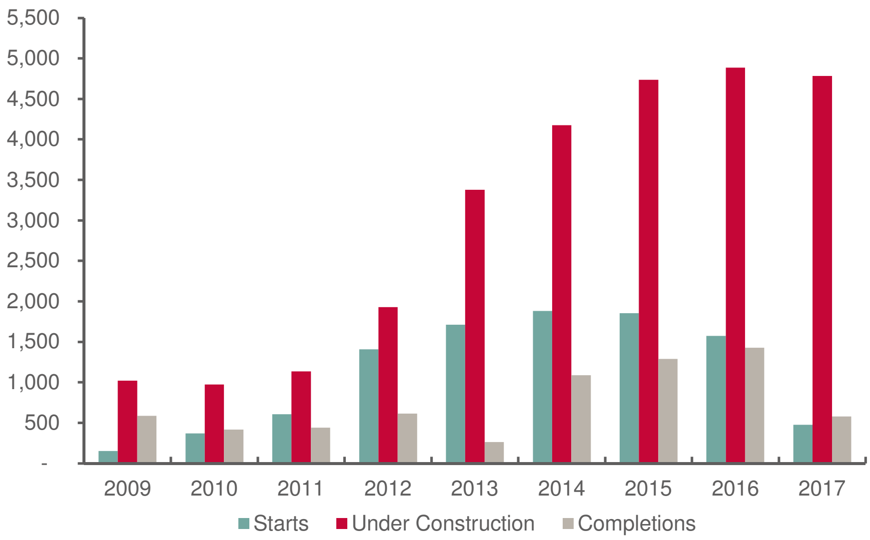


Source: *Strutt & Parker*

Prime Central London residential new homes

According to Molior, there were approximately 6,150 units that began construction (starts) during the first quarter of 2017 across Greater London, with 477 of these units being within the PCL boundary. This is a decrease of 44.0% compared to the first quarter of 2016 for PCL. However, there has been only a marginal decline (5.0%) in sales across PCL when comparing Q1 2016 to Q1 2017.

Figure 5
Construction status of new homes in PCL



Source: *Molior, Strutt & Parker as at 26th April 2017; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster*

Prime Central London lettings market

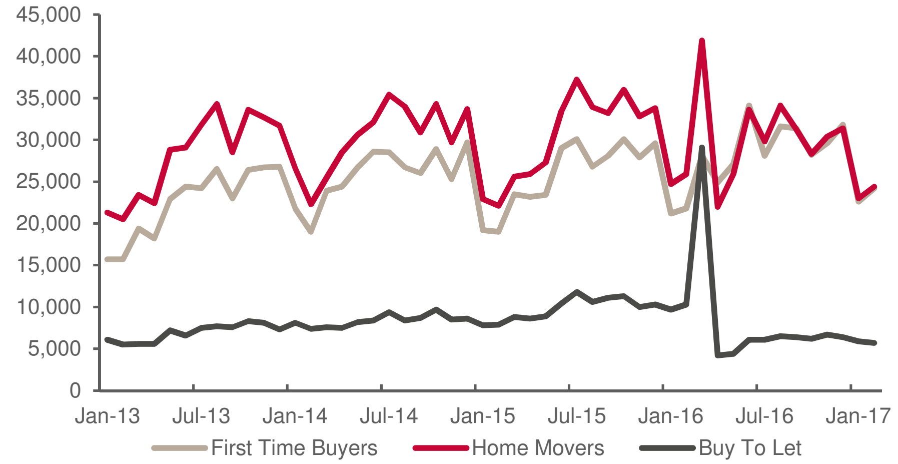
The take-up of new rental tenancies across PCL increased by 22.0% in Q1 2017 compared to the same time last year.

Assessing pricing levels across rental product in PCL and the wider UK can be challenging, however HomeLet is reporting via their tenant referencing service that the combined boroughs of Kensington & Chelsea and Hammersmith & Fulham delivered an average rent of £1,823pcm (1.2% annual increase) and an overall 1.1% annual increase in rents across the UK.

UK Average Rent: £904pcm (HomeLet)

Figure 6

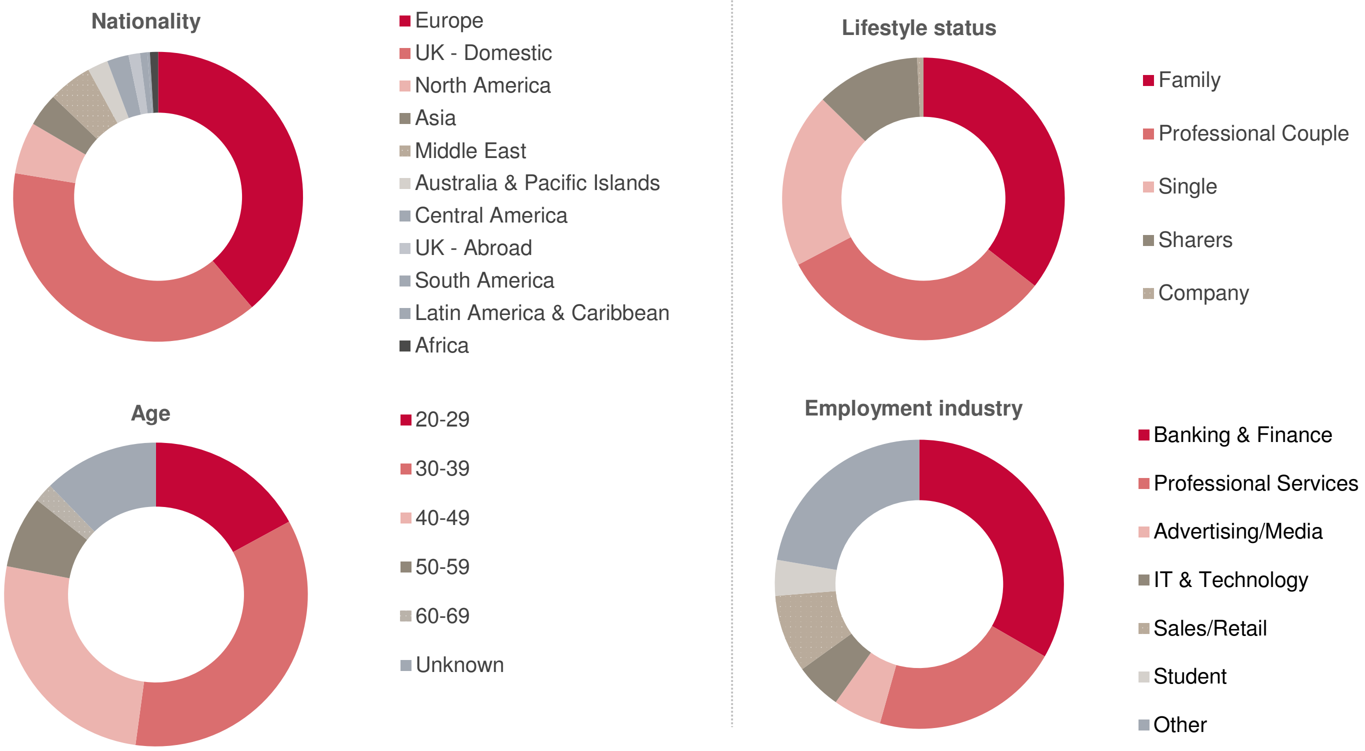
Number of new mortgages for home purchase by buyer type, non-seasonally adjusted in the UK



Source: *CML Regulated Mortgage Survey, Bank of England as at 5th April 2017*

Figure 7

Tenant profiles in PCL Q1 2017



Source: *Strutt & Parker*

Outlook & forecast

Much of the downward pressure on PCL house prices because of Brexit and SDLT has likely already been experienced and although the UK and the world remain in a period of substantial economic and political uncertainty, the outlook for the UK remains reasonable.

The immediate focus should be placed on how Britain will fare with the Brexit negotiations, now that Article 50 has been triggered and the General Election has been called for June of this year. The weaker sterling has been an incentive to international investors to buy UK property but if the US dollar slides it may lose some comparative advantage.

Transaction levels reportedly picked up slightly at the end of 2016 and have continued to do so into 2017, although they remain low by historic standards. Realistic pricing and the continued attractiveness of sterling will continue to be key factors affecting market activity levels in the higher priced sectors.

"Although transaction volumes seem to be picking up across the PCL market, we continue to be mindful of the political uncertainty in the UK and across the globe, when forecasting."

Vanessa Hale

Partner
Research

Table 2. Residential price forecast Q1 2017

Sales	2017	2018	2019	2020	2021	5 Year to 2021
Prime Central London ***Best case***	0%	0%	8%	8%	8%	26%
Prime Central London ***Downside risk***	-5%	-5%	4%	4%	4%	2%
UK	3%	3%	4%	4%	4%	19%
Lettings	**2017**	**2018**	**2019**	**2020**	**2021**	**5 Year to 2021**
Prime Central London	0%	2.5%	2.5%	2.5%	2.5%	10%

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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 Q1 2017 in light of changes since Q1 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.