STRUTT & PARKER

Regional Residential Quarterly I Autumn 2016

Research - Market View

UK Economic Outlook

The political and economic outlook on the global stage is subject to considerable uncertainty, while a growing resentment to free trade and movement will likely lead to changes in the approach world institutions take to brokering future international trade deals. The EU has already shown signs that there is reluctance to continue with the mantra of free trade, increasing tariffs on Chinese steel from 22.6% to 73.7%.

Following the result of the EU Referendum the UK Government has begun to prepare itself for triggering the formal process of leaving the EU, through Article 50 by the end of March 2017. Data shows UK GDP had been growing before the referendum, with growth rates of 0.4% and 0.7% in Q1 and Q2 2016 respectively and, despite a recent increase, inflation remains relatively low.

The central HM Treasury Consensus forecast is that GDP growth this year will be 1.9% and 1% next year, which is in line with the OECD's, estimates which are 1.8% and 1% respectively. However, uncertainty around these forecasts persists, particularly for next year.

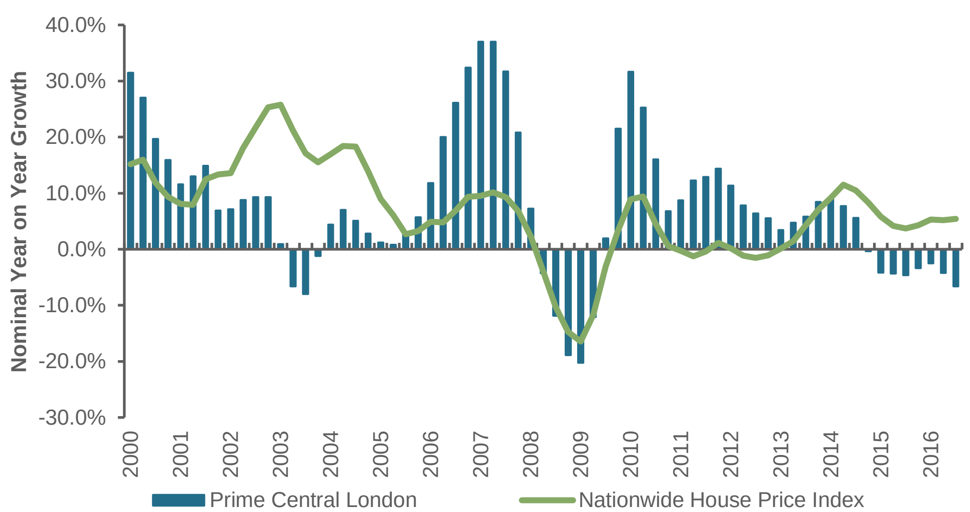
In response to Brexit the Bank of England reduced the base rate from 0.5% to 0.25%.

National property market

According to Nationwide, in 2016 London house price growth was below the national growth rate, which has been driven by growth in other regions, most notably East Anglia and the Outer Metropolitan area of London. PCL house prices have declined by almost 10% over the past year. Q3 2016 reported prices falling by circa 3%.

The latest data shows that YoY growth across London fell from 12% in Q4 2015 to 7% in Q3 of this year. In all likelihood London house price growth will be less than the rest of the UK for 2016.

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



Source: Nationwide House Price Index, Volterra

Market focus

New underwriting standards for buy-to-let market

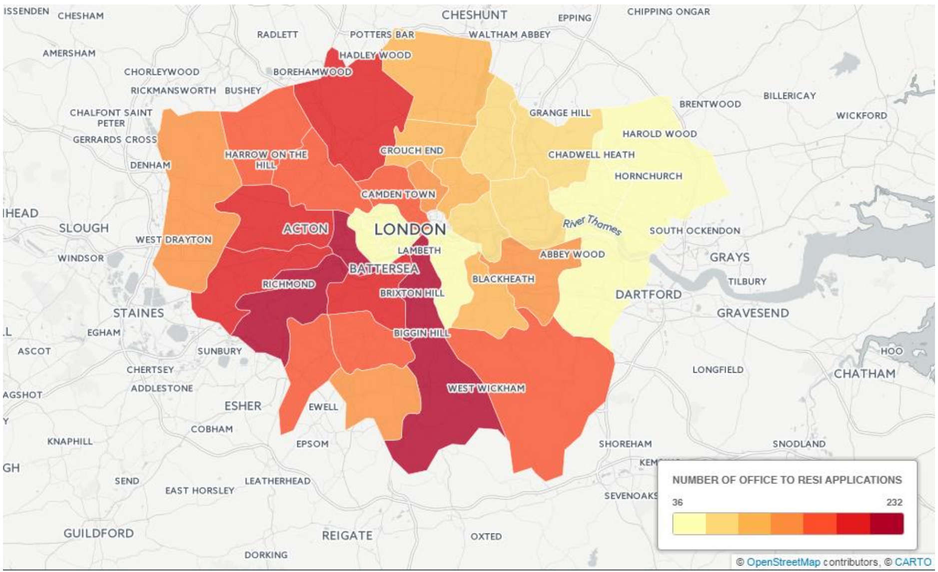
On 29th September 2016 the Prudential Regulation Authority (Bank of England) issued its supervisory statement on underwriting standards for buy-to-let mortgage contracts. Outlined below are three key points from the new policy statement.

- The affordability assessment of a buy-to-let loan will require firms to either use an interest coverage ratio test and/or determine whether personal income is sufficient to meet mortgage repayments. For stress testing purposes the minimum borrower interest rate will be at 5.5%.
- Borrowers with four or more mortgaged buy-to-let properties will be classified as portfolio landlords and subject to specialist underwriting standards.
- Firms will be required to implement the changes to interest coverage ratio tests and interest rate stress tests by 1 January 2017, with the remainder to be implemented by 30 September of that year.

A new west side story

According to data from the UK Department for Communities and Local Government, 2,689 office to residential prior approval applications have been received by London boroughs between April 2014 and March 2016. Approval has been granted for 76% of applications (2,046).

Figure 2. Number of office to residential prior approval applications by London Boroughs, April 2014 – March 2016



Source: Department for Communities and Local Government, Strutt & Parker

Figure 2 clearly shows that while the inner London boroughs have secured exemptions from the permitted development rights regulation, West London Boroughs are experiencing the most activity. Hammersmith and Fulham in particular have received the highest number (232) of prior approval applications of any London borough between April 2014 and March 2016.

"The relaxation of the rules will certainly help London deliver more housing. However it is not a golden panacea and should be viewed as just one of a series of initiatives the Government and the Mayor will need to consider if it is going to get London building anywhere near the number of homes it needs.

Other initiatives must include densification e.g. through Estates regeneration and dare I mention it …. Green Belt release within the outer London boroughs."

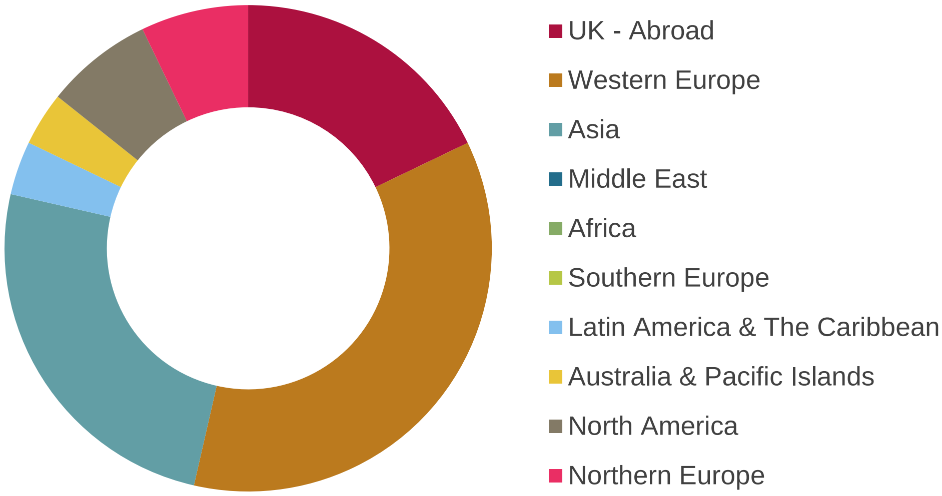
- David Phillips, National Partner, Head of London Planning

Prime Central London second-hand sales market

Strutt & Parker data for the third quarter of 2016 showed a small uplift of 4.6% in UK domestic market buyers when compared to the same period last year. However, despite the Brexit vote and the continuing uncertainty, PCL still retains its attractiveness to overseas buyers with a slight increase of buyers coming from both Western Europe and Asia relative to Q2 2016.

Data shows that the volume of sales have fallen by 47% between Q3 2015 and Q3 2016.

Figure 3. Known PCL buyer nationalities for Q3 2016 (removing UK – domestic market)



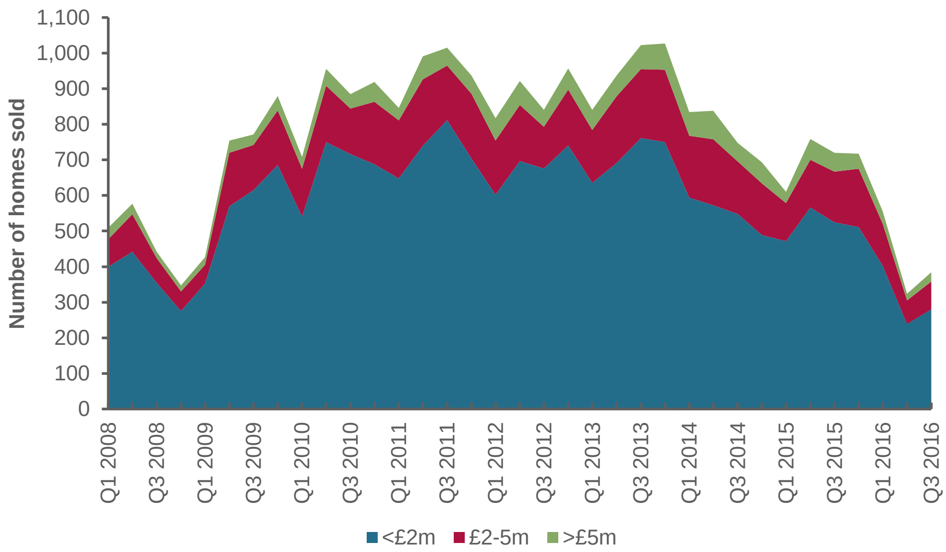
Source: Strutt & Parker

The low volume of transactions is indicative of a market where only properties at realistic prices with motivated sellers are completing.

By the numbers

A total of 384 properties were sold during the third quarter of 2016, which was an overall decrease of 46.7% when compared to the same period in 2015.

Figure 4. Historic number of sales in PCL

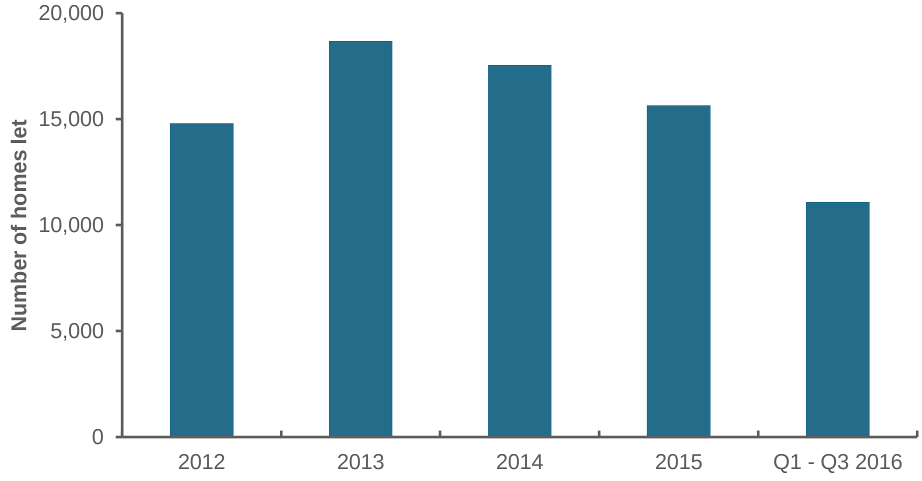


Source: Dataloft, Lonres.com, Strutt & Parker

Prime Central London lettings

There were 3,695 property lets agreed in PCL during the third quarter of 2016, which was 36% down compared to the third quarter of 2015.

Figure 5. Historic agreed lets in PCL



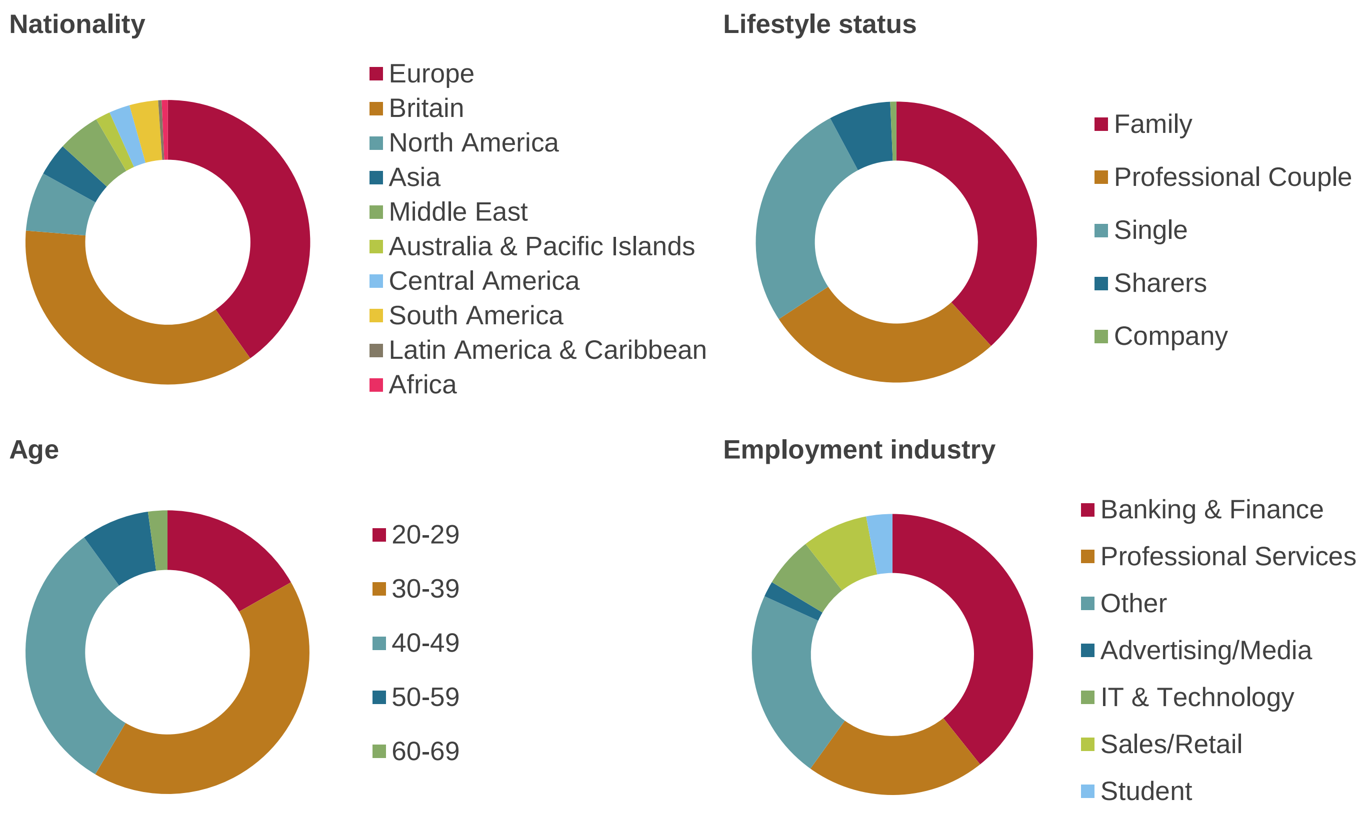
Source: Dataloft, Lonres.com, Strutt & Parker

"Despite volumes being down year on year we have seen tenancy length increase, as well as a surge of demand in 'super prime' with transactions up 50 % year on year for properties over £8,000 per week."

- Kate Eales
Partner, National Head of Lettings

The current economic conditions and SDLT for additional homes are having an impact on the lettings market in PCL. However, Knightsbridge and Belgravia reported that volumes were up 10% compared to Q2 2016.

Figure 6. Tenant profiles in PCL Q3 2016



Source: Strutt & Parker

UK residential sales market

Table 2. Number of Properties Sold by property type for Q3 2016

Region	Flats	Houses
East Midlands	449	8,227
East of England	1,737	9,979
Greater London	5,321	4,516
North East	394	3,465
North West	1,142	11,156
Scotland	9,517	17,431
South East	3,266	13,572
South West	1,785	9,826
Wales	340	4,587
West Midlands	828	8,252
Yorkshire and Humber	719	8,509

Source: Dataloft, Land Registry, Registers of Scotland, Strutt & Parker
Data for the regional figures includes the latest reported transactions through June 2016

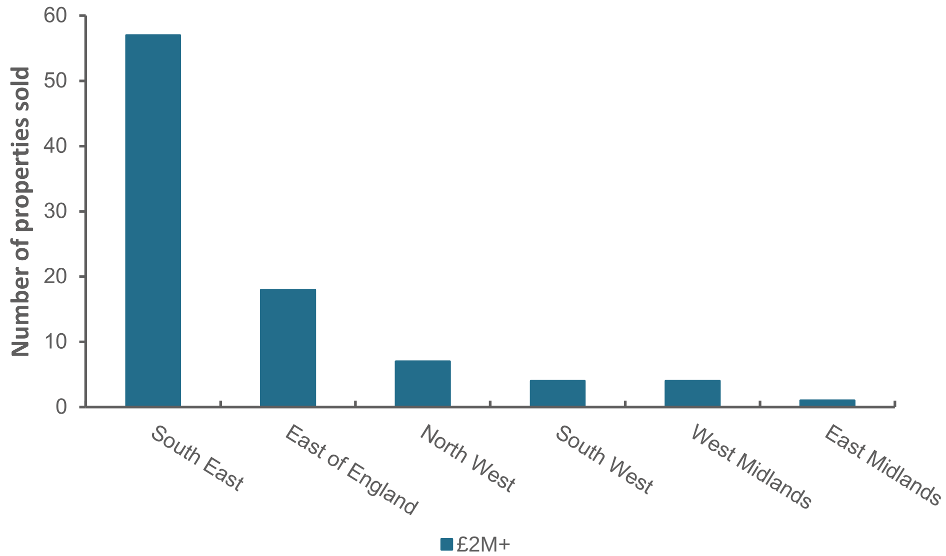
"Activity has improved within the £3m-£6m prime country house market with the majority of sales being agreed to British buyers"

- James Mackenzie, Head of Country Department

Country house highlights

Transaction volumes remained steady in the third quarter of 2016 (compared to third quarter 2015). Last year experienced a slow-down due to the pending General Election and this year the market was subjected to the SDLT on additional homes and the EU Referendum. The South East shows the highest level of activity with 57 houses sold in Q3 2016.

Figure 5. Number of properties over £2m+ sold (England & Wales excl. London)



*Source: Dataloft, Land Registry, Strutt & Parker *North East, Wales and Yorkshire & Humber did not have any transactions over £2M+ recorded as at 7th October 2016*

Outlook & forecast

The increase in Stamp Duty Land Tax (SDLT) for additional homebuyers, combined with a gradually more punitive tax system for the wealthy has been reported to have had a bigger effect on PCL house prices than Brexit, and has slowed demand. The outcome of Brexit for the UK economy, and its particular impact on financial institutions' location choices remains to be seen, but a prolonged period of uncertainty is likely as negotiations continue, even after Article 50 is triggered. Going forward, with more sellers being prepared to review pricing and entertain reasonable offers, the market may have found a level which will provide a spur to transaction levels, and as a result, there may be a lessening of downward pressure on prices. The market is expected to continue to experience low transaction levels as buyers and sellers await more certainty on the economic outlook, and as such the risk is predominantly on the downside. Although the implications of Brexit will not be fully understood for some time to come, the PCL market is likely to remain a safe haven for investors' money in the long term and therefore price growth is expected to return from 2019 onwards.

"The regional property market has improved since the EU referendum and we expect stronger trading conditions to continue through autumn/winter.

Negotiations over Brexit are likely to be protracted and complicated, but it's 'business as usual' in the regional market, with realistically priced property attracting good levels of interest from buyers"

- Guy Robinson, Head of Regional Residential Agency

Table 2. Residential price forecast Q3 2016

Sales	2016	2017	2018	2019	2020	5 Year to 2020
Prime Central London – best case	-10%	0%	0%	8%	8%	5%
Prime Central London – downside risk	-10%	-5%	-5%	4%	4%	-12%
UK	5%	5%	4%	4%	4%	24%
Lettings	**2016**	**2017**	**2018**	**2019**	**2020**	**5 Year to 2020**
Prime Central London - Lettings	0%	0%	2.5%	2.5%	2.5%	8%

Methodology

As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q2 2016 in light of changes since Q2 2015. 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.

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