MAY 2013

NO LET UP SO FAR THIS YEAR

Most commentators took the view that 2013 was expected to be somewhat muted for the prime residential market. The fact that the market seems to be continuing along the same pattern as the past few years has presented me with writers block. Shortages of really good property in the best areas, a challenging but essentially healthy rental market, buyers from all continents descending on London and a tsunami of new developments targeting the most affluent overseas buyers means that the picture has not changed much at all as we head towards the middle of the year.

The rapidity with which the prime markets recovered following the fall out in 2008 was a surprise to many, but maybe less so now for the many reasons discussed in these commentaries before, and with the handy benefit of hindsight. It is perhaps the sustained strength of this recovery nearly 5 years on which has exceeded the most bullish of expectations. The last two years in particular have seen a surge in demand with prices in PCL now anywhere between 25-50% (depending on sector and price category) above the pre GFC peak. Not surprising therefore that a period of consolidation was anticipated.

In terms of overall activity, the largest number of transactions would appear to be with the off plan, new build sector which I commented on in the last commentary. This continues to attract large numbers of a certain buyer profile ignorant of the risks that we feel are so evident down the line and attracted by the deposit down, pay later offering. Market cooling measures in Hong Kong and Singapore have simply given increased impetus to a region which sees new build properties as the way to go and a currency advantage too tempting to ignore.

New or old, built or to be built, the prime central London residential market (typically seen as encompassing most of Zone 1 but now seemingly stretching in to parts of Zone 2 for some) continues in rude health. The following is a rather indicative snapshot of what is going on from our own involvement in acquiring and disposing of an example two flats and houses over the past week or so;

- We were amongst 23 who bid on a totally un-modernised house in Belgravia last week. The potential lay in obtaining planning consent to extend the house from 2,100 sq ft to around 2,800 sq ft but planning was not at all a certainty. Around 70 people viewed the house.
- We have completed on the sale of a 2,240 sq ft house in Knightsbridge we developed for £5.95m, around 5% more than we had projected. We broke the record on a price per square foot for a house of this size which was less of a surprise perhaps than the fact that the buyer was English. Knightsbridge is somewhat caricatured as being owned by Russians and Middle Eastern buyers and I have to say we imagined this would most likely be the eventual buyer. Other serious interested parties were Malaysian, American and Middle Eastern

- In advising a client who was interested in a specific new development where prices range from £5m to £30m (with over 50% sold and occupation in 2015), the largest discount offered, despite trying to negotiate a multi unit purchase, was just 3%.
- We assisted one of our clients to appoint an agent to sell an un-modernised 940 sq ft apartment in St James. The value was thought to be around £1.65m. The asking price was set at £1.695m. After having received two asking price offers, best bids were invited and five bids in excess of £1.8m were received with four being British buyers.

THE BRITISH ARE IN PLAY

Our experiences of British buyers above are not such a rarity, many agents are reporting a large number of 'locals' buying. One agent noted that in Q1 close to 2/3rds of buyers above £2m were British which is more or less a reversal of the previous recent trend. With high levels of income tax (for those who are actually able to source income producing investments), the attractions of pursuing capital growth (taxed at 28% vs 45% top rate income tax) or storing wealth in a principle home (free of tax) has become more obvious.

The new build sector is also seeing a noticeable increase in local buyers. One area of London which is targeting this home grown market is the City. Within the Square Mile there are currently around 7,000 residents and close on 400,000 workers, according to a recent article in the FT. Developers have identified a strong local market demand as areas such as Shoreditch & Hoxton now provide the vibe and nightlife to attract young City workers. As a result, there are some 2,317 units under construction with a further 1,680 with planning consent and a further 1,640 in application. This contrasts sharply with the approximate 1,000 units added between 2001 and 2011. This surge in supply may be better absorbed than the endless new blocks springing up in other parts, but affordability is the key.

There is much talk in the press of a corner being turned for the broad UK housing market. Mortgage applications are up and buy-to-let has been witnessing a resurgence, there are the first real signs of national house prices inching upwards and a new Government scheme to assist first time buyers has been generally well received, albeit with a sensible cautionary caveat from the exiting Governor of the Bank of England. I am not at all convinced this Government intervention is a good move for the medium to longer term as it looks too much like market manipulation for short term political gain.

BUY TO LET IS BACK

Outside of prime central London, the local buy to let market has returned with a vengeance. In an era where lenders have been pricing first time buyers out of the market, hence the Government's new measures, and salaries fail to provide the sufficient multiples required for owner occupiers to trade up, private Landlords are filling the gaps with eager lenders who are attracted to lending on assets showing 5% or 6% yields

Yields are of course fickle in the residential sector but the banks don't really focus on this. A gross yield is good enough for them to work off. Gross yields are surprisingly uniform across the country typically ranging between 5% and 6%. Savills and Rightmove prepared a yield map recently which showed Dagenham and Barking (London addresses!) showing the highest at 7.1% and Bristol & Brighton being typical of the lower end at around 5.5%. Central London has become somewhat separated from the market dynamics of the wider country and Westminster is shown as offering around 4%.

Gross yields of course ignore buying costs, improvements and, most importantly, vacancy. Typically lettings and management fees together with an allowance for small repairs etc. reduces the gross by around 20% to 25%. This of course is before vacancy and more significant upgrades. Higher value property yields in prime London are closer to 3% gross.

OUR TENANT PROFILE

The rationale behind the resurgence of buy to let is in the main due to the UK is seeing a major swing towards tenants as opposed to home owners, something the Government worries about, hence their recent intervention. Lack of mortgage funding which is in the main due to would-be buyers inability to save sufficient deposits is forcing these 'buyers' to become long term renters. Despite the Government's tinkering at the edges with help to buy schemes and relaxation of planning, the UK is not building enough new homes and therefore the only way for rents is up.

For landlords in prime central London, the market is more dependent on the City's economic performance and foreign occupants. The financial sector is of course the most influential but this is gradually adjusting. The break down of tenants in the Obbard Portfolio shows a comforting cross section. Whilst Banking & Finance make up the largest number of tenants, as might be expected particularly given that our average weekly rent is around £1,500pw, they only make up just over a third (35.7%) of the total. Other key sources of tenants are from the Oil & Gas and Media & Technology sectors. One other noticeable increase which is a testament of our times, has been the number of 'students' paying the sort of rents usually paid by bankers and lawyers!