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Beware the Ides of March

April 2016

Thankfully March is now behind us, the clocks have moved forward, Spring is in the air and we have 9 months before the next budget. Budgets seem to come round all too quickly these days, in part this is due to the beefing up of the Autumn statement in December which effectively means we get two budgets each year. Since George Osborne took the helm as Chancellor of the Exchequer, budgets have tended to consist of fairly far reaching announcements (usually having been leaked previously) which are often then rather bizarrely subject to consultation periods. These usually come in tandem with some pretty radical or mealy mouthed new measures which are then withdrawn within a matter of days based on the ensuing political backlash (think disability benefits and pasty taxes).

Most chancellors are highly political animals but this one seems to take the biscuit. Nothing demonstrates this more clearly than Osborne's relentless attacks on the property market. The man in the street will likely have little sympathy for the protestations of pain from the super wealthy, and parents struggling to see how their children could ever get to own their own property will welcome anything that stems the relentless gap between house prices and affordability. Many will profess to be blind to any positives brought from ownership of second homes, private landlords or the influx of foreign buyers. However despite its inherent unfairness and a genuine issue surrounding the haves and have nots, on balance the UK residential market, with all its varying degrees of performance, has been shown to be a force for good and real progression over the past two generations.

Politics in the UK is in a bizarre place, but we are not alone there! Both the Government and Her Majesty's opposition are fundamentally divided and operating effectively like coalition parties. The parliamentary Labour party has no time for its leadership with its 'back to the 80's' world view and who are there primarily through the narrow support of its party membership and trade unions. The Government meanwhile has staked its position as a Remain party for the upcoming European referendum, yet two thirds of Tory MP's are likely to vote for Brexit. Tensions have been kept quite well hidden but they exploded in to view a couple of weeks ago when a previous leader of the party, and a cabinet member, Ian Duncan Smith (known as IDS), sensationally resigned by metaphorically stabbing Osborne in the back leading to many IDS of March quips.

Within this mix is a Tory chancellor who has taken it upon himself to directly influence and manipulate the property market. He first got a taste for this in 2012 when he looked at closing Stamp Duty avoidance loop holes and in doing so raising Stamp Duty for higher value properties and corporate vehicles. Around this time, in response to the cries of anguish from first time buyers who were unable to save for deposits in a flat lining economy with zero wage growth, he introduced Help to Buy to assist those trying to get on the housing ladder.

Having seen the UK housing market stir from its post GFC slumber, and with his changes at the upper end barely causing a ruffle, he went yet further……and further. Stamp Duty has been overhauled completely and has effectively doubled in 4 years for properties at around £2m or more. A penalty rate @ 3% has been added on top for all 2nd home or investment purchases and mortgage interest relief on buy to lets is being phased out.

In short Osborne's policy on housing appears to be to facilitate 95% mortgage funding for first time buyers, kill the mass buy to let market (for context the average purchase price is under £200,000 similar to the national average house price) and cool the luxury sector, London in particular, to dissuade overseas buyers.

The net result of all this interference is only really starting to become apparent, although it was highly predictable. Turnover of property sales above £1.5m are down quite significantly (14% according to the Land Registry for 2015 but over £5m they are down by as much as 30% or more). This is expected to lead to a significant reduction in Stamp Duty receipts. Added taxes and removal of certain reliefs for buy-to-let is expected to see rents rise as Landlords try to pass on as much as they can at a time that rental costs as a percentage of take home pay are at an all time high and exceed typical mortgage payments. Falling sales of luxury apartments is affecting profits earned by the UK's main house builders and reduced profits may well translate into reduced activity in developing more affordable supply.

There is a missing piece of course which is the need to address the fundamental underlying issue and that is a detailed and long term plan to build more houses of which the country at large has a desperate shortage. Addressing this means changing planning laws and processes, reconsidering the sacrosanct green belt and squaring up to NIMBY's (not in my back yard). NIMBY's are generally middle class sway voters. They have effectively prevented the desperate need for Heathrow expansion, materially delayed key rail infrastructure like HS2 and frustrated the greater majority of major planning applications. Addressing this addresses the root cause, but a cynically political chancellor can always be expected to shy away from that battle.

Prime London down, but not out.

Coming to terms with all the tax changes on residential property these past 3 years or so requires a bit of getting used to and we are all feeling a bit battered and bruised. Over a very short period the UK has moved from being a near tax free haven for overseas property investors (legitimate or otherwise) to a highly regulated, relatively high tax jurisdiction where scrutiny of actual beneficial ownership is becoming ever more intense.

Comparing relative transaction and ownership costs for residential around the world is extremely complex due to variances of annual taxes, broking fees, transaction taxes (foreigner vs domestic) and treatment of gains. The UK now sits in the mid upper range, having come from mid lower, with overall costs now more similar to the US and Australia.

The London market has effectively been split in two. For properties below £1m the market is extremely robust driven primarily by domestic demand but huge variances exist in performance. Hillingdon, on the edge of greater London to the north west has recorded 17.1% year on year price growth according to recent Land Registry stats, whereas the borough of Camden (taking in the likes of Regents Park) just 3.6%. Most recent activity includes a surge of buy to let investors who looked to beat the introduction on 1st April of the 3% Stamp Duty surcharge. The financial year April to April is likely to see buy to let investment match the 2007 high of £47bn (this had fallen to £10bn in 2009). 2015 saw £37bn in transactions. This continued insatiable appetite for buy to let has led to the possibility that the Bank of England may be brought in to regulate the sector through tighter restrictions on lending.

For properties above £1m the picture changes and becomes more pronounced the higher the value. As alluded to earlier, transaction numbers have fallen significantly at the multi million pound level and for many existing owners the higher cost burden in buying and selling has pushed them to reappraise their existing homes and the potential to add space (typically digging basements or extending in to roofs) rather than move.

A recent report by Knight Frank on prime London shows a mixed picture for year on year price performance to March 2016. High value areas have been more effected with Knightsbridge (average house price according to Rightmove £2,827,735) down by 6.8% in contrast to lower value prime such as The City (average house price according to Rightmove £963,028) showing 8.2% growth.

Compared to the previous 4-5 years where it seemed anything would sell and demand just kept growing, the prime London market feels far more evenly balanced. Self evident over pricing yields no results, whereas any hint of a deal or something special offered at a discount and there are competing buyers. Given a very specific brief and the chances are there is little or no choice. Despite a widely accepted view that prime London has peaked and prices starting to soften, the number of sellers remains relatively modest in the established secondary market, this being distinct from the luxury new build sector.

Here are half a dozen anecdotal examples from our own recent experience which are quite representative;

Case 1

For well over a year we have been tasked in finding a house for around £3-£4m with a garden in Notting Hill and had missed out on more than one occasion. One of the best houses on the street where we had previously attempted to agree a purchase came up for sale at £3m needing extending (subject to planning) and a total refurbishment (circa £600k) having been in the same possession for 40 years. Six parties went to best bids and we were not even the second highest bid at £3.15m.

Case 2

Client agreed to buy an off market mews house in Knightsbridge at the very end of last year for £5.25m. Needing a basement extension similar to the neighbouring house and a full refurbishment. Client withdrew from the purchase based on advice from financial advisor. House has just sold to a developer for £5.5m and neighbours house has come to the market asking £8.25m.

Case 3
Client has a simple brief – 2 beds, 2 baths turn key apartment circa 150 sq m with some outside space (small terrace or balcony), parking and 24 hour porters in recognised prime London. Budget £5m +/-. There is nothing that fits the brief.

Case 4
One of the best lateral apartments on Onslow Gardens was discreetly marketed 'off market'. Guide price was £9.5m. Significant interest saw 4 offers of which the highest was equivalent to £5,500psf. At this point the seller decided not to sell after all.

Case 5
Popular block on Kings Road saw a 7th floor 3 bed asking £2.25m sell for £2.1m in December. Similar flat but with obstructed view on lower floor asking £2.35m has no interest. A 6th floor flat came to the market a week ago asking £1.9m, very similar size with good views. Potential to buy 150 sq ft of hallway for £25k. Already three offers received.

Case 6
Just as we are about to start a fairly significant refurbishment for clients of one of the 12,000 sq ft +/- Holland Park mansions (previously owned by Richard Branson back in the day) a house a few doors along has been widely reported as selling for £53.5m, attracting a near £8m Stamp Duty levy. Prime London, down but not out!

Luxury new build sector – reality beckons
It is typical, indeed entirely predictable, that large development schemes tend to complete and be ready for handover much later than anticipated. We know of one where the marketing material still says 'due for completion in late 2017' and best case is mid 2019. For some investors a delay in paying down the final 80% might be welcome but for those wanting a home, it can be extremely frustrating.

Over the past 12 months or so we have started to witness a growing tide of actual completions. As the handovers take place, the reality of the gap between rents projected and rents achievable becomes clear and so too the holding costs through debt servicing, service charges etc. More significantly perhaps is the gap in expectation between revised sales value and actual value. We know of one leading valuation firm who simply avoids formally valuing new builds due in part to the rising number of units for sale by 'flippers' which is dragging down values (over 500 alone around the Battersea regeneration area according to an article in Property Week this week) but more due to the angry reaction of some clients who are fast learning that their perceptions of profits earned don't always meet with harsh reality.

A simple truth is that buying residential property in itself doesn't guarantee to make you money, aside from possible income (and residential historically has never volunteered much here), its only when you come to SELL that any profit is realised….it seems too many just over look this plain fact.

Outlook remains positive
Nobody denies the impact on the market as a result of all these many quite radical tax changes. The domestic market, being equity challenged, is sensitive to these changes perhaps more so than overseas buyers, but with principal home ownership still a key tax break and extremely low borrowing costs (the lending market in the past year has become increasingly competitive) the appetite for quality residential property sensitively priced is undimmed. More broadly the UK has a major housing supply deficit with increasing demand (affordability being helped finally by real wage

growth). Meanwhile foreign buyers have given no signs that they are turning their back or losing confidence in the UK as proven by the relative stability in the overall number of sellers. Would be buyers are simply standing back for now and in many ways this is as much due to macro global issues (oil prices, China slow down), specific economic woes in hitherto influential countries (Russia) and short term uncertainty surrounding the UK's position in Europe.

Compilers of data from agents research departments to the Land Registry, show that the market has been adjusting in a very measured manner. Savills Prime London research shows PCL values off 6.7% from the mid 2014 peak. Land Registry shows transaction volumes down at the top end but not by as much as one might have expected. The 1st April deadline to beat the 3% levy on 2nd homes will have given a short term boost but I suspect the next quarter may show a more significant drop. In fact the 16% year on year increase in Estate agency insolvencies probably paints a clearer picture of falling volumes

Most surveys whether done by agents or professional bodies such as ARLA or RICS, are remarkably upbeat on the prospects for all sectors of the UK housing market. Two decades of near uninterrupted growth may have entrenched these views but with such strong market sentiment you bet against the residential market, specifically prime London, at your peril.