Change in the air

November 2014

Since 2010 the Prime London property market's inexorable rise has continued unchecked. Staying firmly on the buy side, as we do, we are always sniffing the air for signs of a market shift and the Autumn is often a time for spotting change. This time two years ago we sensed a slight easing off as the market absorbed some pretty radical new measures announced in the March budget earlier in that year. However this proved to be temporary as other countries introduced similar measures, primarily targeted at foreign ownership, in an attempt to cool their housing markets. Last October we discussed the impact of the Government's Help to Buy and the challenges of finding value in a seller's market and we questioned whether we were witnessing a pricing bubble given certain press speculation at the time.

Any reference to a bubble infers an ensuing burst. In practice the UK housing market has seen this on just two occasions over the past 30 years (1990 and 2008) the impact of which affected the Prime London and investment market quite differently from the broader market, with the latter experiencing far greater pain. In 1990 the root cause of the 'burst' was spiralling interest rates and in 2008 the withdrawal of credit. Aside from these, over the past few decades we have experienced several slow downs characterised, in The Prime London market in particular, by extended periods of muted activity in the market and relatively minor price adjustment or stagnation. Since the earlier part of this year we sensed that The Prime London sector was likely to be entering one of these slow downs. Recent statistics from LonRes and Deutsche Bank have confirmed this as they have showed that transaction levels in Q3 were down one third on last year.

During the course of the year we have felt that buyers in The Prime Central London market were starting to show a resistance to pricing levels which had reached around 50% above their pre GFC highs in the summer of 2007, by contrast the broader UK housing market only returned to its previous highs late last year . On top of this the openly debated topic of possible mansion taxes (discussed below) has introduced needless uncertainty. Many are looking ahead to the general election next May believing the outcome to be critical in terms of how this might affect their own tax position, but more importantly how this might impact on the UK's current favoured position as one of the best performing Western economies.

Increased withdrawals and more sensible asking prices.

We have therefore entered a phase in the market where buyers sense a shifting dynamic as the market changes down a gear. Seller's on the other hand are under little pressure to make any radical adjustments and as a result many are choosing to withdraw their properties from the market or simply reign back rather ambitious asking prices. LonRes figures show a 21% increase in withdrawals compared to this time last year. Meanwhile around 35% of properties on their database have seen asking prices being adjusted down by around 6% – 8% (the higher the value the greater the adjustment typically). Experience shows that when a market hits a peak, asking prices adjust as the top 5% evaporates immediately as competing buyers stop chasing the market up.

A sample review of transactions in October between £1m to £5m in Chelsea & South Kensington shows 15% achieved asking price, 18% sold in excess of asking price and 67% had price reductions negotiated. Of the price reductions 58% were below 5% with 21% between 5% & 10% and 21% in excess of 10%. Approx. 40% had revised their original asking prices down and a clear correlation can be seen between the price reduction and proximity to asking price being achieved.

Most statistics currently produced simply show a slowing of price growth, hence the reigning back of over ambitious asking prices, but our experience is that their are real discounts to be had where sellers are prepared to meet buyer's expectations and the need to sell is genuine, we therefore see opportunity in the next 6 months as the market feels the impact of the pre-election inertia.

The statistics and examples above relate to the established second hand market in recognised prime central London. The world of the new build/off plan market is quite different. It is this market sector that absorbs so much of the inward investment, and we observe this continuing apparently unchecked most notably in the large regeneration schemes on the fringe of Prime Central London. A leading agent told us that 85% of the recently launched first phase of the Wandsworth Ram development had been sold in the past couple of months. The latest phase launch at Battersea Power Station this week was accompanied by the CEO stating that interest remains undimmed and 'leaking' the news that Sting had bought an £8m flat in the power station phase. The deals may well be flowing as down payments and deposits are paid for flats to be handed over in 2-3 years from now, but we remain wary.

Beware perceptions of profit

I met someone recently who bought in the first phase of one of the new schemes in Nine Elms back in 2011 at around £1,000psf. The final phase is being marketed closer to £1,500psf for a comparable unit on a high floor with partial river view. Clearly this implies a healthy return. Notwithstanding buying and selling costs at around 10% the implication is a profit in the order of 40% maybe. However the reality is that barely any second hand market exists as yet and this 'profit' is unlikely to be realised. Most buyers for new build are attracted by the down payment & pay later process coupled with easy funding linked to the developer and therefore any new buyers will tend to take this path. Furthermore, and perhaps more significantly, few buyers looking for a home today actually have Nine Elms down as their most preferred area of London.

I made a recent search for 'transactions' in October in SW8 which covers Vauxhall, Nine Elms and Battersea Power Station. Using the same website referred to above (LonRes is a subscription site for the industry and widely used and respected) Out of a total of 319 apartments on the market in October just 5 were sold and 27 had been withdrawn from the market. This is a ratio of over 5 withdrawals for each sale and the equivalent of 1.56% of stock being sold. If I compare this to say flats on the market and transactions in the same period in SW3 (Chelsea), the total number on the market was 281 of which 22 sold and 24 were withdrawn. A ratio of nearly 1:1 withdrawn and 7.8% of stock transacting in the month. Interestingly LonRes current stats for RBKC and Westminster show the ratio of withdrawals to sales at around an average of just under 2 to 1 which is still noticeably higher compared to previous years. It should be noted that this is not a reflection of the total market activity as LonRes captures only a proportion of all activity (possibly 60%-70%) but it is a very telling indicator of activity in the second hand market.

The most obvious and distinct difference between SW3 and SW8 is in the new build activity. Data on actual off plan or direct developer sales are strictly controlled by the developers and Land Registry only records the sales some months after actual completion (typically 2-3 years on from the off plan sales). Of the 319 flats in SW8, 207 (or 65%) were re-sales that were still under construction or being sold on at the point of handover from the developer. There are a few small new schemes in SW3, under construction or completed within the past 18 months, totalling no more than maybe 100 units, whereas in SW8 the Battersea Power Station project alone amounts to 3,400 units with adjacent Embassy Gardens totalling 1,982 units and Riverlight at approx. 1,500 units. Even developments originally started a decade back are adding further phases, for example the 223 unit Tower at St Georges Wharf. If nothing else this at least provides some sort of a context when assessing future supply and demand issues.

Mansion Tax nervosa

Ever since the Liberals introduced their idea of an American style property tax, the market has been speculating furiously on what the levy might be, should it be introduced. In the early days a 1% annual charge on the value of properties over £2m was suggested but this has been comprehensively shelved. A new band of council tax has been the most recent favoured solution yet this will only serve to make the richer parts of the country richer. Labour have been quick to say how much they would raise (£1.2bn) but not how it would be levied. Ed Balls, the labour shadow chancellor, has indicated an annual cost of around £3,000 for a £3m property (similar in fact to current council tax levies in London) but has not explained how that might be charged and who might be exempt.

The uncertainty and confusion has clearly effected the top end of the market . Potential buyers do not necessarily fear a proportionate tax (Stamp Duty rose from 1% to 7% for properties over £2m within a decade and this barely caused a ruffle) but they don't like uncertainty. There is a lot of cheap political rhetoric about and often foreign buyers come in to the firing line, yet many recognise that it has been foreign cash that has helped kick start the moribund construction sector that had been such a drag on the desperately needed recovery.

The political posturing is likely to continue in the months ahead in the long lead up to the General Election. Meanwhile, the newly introduced LBTT which is set to replace Stamp Duty in Scotland has been very badly received, Nationwide reported a second consecutive month of slowing price growth in the broad housing market and London, the market's engine, is showing a clear cooling off. Not the best backdrop to introduce new taxes in a property dependant economy. There is even considerable concern within Labour's own ranks, the following is a snapshot of views in the press during October. In fairness I have not included the 'plague on your houses' comments in the Guardian which remains a lone voice for soaking the rich and turning away foreigners who are not here to study or earn the minimum wage!

Rebellion over mansion tax

Labour councillors are rebelling against Ed Miliband's plans to impose a new mansion tax. Hammersmith and Fulham council has officially voted to oppose the levy, a motion backed by the ruling Labour group, and warned that the plans would lead to "many local people being forced to move out of the borough". Emma Dent Coad, leader of the Labour group on Kensington and Chelsea council, said that the well-off should pay more property tax. However, she was opposing the mansion tax idea. "We're rebelling, because it's bonkers. Our minds are open but we're not happy with what's being proposed at the moment," she added.
The Times

L&G boss hits out at mansion tax plans

Nigel Wilson, CEO of Legal & General, has said that Ed Miliband's plans for a levy on £2m homes is "poor economics" and will "punish" families who have saved hard for a property. Mr Wilson said: "A well-functioning housing market needs people to move. We're already seeing the threat of a mansion tax slowing down sales at the upper end of the market – and this has repercussions down the chain. What may well happen is that fewer top-end houses get built, more homeowners stay put, and ultimately fewer opportunities exist for first-time buyers." He also warned that the policy is unlikely to raise even a tenth of the £1.2bn that Labour says it will as homeowners are likely to find legitimate ways of avoiding it.
The Daily Telegraph

Cases against the mansion tax

A number of letters carried in the Evening Standard lambast Ed Balls' proposed mansion tax. "Focusing a tax on those who already pay an enormous amount of tax, simply out of the politics of envy, is deeply short-sighted," argues one, adding: "Politicians and HMRC seem to fail to understand that top-end buyers are the lifeblood of the aspirational London market and that it's important that they continue buying larger homes to free up properties down below." A separate letter describes the tax as a "real stinker", calling it "easily avoidable", "hard to calculate" and fundamentally unfair. Elsewhere, the paper's Simon Jenkins also takes issue with the proposals, arguing that we should instead increase the number of higher council tax bands,

allowing more spending on local services and less on central ones. Mr Jenkins attacks Labour donors, the Conservative party, Ed Balls and Boris Johnson, claiming that all of them have failed to understand or take action on what needs to be done with the UK's current tax system.
Evening Standard

Buck concerned over mansion tax

Karen Buck, the Labour MP for Westminster north, has raised concerns over her party's planned mansion tax, suggesting it could force thousands of those on low incomes to move home. Ms Buck, who is Ed Miliband's parliamentary secretary, explained: "I have spent the last four years dealing with huge numbers of people who have been forced out of Westminster through everything else that the Government is doing. I am very, very anxious to protect people who are under pressure and to keep Westminster a lively mixed community."
The Daily Telegraph

Mansion tax prompts further discord

Top Labour figures have once again attacked Ed Miliband's plans for a mansion tax. Labour's biggest donator John Mills said it would "cause all sorts of problems", while public accounts committee chairman, Margaret Hodge, added that it was "too crude to work properly".
The Times