A Brexistential Crisis

Summer 2016

Some would say the UK has set off down a path to backward isolationism, thumbing our noses at our closest neighbours which will lead to economic oblivion. However other's would argue that we have freed ourselves from a political project in long term decline and retaken our democratic will and ability to self govern which will result in an era of unprecedented growth. Nothing is certain and opinions remain just as polarised as before 23rd June. In fact it would probably be most apt to quote Donald Rumsfeld's words of wisdom– *There are known knowns. These are things we know that we know. There are known unknowns, these are things that we know we don't know. But there are also unknown unknowns. These are the things we don't know we don't know.*

Thankfully the Tories 'resignation, nomination, assassination and coronation' as David Cameron put it so succinctly avoided further weeks, months even, of political drift and insecurity over the summer. Imagining, at the time of writing, that we could have still been in the middle of a fractious leadership campaign with an impotent prime minister at the helm doesn't bare thinking about. Theresa May's all inclusive one nation speech made prior to her stepping in to Number 10 as PM for the first time had certain parallels with Margaret Thatcher's reciting St Francis of Assisi. It can't be said that Thatcher exactly brought 'harmony where there was discord' and Theresa May's direct promise to the 'many and not the few' had echoes of Gordon Brown's 'not being driven by the privileged few' line. In truth most if not all prime ministers start out offering to spread fairness. To realistically understand what sort of Government the UK now has we must wait for the Autumn statement which will be delivered by a rather grey managerial chancellor of the exchequer in stark contrast to the two most high profile recent incumbents, George Osborne and Gordon Brown, whose every word and number were laced with political inference.

To comment or not to comment

The temptation to make comments and predictions in the immediate aftermath of the shock result was significant. Most couldn't resist. I am not sure which were worst, those predicting doom and damnation out of sheer bloody anger with the result or the one's claiming 'its all going to be great' without actually knowing what 'it' is. I am conscious that there is Brexit overload when it comes to written and spoken opinions coming as they have in an incessant flow from all quarters. The reality is that this will play out over a lengthy period and few can truly predict what comes next. For most this is more about gut instincts and I do detect a greater underlying confidence than most 'remoaners' would have you believe. For the majority, the focus is on the short term (possibly the next 18 to 24 months) and for sure things looks very unclear encouraging many to stand back, which is why we are now rather interested.

Are we about to see a genuine buyer's market?

At the end of this commentary are examples of what we hope will be the start once more of highlighting genuine buying opportunities. Followers of these bulletins might have noticed that it has been quite a few years since we have been able to highlight such opportunistic deals. With prices having hit such a high, supply so tight and ever decreasing costs of funding protecting sellers from any degree of pressure, we could only point out the rather special or perhaps better value with the occasional developer angle. In fact several recent commentaries have not highlighted any investor buying opportunities at all which reflected the reality of how we saw things.

The last genuine buyer's market was during the first half of 2009. It was a narrow window, blink and you missed it. I know of very few who took advantage at the time as the world outlook was truly bleak, however I recall how opportunities suddenly presented themselves such as a building in South Kensington that we desperately tried to find an investor to buy for £4m which was bought and then flipped on for £6.9m within three years. A friend bought a flat on Eaton Square at a knock down £1,500psf and sold this in 2013 for just over £3,300psf having spent around £600psf to refurbish and extend the lease . Good examples where we successfully transacted were a 2,800 sq ft flat overlooking Hyde Park for £2.95m and a 1,100 sq ft first floor flat in Onslow Gardens for £1.26m….happy days!

Apart from the period post the Dot.com collapse in the early noughties that saw the market plateau for three years, we have experienced a fairly unprecedented bull market in prime central London since the mid 1990's. This hit a ceiling in late 2014, exactly 20 years since we started this business.

Change is afoot

Contrary to broad perception, the prime London market has been losing steam as noted as far back as late 2014. The catalyst was George Osborne's radical overhaul of Stamp Duty in December 2014 which effectively doubled rates from 7% to 13.28% for a £5m property (if bought as a 2nd home) meanwhile reducing by 25% from 4% to 3% for a £500,000 first home. For those interested in a brief history of changes to the taxation of residential property, the following summarises the past 10 years;

10 YEARS OF CHANGE TO RESIDENTIAL PROPERTY TAXES

2006

- Stamp Duty threshold rates are;

  0% up to £150,000
  1% on purchases between £150,001 to £250,000
  3% on purchases between £250,001 to £500,000
  4% on purchases from £500,001 +

2010

- Stamp Duty threshold rates are revised;

  0% up to £150,000
  1% on purchases between £150,001 to £250,000
  3% on purchases between £250,001 to £500,000
  4% on purchases between £500,001 to £1m
  5% on purchases from £1,000,001 +

2012

- Stamp Duty threshold rates are revised;

  0% up to £150,000
  1% on purchases between £150,001 to £250,000
  3% on purchases between £250,001 to £500,000
  4% on purchases between £500,001 to £1m
  5% on purchases between £1,000,001 to £2m
  7% on purchases from £2,000,001 +

2013

- CGT exemption for non residents owning residential properties worth over £2m is withdrawn.
- New Stamp Duty rate for 'non natural persons' introduced (exemption applies if an investment property)

  0% up to £150,000
  1% on purchases between £150,001 to £250,000
  3% on purchases between £250,001 to £500,000
  4% on purchases between £500,001 to £1m
  5% on purchases between £1,000,001 to £2m
  7% on purchases from £2,000,001 +

  15% is introduced on purchases by 'non natural persons' .

2014

- Stamp Duty rates are completely overhauled with the abolition of the old thresholds;

  0% on purchases up to £125,000
  2% on the portion between £125,000 and £250,000
  5% on the portion between £250,001 and £925,000
  10% on the portion between £925,001 £1,500,000
  12% on the portion thereafter.

- ATED (annual tax on enveloped dwelling) is introduced on properties owned by 'non natural persons' of a value over £2m (exemption applies if an investment property).

£2m to £5m	£15,400 pa
£5m to £10m	£35,900 pa
£10m to £20m	£71,850p a
£20m +	£154,750 pa

2015

- CGT becomes applicable to non residents on ALL residential property.

- ATED is revised and includes properties worth £1m plus

£1m to £2m	£7,000 pa
£2m to £5m	£23,350 pa
£5m to £10m	£54,450 pa
£10m to £20m	£109,050 pa
£20m +	£218,200 pa

2016

- From 1st April an additional 3% Stamp Duty levy applies on all buy to let or 2nd home purchases.
- Mortgage interest relief on buy to lets starts to be phased out over 3 years.
- ATED is amended to include properties from £500,000 to £1m paying £3,500 pa.

According to Savills most recent research, prime central London prices are off some 8% since the end of 2014 but the real casualty has in fact been transaction volumes. By way of an example, using one of the more respected databases and comparing the number of £1m to £10m sales in the first half of this year and 2014 in three key postcodes (SW3,SW7,W8), volumes are down 36%. This increases to over 40% in volume reduction for £5m plus houses.

With such a significant drop off in transactions, one would have expected a sharper adjustment in prices but the other reality has been the lack of properties coming to the market. Owners are simply choosing to sit tight as transaction costs (Stamp duty mainly) deter trading up or down and those tempted to exit the market are faced with a lack of alternative options for where to put their funds. This is impacting on rents as supply of rental stock is increasing as decisions to sell by investors or 2nd home owners are deferred in favour of renting out, coming at a time when much of the off plan sales of new build projects are starting to come on stream with new landlords searching for tenants.

Typical to previous downturns in prime central London, the lack of sellers is underpinning prices. However buyers do currently hold the stronger hand. Sellers who can simply play for time will offer little opportunity but those with a genuine need or intent to sell will have to adjust their expectations to achieve a sale.

There is of course one sector where supply is far from limited and which is not included in the database referred to above. This is the luxury new build sector and the oxygen that keeps this market alive has been off plan sales, typically to overseas buyers. It is notoriously difficult to get reliable stats on off plan sales as developers control the flow of information and off plan sales are recorded at the land registry several years later following actual completion. One consultancy has estimated that sales were down 43% in the first six months of 2016. Off plan sales took off around 2012, when we first started warning of the pitfalls, and completions of these schemes are hitting a record high. Many of these buyers were speculators who have since placed their apartments back on the market to compete with latter phases coming through.

Brexit has thrown a big spanner in the works and much of the forecast supply may now be significantly delayed. This is actually good news, the market will have an opportunity to absorb the current supply under way and a fair rebalancing of pricing can be expected. The developers however are going to have to take much of the pain as their sales volumes fall further and canny buyers may be able to strike some good deals. The key is to pick the best units with the full discounts and to truly understand the ultimate occupier market, whether tenant or next owner.

If developers are needing to shift their fast completing inventory and the market continues to shift towards domestic need, as opposed to overseas investors, prices are going to have to reflect local affordability and this relates to both rental and sales pricing. Many new schemes in fringe central locations have one bedroom flats marketed at £800,000 to £1m which are way beyond the reach of ‘real’ demand. It is easy to see that there might be foreign buyers taking advantage of weak sterling who might comfortably afford such prices but the ability to achieve rents anywhere close to a market yield which in itself will unlikely cover mortgage interest and outgoings is in dream land. Two bed units well in excess of £1.25m are sticking and more plentiful in number, we are watching this closely as we see potential for heavy discounting.

A welcome pause

Few could honestly expect central London prices to continue rising at the rates seen since 2010. However, if George Osborne hadn’t intervened with his various stamp duty adjustments we might well have seen prices rise way beyond common sense. We are now two years in to a downturn which feels as if prices have modestly adjusted (coincidentally or not reflecting the higher Stamp Duty levy) and it is easy to see a further two years of this plateau. Meanwhile, the prime market’s downturn coincided with some stellar growth in secondary locations. Knight Frank research actually shows 4.2% growth in Kensington & Chelsea (average house price just in excess of £2m according to Rightmove) for the year to April 2016 but this is hugely overshadowed by, say, Lewisham @ 19.9% for the year (average house price £411,663 according to Rightmove). The growth in RBKC contradicts the recognised slow down in prime markets but this reflects the large number of relatively affordable property in London’s largest borough. In essence there has been a big shift as the market that had been so reliant on overseas buyers and domestic investors, shifted to a more domestic owner/occupier focus. This domestic market includes a large number of foreign nationals with permanent or semi permanent residency. A significant pick up in first time buyer activity across the UK, assisted by the likes of Help-to-buy, has also been seen in prime addresses. Data from Marsh & Parson a multi branch agency in PCL, notes first time buyers as a percentage of sales increased from 22% in the first quarter to 34% in the second quarter of 2016.

A pause at the top and increased activity at the bottom can only be healthy in the long term. A flat market offers little to those who simply ride a rising market but for value seekers it can offer a world of opportunity.