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Stepping back in time

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Voters!....they don't do what the media tells them, or what the politicians expect from them and, what the majority reading this, want from them. No surprise perhaps when the world's leading democracy votes for a bogus businessman/reality TV star.

The UK has flirted with extremes over the past 12 months. Firstly in pursuing a zero compromise, hard Brexit (surely off the table now) and then coming within a few seats of electing a Marxist government (with the focus so much on Corbyn, it's easy to overlook his henchman John McDonnell who is real old school hard left). Commentators often rather smugly say the electorate get what they want and this implies the UK wanted uncertain, impotent leadership over strong and stable.

The final insult to anyone who thought that they understood politics and the will of the people, was labour winning 'true blue' Kensington where property values are 6 times the national average. A logical explanation for this could be that the percentage of foreign buyers (who don't get to vote) is now so high that the core vote is closer to being made up by the considerable number of council tenants that are spread throughout the borough.

Some believed the Brexit vote was a desire to return to the past, and on that theme I had started drafting this a few weeks back. Confident that Theresa May would increase her majority to around 50 seats, I was focusing on how there were certain similarities to the 1980's. That decade started with a newly incumbent female Tory prime minister up against, in Michael Foot, a generally liked but broadly ridiculed leader of the Labour Party pursuing a socialist agenda. As the decade progressed the Tories were the ones introducing radical changes to taxation on property (abolishing MIRAS which had allowed mortgage interest to be off set against income) and introducing right to buy for council tenants. Removal of mortgage relief on buy to let and the introduction of help-to-buy are the similarities for today. Finally of course we had the great financial crash (Black Monday) in 1987 to mirror (but not exactly by any means) 2008.

Today however it has to be said our politics has more of a whiff of the 1970's about it. We have an emboldened radical left wing Labour Party (RIP the Blaireites, hail the resurrection of the Bennites) and a seriously weakened Tory party with a largely irrelevant Liberal party. We also have the inertia of a hung parliament as experienced under James Callaghan. The similarity to that era is further highlighted as we held the last European Referendum in 1975. I recall studying in France in 1979 and having to face up to the bold and confident French who rather sneered at the UK at the time. With the Macron revolution and the May mayhem, history looks to be repeating itself as so often it does. But talking of Wilson, Heath and the 'sick man of Europe' to the large number of young mobilised by Corbyn's undeniably effective campaign of 'jam today and ruination tomorrow' is only likely to fall on deaf ears.

SO WHAT DOES THIS MEAN FOR THE PROPERTY MARKET

As the shock of election night starts to dissipate, the overriding feeling that remains is one of naked uncertainty. There was of course uncertainty before, in essence focused around Brexit, but this was tempered in the belief we had a strong and united political force in the UK. As of today, we don't know who will see the negotiations through and to what extent a weak 'team UK' exactly helps Brussels' position.

Uncertainty will feed through in to everything and every decision. The sheer unpredictably of political events over the past two years, and their outcomes, has completely overshadowed life in general and this includes the UK property market. However, it has been more the micro political meddling, as opposed to the macro situation, that has really impacted the market and this has been discussed at length previously in these commentaries as we have highlighted the raft of changes to taxation on property which started back in 2012.

Over the past 3 years we have noted definite shifts in buyer motivation and strategy, most of which I believe has been influenced by the changes to taxation and far less as a result of broader political events, Brexit of course being the key one, although sterling's post referendum devaluation was clearly influential for some foreign buyers. The volume of transactions has been falling significantly over the past 2-3 years and the higher up the pricing point the more this was pronounced. Those looking simply to store wealth (a major factor in the years post 2008), or invest in buy-to-let, fell away and the one's transacting tended to have a clear and specific need linked to their decision to buy. This would likely be a new primary home, or a purchase linked to children (their first step on the ladder or a base while being educated in the UK), a second home or a move linked to changing circumstances like downsizing, returning or relocating to the UK from overseas etc.

As a result of these specific motivations, there has evidently been a fairly significant change taking place in the residential market. With this in mind, the following are my current observations and thoughts;

<u>NEW SUPPLY OF SUPER PRIME UNITS</u>

In nearly 30 years of dealing with prime London property, I cannot recall a situation that comes close to seeing the levels of new projects that we are experiencing at the very upper end. A classic example is Grosvenor Square, an uber prime address, this has TWO landmark schemes currently under construction (the ex US Naval Intelligence office and the Canadian embassy) and in addition the US embassy is earmarked for redevelopment as a Hotel plus super prime residential. These schemes have expectations of sales prices well in excess of £4,000psf.

There are projects expecting to sell for £3,000psf plus in Victoria, Chelsea, Marylebone, St Johns Wood, The City, Holborn, Holland Park, Kensington….and the list goes on.

Prior to the new millenium, supply of new super prime stock was limited to the activities of a few specialist developers redeveloping existing single houses or apartments in period buildings. Very occasionally there would be a new build scheme targeted at the very top end but this only really changed with the construction of The Knightsbridge and One Hyde Park which go back just 12-15 years ago. It is sobering to think that One Hyde Park, an unqualified success, took 7-8 years (from off plan to final sale) to sell the 86 apartments (between 5 and 10 of which were bought in/retained by the developers). This at a time with little or no competition and all the benefits of the lightest touch on tax.

<u>NEW SUPPLY OF LUXURY UNITS</u>

I have written endlessly on this and Nine Elms/Battersea is the obvious example with around 20,000 units in the pipeline. Planning consents are given based on the planners desired 'mix' and not on the developers wishes based on saleability. Consequently developers ability to build small units below £1m, where the market remains very active, is frustrated as each project has to have a mix of one, two, three and larger 'family' units. With target sales prices from £1,250psf (adjusted down quite considerably already) many of these are basically unaffordable to the local market (both for sale and rental) and unappealing to the overseas market due to stamp duty and ATED costs on higher value property.

For serious cracks appearing in the market, all focus should be on this sector. Developers will be presenting a brave front and as ever true up to date data will be hard to come by, but only a few months ago the developers of Battersea power station in their battle to reduce the affordable housing content in their scheme, revealed in their pitch to the planners that their projected IRR had been reduced from over 20% to 8%. With the headwinds building, this is starting to look very thin and their recent moves to switch from residential to more commercial space shows the rethinking that is going on.

PIEDS A TERRE

It seems the term 'pied a terre' fell out of favour some time back as this became replaced by purchases of 2nd homes. In recent times a few would buy a small bolt hole, but more often the London base would be a substantial alternative/second home. As we see foreign buyers in particular pull back as they look at the substantial 'losses' incurred through the increase in stamp duty, I wonder whether we will see the more wealthy buyers revise down their budgets which may give a boost to the £2-£5m bracket in the best locations. This pricing bracket has clearly hit the broader domestic market as stamp duty dissuades buying and selling in the mainstream markets, however it is the £10m plus sector that has seen buyers retreat en masse. In fact the biggest winner has been the very top end rental sector with many UHNW's choosing to sit out the market, preferring to pay substantial rents in the short term rather than gift the Government huge cash sums in stamp duty payments, something we have seen underlined this month with two lets agreed at £6,800pw and £5,000pw plus a renewal for a further year at £11,000pw.

Meanwhile, the sub £1.5m bracket remains quite buoyant and there has been a definite pick up in the £2m to £5m pricing point. It may be that some of these buyers have already adjusted their budgets down to reflect this new attitude.

BUY-TO-LET

The typical buy to let investor has been hit hard. The 3% stamp duty penalty was a tough one but the removal of mortgage interest relief has had a far greater impact. With capital growth looking muted for some time and rental income rarely sufficient to produce a meaningful yield, the buy-to-let market in London and the South East, in particular, looks very challenging. Many chasing yield have been seduced in to student housing and the next emerging sector is likely to be retirement housing. In both instances investors are wise to remember that these are not property plays in the real sense but income investments where the key lies in the quality of the operator/management company and it is here that the due diligence needs to be forensic.

With buy-to-let fast falling out of favour with buyers of individual units, we are meanwhile seeing the rapid growth of professional Landlords with large portfolios. The role of institutional investors is already starting to change the landscape significantly and we will be seeing much more build to rent schemes in the years ahead. Buy-to-let is far from dead but the days of weighty leverage are gone and the sector is likely to favour the cash rich who can use gearing lightly and cherry pick their investments which are best suited to longer term capital growth.

LONDON'S STUBBORN REFUSAL TO OFFER UP A BUYERS' MARKET

Classic buyer's markets just don't seem to come along in prime London. Even at times when interest rates rise sharply (essentially the key cause of market falls) prime London has tended to ride this out as London property has always been the asset of last resort to be disposed of. In prime London properties are often financed because funding is available as opposed to being a necessity, a key distinction with the broad domestic mortgaged market. After Lehman's collapsed in late 2008 we saw a classic buyer's market as sellers panicked, however within 8-10 months this had passed, a genuine anomaly. This was followed by a period of substantial growth on the back of a huge surge in demand. Only recently have we seen a far more balanced market with things starting to tip towards the buyer as changes to taxation acted as a drag on demand.

Following Thursday's election result, I had expected quite an adverse reaction from buyers. However it seems I have got this wrong. The coming weeks are often peak time for us as we have so many clients in town from overseas during the summer. We have been preparing for three specific clients and have to honestly say that I have been taken aback by what we are coming up against. The following is a snapshot;

CLIENT 1 (HK based)

Requirement 3 beds. Kensington, South Kensington, Notting Hill, Bayswater, Chelsea, Earls Court.

Budget £3m all in

Short list Only three potential properties of note

Current status Two of the three agreed since June 8th. The third has had the price reduced by 7.5%

CLIENT 2 (Singapore based)

Requirement 3-4 beds. 2,500 sq ft plus. Kensington, South Kensington, Notting Hill, Bayswater, Knightsbridge

Budget £8m

Short list 11 properties

Current Status 5 under offer or sold of which three agreed since June 8th. One is in a development of 53 flats where there have been 6 deals since June 8th.

CLIENT 3 (UK based)

Requirement 4 bed house with garden. Notting Hill, Kensington

Budget £5m

Short list 8 houses

Current Status 2 under offer since June 8th

CLIENT 4 (Dubai Based)

Requirement 3 bed apartment. Kensington

Budget £2.25m

Short list 3 apartments

Status We agreed terms on a flat reduced from £2.35m to £2.1m on 13th June at £1.85m. Two days later we were gazumped with an offer of £1.9m. Seller now wants £2m minimum.

These above examples are far from painting a picture of the buyer's market that so many hoped for and which we, being on the buy side, had rather optimistically expected. For sure the transactions are typically around 5% (maximum 10%) off asking price and many will have revised down their over ambitious asking prices previously to reflect the approximate 10% adjustment (much less in the lower pricing brackets, sub £1m, and more in the upper brackets, over £5m) we have seen on average since the peak of late 2014.

Of course a genuine buyer's market is when buyer's aren't buying. This is clearly not the current situation and there has even been a bit of a post election boost to defy expectations, one leading agent telling me today with a broad grin that they have done double the business in June already compared to last year.

What I feel we have entered is a value driven market where buyers at all pricing levels seek fair value and are willing to move ahead when it is offered.