

RESIDENTIAL RESEARCH



LONDON RESIDENTIAL REVIEW

AUTUMN 2018

THE BREXIT EFFECT

RISING RENTS

PROPERTY VERSUS STOCKS

KEY FINDINGS

12.5%

Increase in the number of new prospective buyers in Q3 2018 compared to Q3 2017

9%

Decrease in the number of transactions in the year to August 2018 compared to the previous 12-month period in PCL

31%

Rise in the number of prospective buyers in prime central and prime outer London since January 2016

14.6 million

Total square feet of office space taken up in central London in the year to June 2018, up 15% from 12 months earlier



TOM BILL
Head of London Residential Research

“The fact prices have now adjusted for higher rates of stamp duty suggests sales volumes will strengthen once the political uncertainty recedes.”

PRIME LONDON SALES MARKET INSIGHT

Sales volumes are weakening as Brexit approaches, however pent-up demand is building

Uncertainty surrounding the outcome of Brexit talks has affected the sales market in several ways in the second half of 2018.

First, it has curbed sales volumes. In the year to August 2018, there were 9% fewer transactions in prime central London than the previous 12 months, LonRes data shows.

This decline contrasted with an increase of 7% recorded in the year to March, which was a sign that transactions had begun to recover following the EU referendum. However, as Brexit approaches and the negotiations become more urgent, volumes have receded. A similar downwards trend in the number of sales across Greater London since last year can be seen in figure 2.

This somewhat changeable flow of data has been a feature of the prime London property market in recent years. As transaction volumes or pricing begin to stabilise, external events put any recovery on hold.

In recent years, these external events have included two general elections, the EU referendum and tax changes. However, none of this should obscure the fact that underlying demand remains robust as the Brexit talks near their conclusion.

Some 12.5% more new prospective buyers registered in the third quarter of this year than the same period in 2017, as figure 1 shows. Meanwhile, the total number of prospective buyers was up by a fifth over the same period.

Indeed, the number of prospective buyers in both prime central and prime outer London increased by 31% between January 2016 and August this year.

On the supply side, the number of new listings declined 10% in the third quarter of 2018 compared to the same period last year. Meanwhile, the number of properties valued for listing fell 6% over the same period. Rising demand and falling supply suggests pent-up demand is forming.

The other impact of political uncertainty has been on pricing. In a similar way to transaction volumes, pricing trends have also been inconsistent over the course of 2018. Average prices fell 2.9% in the year to September, which compared to a more modest decline of -0.7% in January.

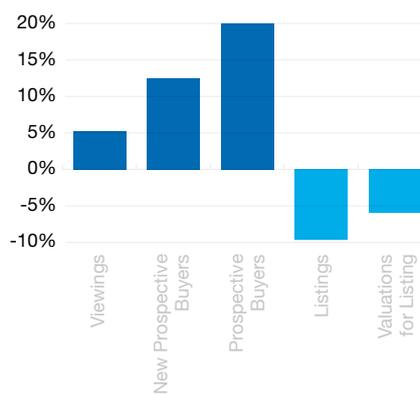
In addition to the political backdrop, price declines were exacerbated earlier this year by an increase in supply as more landlords respond to tax changes by selling or listing their property for sale, though the number of listings has dipped in recent months ahead of Brexit.

Although Brexit uncertainty is intensifying, talks are due to reach some form of resolution by the end of this year, which suggests current levels of uncertainty will be short-lived.

Furthermore, the fact prices have now adjusted for higher rates of stamp duty suggests volumes will strengthen once the political uncertainty recedes.

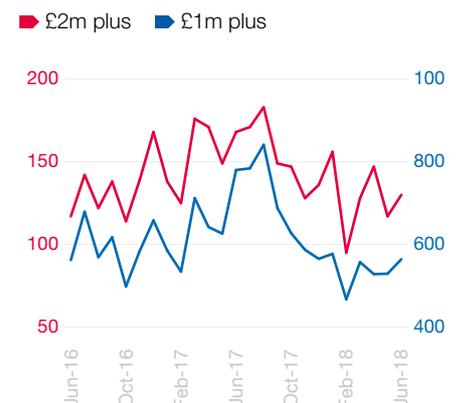
Meanwhile, in a positive signal for demand in the prime London property market beyond Brexit, the take-up of new office space in central London has been rising. The 12-month rolling total rose to 14.6 million square feet in the second quarter of 2018, which was 15% higher than 12 months ago.

FIGURE 1
Pent-up demand rises as Brexit approaches
Q3 2018 versus Q3 2017 % change, PCL



Source: Knight Frank Research

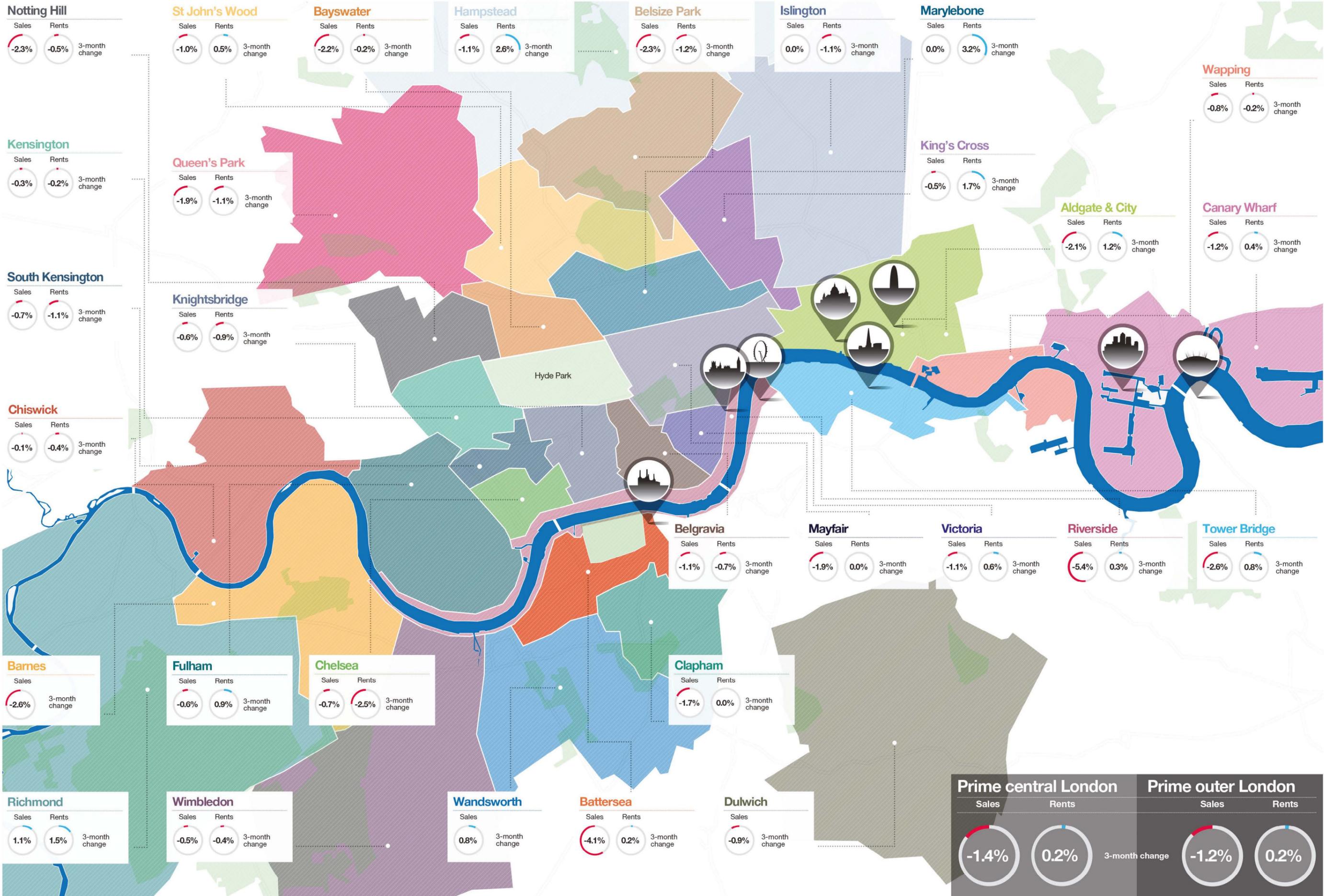
FIGURE 2
Sales decline as Brexit approaches
Greater London sales since the EU referendum



Source: Knight Frank Research / Land Registry

Please refer to the important notice at the end of this report

PRIME LONDON PRICE AND RENTAL GROWTH, SEPTEMBER 2018



KEY FINDINGS

1.1%

Rental value growth in prime central London in the year to September

6%

Increase in the number of new tenancies agreed by Knight Frank in London in the year to September 2018 compared to the previous 12-month period

7%

Decline in the number of new lettings listings in prime central London in the year to September compared to the previous 12 months

-5.6%

Fall in the gold price in the 12 months to mid-October, which compared to an annual total return of 0.3% in prime central London in the year to the end of September

PRIME LONDON LETTINGS MARKET INSIGHT

Rental value growth gathers pace in prime central London as tax changes mean supply levels continue to fall

While uncertainty surrounding Brexit is having a discernible impact on the sales market, the lettings market has been more affected by fiscal than political events.

A succession of tax changes for landlords that continue to 2020 means an increasing number have either sold or listed their property for sale. This, in turn, has resulted in a decline in supply and put upwards pressure on rental values.

There were 7% fewer new lettings listings in prime central London in the year to September 2018 than the previous 12 months, Rightmove data shows. The equivalent decline was 10% in prime outer London.

As a result, annual rental value growth has returned to prime central London and the annual declines in prime outer London are moderating.

Average rents in prime central London grew 1.1% in the year to September, while the annual change in prime outer London was -1%, which was the most modest rate of decline in two and a half years, as figure 4 shows.

A reform to tenant fees is one recent change that may exacerbate this trend. The change, which is likely to be introduced next year, could prompt more landlords to review their portfolios amid increased administrative charges.

Other tax changes in recent years relate to mortgage interest relief, wear and tear allowances and stamp duty.

Meanwhile, there was an announcement in the Budget that landlords who have previously lived in the property being rented out will no longer benefit from capital gains tax relief, which will impact owners who have become landlords after being unable to sell.

As a result, landlords have a growing list of considerations when managing their portfolio. The proposal by a Conservative think tank to scrap capital gains tax for landlords who sell to tenants who have lived in the property for three years is another example of this.

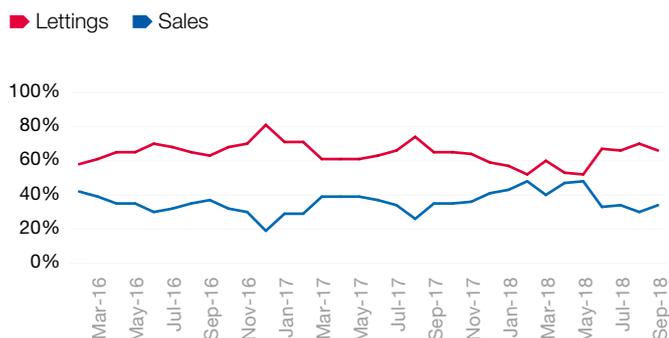
Though some landlords have attempted to sell in recent months in response to recent tax changes, a number of them have returned to the lettings market after their pricing expectations were not met, as figure 3 shows.

Despite declining levels of supply and the uncertain political backdrop, Knight Frank agreed 6% more new tenancies in the year to September 2018 than the previous year.

The total annual return in prime central London, a figure that takes the gross initial yield and annual capital value growth into account, was 0.3% in September.

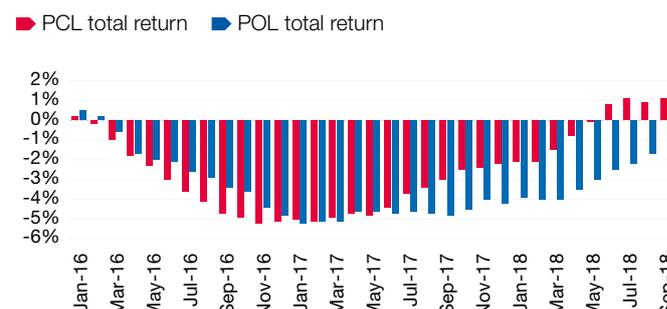
While this is lower than some previous years, it is stronger than other asset classes. The price of gold and the FTSE 100 fell by more than 5% in the year to mid-October.

FIGURE 3
To sell or to let? % share of all listings in prime London



Source: Knight Frank Research / Rightmove

FIGURE 4
Property outperforms other asset classes
Annual change, PCL and POL to end of September, FTSE100 and gold to 18 October



Source: Knight Frank Research

MACROVIEW BREXIT APPROACHES

As Brexit negotiations reach their conclusion, there has inevitably been an impact on decision-making in prime London property markets.

While the number of sales transactions have dipped in response to the uncertainty, pent-up demand is forming, as we examine on page 2.

The outcome of the negotiations is unknown but there are grounds to believe a deal can be reached between the UK and the EU that prevents a disorderly exit.

Although brinkmanship is rising during the final stages of the talks, both the EU and the UK appear to be edging towards an agreement. One of the key points of disagreement has been the so-called Irish backstop arrangement, which is effectively an insurance policy in case a trade deal does not materialise.

The backstop plan involves the UK remaining in a customs union with the EU, which one group of Brexit-supporting MP's believes must be time-limited. The EU has indicated it does not want a time limit.

Despite the disagreement, there is also a group of MPs who believe the risk associated with voting down any plan the PM agrees is that the process is derailed altogether.

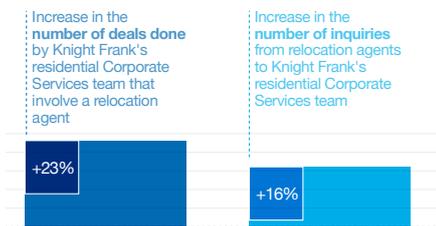
Trade Secretary Liam Fox gave an interview in October in which he suggested that any deal could be refined after March but that the overriding priority was to ensure Brexit took place.

Given the degree of pent-up demand forming in the sales market, if a deal is reached and ratified, this is likely to provide a boost to transaction volumes.

There is also evidence that far fewer jobs have been relocated from London than initially estimated as a result of Brexit. As few as 630 UK-based finance jobs have been moved overseas ahead of Brexit, recent analysis by Reuters showed. Indeed, a rise in the number of deals and inquiries involving relocation agents underlines the strength of demand from corporate tenants, as figure 5 shows.

Furthermore, the Reuters survey showed the number of jobs expected to move in the event of a hard Brexit was 5,766, down from 9,777 in September 2017.

FIGURE 5
Executives are still relocating to London
Year to September 2018 versus year to September 2017



Source: Knight Frank Research

RESIDENTIAL RESEARCH

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PLEASE GET IN TOUCH
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The grid contains the following report covers:

- The Wealth Report**: A report on global wealth trends.
- Prime London Sales Index September 2018**: A report on the prime London sales market.
- Prime London Rentals Index September 2018**: A report on the prime London rental market.
- Super-Prime Lettings Autumn 2018**: A report on the super-prime lettings market.
- London Hotspots**: A report on residential development hotspots in London.
- Mayfair and St James's Market Insight 2018**: A report on the Mayfair and St James's market.
- Richmond Lettings Market Insight 2018**: A report on the Richmond lettings market.
- Bayswater Lettings Market Insight 2018**: A report on the Bayswater lettings market.