Residential Quarterly | Summer 2017

Research - Market View

Economic Outlook

The repercussions of activating Article 50 and the start of formal negotiations, together with the outcome of the General Election on 8th June, are likely to increase uncertainty and political wrangling in the UK.

Information on the ongoing Brexit negotiations is opaque but signs suggest there is disagreement within the Cabinet. The absence of a majority for Theresa May further weakens her authority and negotiating position.

Centrist, and pro-European, Emanuel Macron has won a large majority in the French Parliament, going against the recent trend of the support of extreme parties although he is still a political novice. In September, Germany will hold a General Election, Angela Merkel has shrinking support but many predict she will remain as Chancellor with some kind of coalition Government. This would represent the status quo and is likely to bring an element of stability for Europe. The election in Germany has huge implications for Brexit negotiations given Germany's prominent position within Europe.

Outside of Europe, relations between Russia and the US are worsening, partly because of tensions in the Middle East but also the accusations, which are gathering in terms of momentum and evidence, of Russian interference in the US presidential election. Furthermore, there remains considerable concern over the escalating situation between the US and North Korea and relations between Qatar and the surrounding Middle Eastern States.

All of which result in a volatile international outlook.

The ONS estimates that the UK economy grew by just 0.2% in Q1 2017, the lowest across all G7 countries. This is in contrast to the end of 2016 when UK economic growth was the highest of the G7 despite the Brexit shock. The British Chamber of Commerce (BCC) estimate that Q2 growth was around 0.4% and are predicting a prolonged (c. 3 year) period of 'anemic' growth of 1.3% to 1.5% growth each year. Additionally, the IMF has reported that the UK economy will expand more slowly in 2017 and has downgraded it to 1.7% from earlier forecasted 2.0%, but remained at 1.5% for 2018.

The BCC report although business confidence could be lower there is still subdued growth particularly in the service sector and investment intentions remain low. This shows a cautious and uncertain business outlook, mirroring the position across economic commentators and highlights the need to get clarity on Brexit as soon as possible.

Rising costs for businesses (apprenticeship levy, business rates, living wage), coupled with the weak exchange rate, may still further impact the domestic market, both by increasing costs for domestic firms and making imports more expensive. The YoY growth of the CPI had been low throughout 2016; in November 2016 inflation was 1.2%. In 2017, however, this has been higher, with inflation above the Bank of England's target rate (2%) for most of the year to date. Inflation is now at 2.6%, having peaked at 2.9% in May. This slight decrease should alleviate some of the pressure on the Bank of England to raise interest rates.

2.6%

June 2017 inflation was at 2.6% down from 2.9% in May 2017

PMI Services down from 55.0 & PMI Industrial up from 54.2

Average household real disposable income fell by 1.4% over Q1 2017

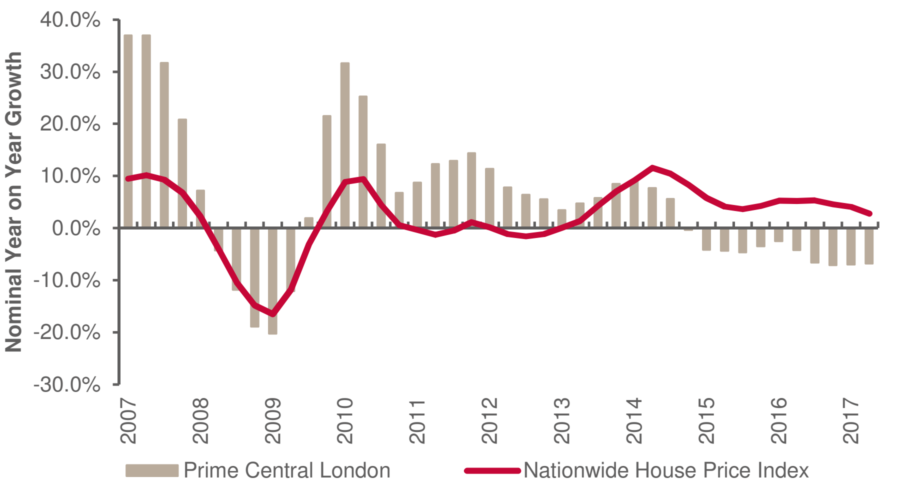
Property market pricing

According to the Nationwide House Price Index, national house prices are now 13% above the 2007 peak with London 55.8% above the peak. However, six regions remain below: The North (-6.9%), Yorkshire and the Humber (-2.6%), and North West (-2.8%), Wales (-5.7%), Scotland (-5.8%) and N. Ireland (-40.8%).

Quarterly figures though show that London suffered a significant decrease of -2.0% during Q2 2017 along with the Outer South East seeing -0.7%. The negative growth rate of these two regions is what has caused the national quarterly growth rate to Q2 2017 to become very slightly negative (-0.1%).

Figure 1

UK house price growth vs Prime Central London (PCL)



Source: *Nationwide House Price Index, Volterra*

UK property prices grew 2.8% Y-o-Y in Q2 2017

UK residential sales transactions

Table 1. Number of registered properties sold by property type for Q2 2017

Region	Detached	Semi-Detached	Terraced	Flats
East Midlands	2,372	2,274	1,802	389
East of England	2,640	2,411	2,608	1,352
Greater London	428	1,377	2,475	3,820
North East	627	1,178	1,334	384
North West	1,817	3,541	3,666	1,023
Scotland	6,185	4,421	6,329	9,506
South East	3,452	3,250	3,643	2,584
South West	2,564	2,132	2,701	1,478
Wales	1,267	1,230	1,489	274
West Midlands	1,785	2,532	2,174	669
Yorkshire and Humber	1,665	2,573	2,548	605

Source: *Dataloft, Land Registry as at 11th July 2017; Registers of Scotland as at 1st August 2017*

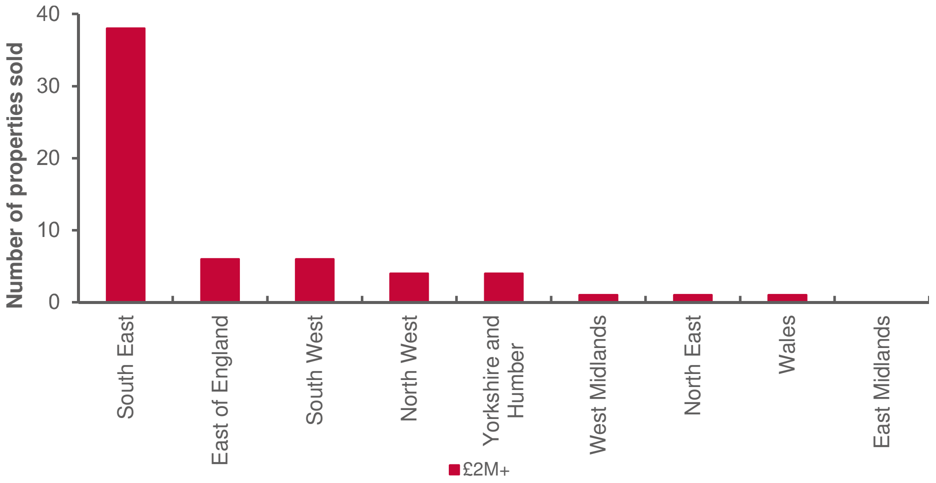
National house prices are now 13% above the 2007 peak

Country house highlights

As the reported figures for Land Registry come in for the end of 2016, it can be reported that the country house market increased by 19.0% compared to 2015. The majority of this growth was seen in the South East and South West, as the London ripple effect continued but perhaps more interesting was seeing increases in both Yorkshire & Humber and the North West, specifically in detached houses in the £2-5M bracket. The second quarter of 2017 however continued to see the South East have the highest number of sales transactions.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in Q2 2017



Source: *Dataloft, Land Registry as at 11th July 2017*

"Over the past quarter we have seen a positive shift in buyer sentiment. We have some excellent stock on our books and new applicants are up nearly 5% (y-o-y). When we look at the average number of applicants we have per property across the UK, it's higher than it has been at any point since 2012. More prospective buyers lead to higher viewing numbers, which should generate an increase in sales, which is very encouraging."

Guy Robinson

Partner

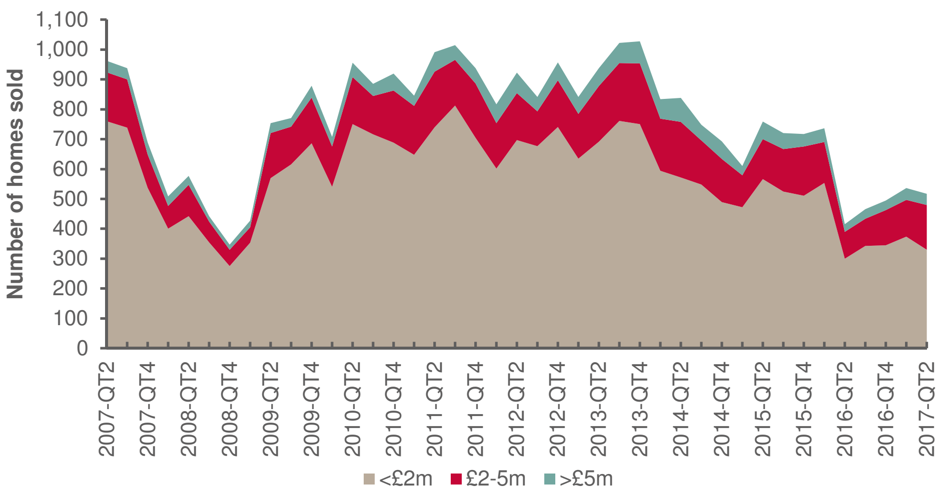
Head of Regional Residential Agency

Prime Central London residential sales market

Transactions across each of the price bands compared to Q2 2016 saw positive increases: sub £2M market (10.0%), £2-5M market (66.7%) and £5M+ market (42.3%). The entire PCL market was up 24.3% compared to the same time period in 2016. In contrast though, total transactions have decreased by -3.5% in comparison to the previous quarter and is -22.7% below the five-year average for Q2.

Figure 3

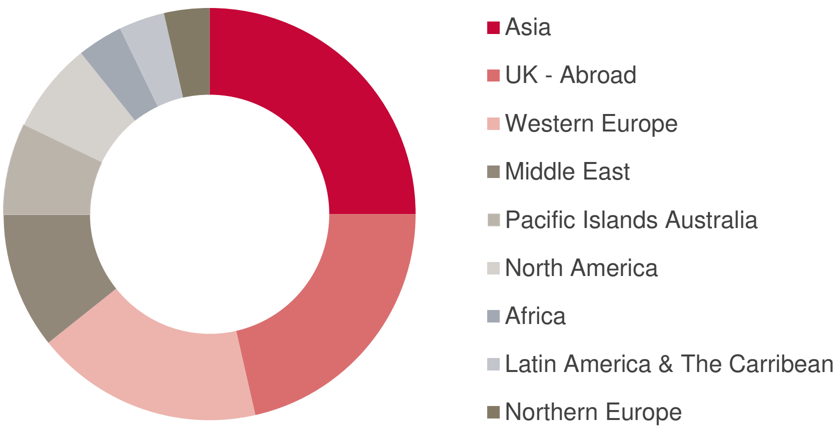
Historic number of sales in PCL



Source: *Dataloft, Lonres.com, Strutt & Parker as at 11th July 2017*

Our agents report that new buyer registrations are up, and the sentiment reflects a need to just get on with it after a lengthy period of inactivity. However, the increased levels of trade and buyer interest are in part due to lower values. If the recent upturn in transaction levels continues there is a chance that pricing will pick up in the second half of the year, and regain the falls experienced in the first half. Even so, the market remains sensitive and any further political upheaval or negative news will put this at risk.

Figure 4
Known PCL buyer nationalities for Q2 2017 (excluding UK domestic market)



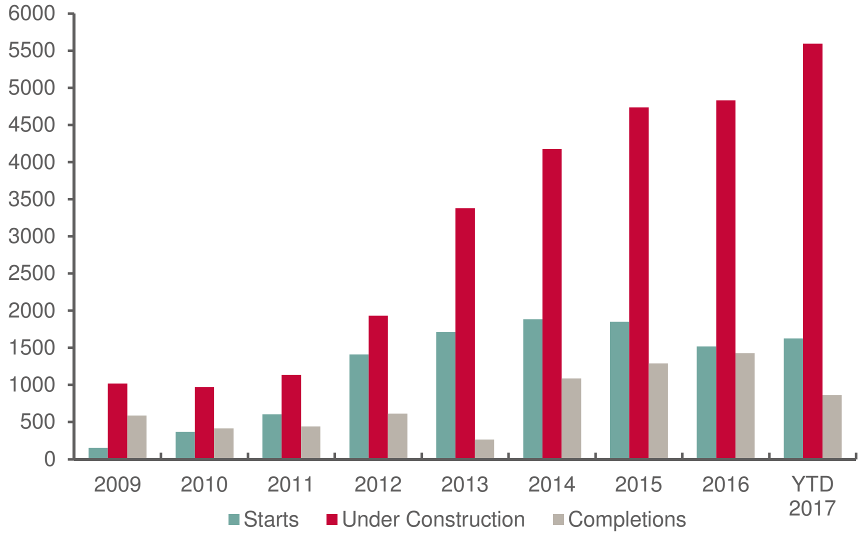
Source: *Strutt & Parker*

Prime Central London residential new homes

According to Molior, there were approximately 7,000 units that began construction (starts) during the second quarter of 2017 across Greater London, an increase of 1,000 units compared to the quarterly average throughout 2016. There were 1,628 units that began construction within the PCL boundary.

Build to Rent product under construction in PCL is only 26 units, which accounts for only 2% of starts so far in 2017 in Greater London.

Figure 5
Construction status of new homes in PCL



Source: *Molior, Strutt & Parker as at 17th July 2017; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster*

"Transaction levels in Prime Central London, across all price bands, are up on this time last year and this uptick in volumes is very welcome. However, the values being achieved are lower than they have been – savvy buyers are choosing now to take advantage of current pricing. Whilst one might have expected more transactions from overseas buyers due to the currency benefits, domestic buyers are currently the most prolific. We expect prices to remain flat for the rest of 2017 and into 2018 which we hope could spur further activity."

Charlie Willis

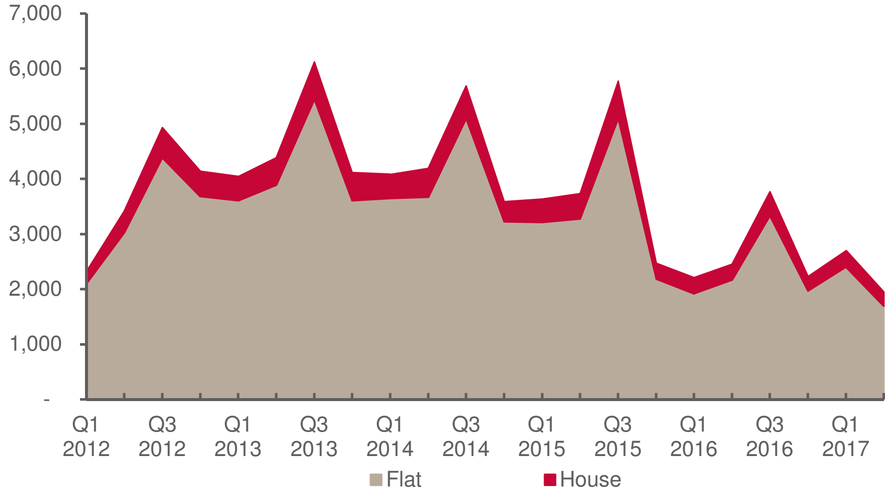
Partner
Head of London Residential Agency

Prime Central London lettings market

The take-up of new rental tenancies across PCL decreased by 20.7% in Q2 2017 compared to the same time last year and is down 19.4% on the five-year average for the quarter.

UK Average Rent: £908pcm (HomeLet)

Figure 6
New rental tenancies in PCL by house type



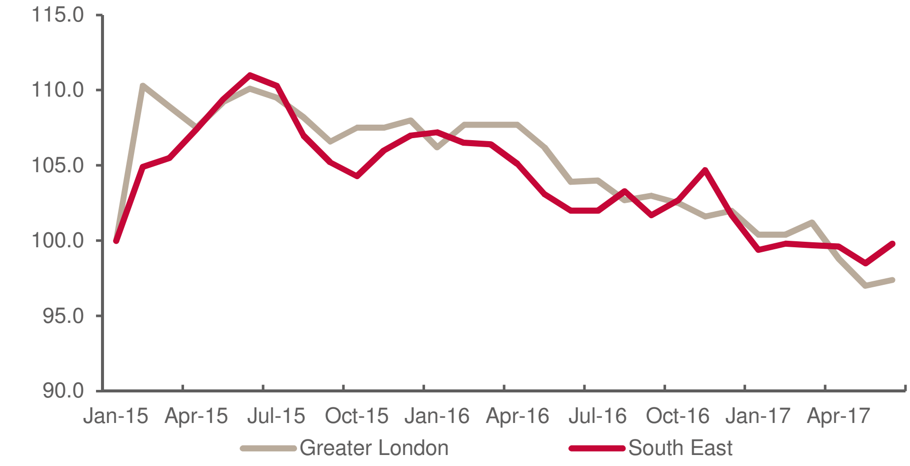
Source: *Dataloft, Lonres.com as at 20th July 2017*

Assessing pricing levels across rental product in PCL and the wider UK can be challenging, however HomeLet is reporting via their tenant referencing service that Greater London is achieving £1,524pcm whilst the combined boroughs of Kensington & Chelsea and Hammersmith & Fulham are attaining an average rent of £1,881pcm (4.3% annual increase).

These figures however are not showing the decline that can be seen when indexing the annual average rental variance back to 2015 by region. There has been a steady downward trend that can be seen when viewing almost all of the UK regions, however, it is most clearly demonstrated when looking at Greater London and the South East (see Figure 7).

As the data suggests, generally these new leases are likely paying less than two years ago as many existing tenants renew existing leases.

Figure 7
Annual Average Rent Variance by Region, Index (2015 = 100)



Source: *Strutt & Parker, HomeLet as at 20th July 2017*

Outlook & forecast

Much of the downward pressure on PCL house prices because of Brexit and SDLT has likely already been experienced and although the UK and the world remain in a period of substantial economic and political uncertainty, the outlook for the UK remains reasonable.

The immediate focus should be placed on how Britain will fare with the Brexit negotiations. This will depend greatly on how the relationship with the DUP unfolds and whether Theresa May remains Prime Minister. And theoretically, the weaker pound should be an incentive to international investors to buy UK property but if the US Dollar slides it may lose some comparative advantage.

Transaction levels reportedly picked up slightly at the end of 2016 and through the first quarter of 2017 in PCL, however they remain low by historic standards. Realistic pricing and the continued attractiveness of Sterling will continue to be key factors affecting market activity levels in the higher price sectors.

Table 2. Residential price forecast Q2 2017

Sales	2017	2018	2019	2020	2021	5 Year to 2021
Prime Central London ***Best case***	0.0%	0.0%	4.0%	5.0%	6.0%	16.0%
Prime Central London ***Downside risk***	-5.0%	-5.0%	0.0%	1.0%	2.0%	-7.0%
UK	3.0%	3.0%	3.0%	4.0%	4.0%	18.0%
Lettings	**2017**	**2018**	**2019**	**2020**	**2021**	**5 Year to 2021**
Prime Central London	0.0%	1.0%	1.5%	2.5%	2.5%	10.0%

"Surprisingly the UK economy has been more resilient than anticipated considering the political uncertainty over the past 12 months. As consumer and business confidence begins to wobble, supply for new housing is still extraordinarily low and demand has not significantly dipped. Therefore, even though the market may now be faced with increased inflation and weak household income growth, cheap credit conditions remain and consequently property priced correctly will continue to transact."

Vanessa Hale

Partner
Research

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Methodology
As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q2 2017 in light of changes since Q2 2016. Data may also be compared on a rolling month on month basis. When referring to the PCL market it includes those markets which Strutt & Parker operate in (Knightsbridge, Belgravia, Kensington, Chelsea, Notting Hill & Fulham) and as such is reflective of London's most prime markets. Economic views are attributed to Strutt & Parker's retained economic advisors, Volterra. Additionally, Lonres.com data is used to assess the London sales and lettings market. The behavioural data is collected from our activity in PCL markets: our proprietary "behavioural data" is not representative of the UK as a whole. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.