Residential Quarterly | Summer 2018

Research - Market View

Economic Outlook

Brexit is making gradual progress with details slowly being released. Theresa May has outlined the UK's desired position with regards to the UK's future relationship with the EU. However it is important to note this is just the government's preferred position and has yet to be agreed by the EU and could therefore change substantially over the coming months. The recent announcements have also highlighted the lack of consensus within the government, seeing both the Brexit Secretary and Foreign Secretary resigning.

Looking beyond Brexit and concentrating on the UK economy, the National Institute for Economic and Social Research estimate that the UK economy grew by 0.2% in Q1 2018. Q2 has seen a higher growth of 0.4% and they expect this to improve further in Q3 (0.5% growth forecast). The reason for the higher growth as the year goes on is that Q1 growth was thought to have been hampered by bad weather whereas Q2 has seen boosts in consumer spending as a result of the warm weather, two bank holidays, the World Cup and a royal wedding. Furthermore, independent forecasts collected by Her Majesty's Treasury (HMT) predict total growth by the end of 2018 ranging from 0.7% to 1.9%, with the average forecast being 1.4%. This outlook has been downgraded slightly from Q1 2018 (when the average outlook was 1.6% for 2018) but remains reasonable. As for the British Chamber of Commerce, they have also slightly downgraded their growth forecasts for the UK economy. GDP is expected to grow by 1.3% as oppose to 1.4% for 2018 and if this forecast is realised it will be the weakest growth since 2009. This downgrade is driven by a more conservative outlook for consumer spending, business investment and trade. BCC acknowledge that real wages are now rising, but so far the increases have been so negligible it will not translate into any growth in consumer spending. In addition productivity remains weak, which will also limit increases in real wages.

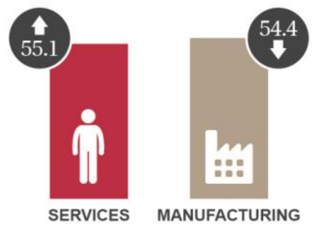
In Q1 2018, the ICAEW Business Confidence Monitor saw an increase in business confidence rising to -1.0 from Q4 2017. But for the first time since Brexit, in Q2 2018, business confidence is positive (+7). Although this remains a fairly neutral score, it is significant that this is the first time all UK regions have registered positive business confidence. This increase is likely to stem from greater clarity on Brexit and improving sales growth. The things likely to hold back future improvements are regulatory requirements, high staff turnover and the continued uncertainty over Brexit.

Rising costs for businesses (apprenticeship levy, business rates, living wage), coupled with the weak exchange rate, may still impact the domestic market, both by increasing costs for domestic firms and making imports more expensive. In April inflation was as low as 2.2%, the lowest rate in a year. However, since April it has crept up again and according to the latest figures from ONS currently stands at 2.3% with the slight increase attributed to rises in motor fuel and ferry tickets. Given that companies are expected to increase wages by 3.1% in 2018 it would mean earnings growth would slightly outpace that of inflation. This should help support consumer spending, a key driver of the UK economy.

The official bank rate was increased by 0.25% to 0.75% on the 2nd August 2018. The rate remains low by historic standards. Any additional rise in interest rate that may occur will likely be introduced slowly and steadily to eliminate economic shock.

2.3%

June 2018 inflation (CPI) was at 2.3% up from 2.2% in April 2018
Source: ONS



PMI Services up from 51.7 & PMI Manufacturing down from 55.1
Source: IHS Markit/CIPS

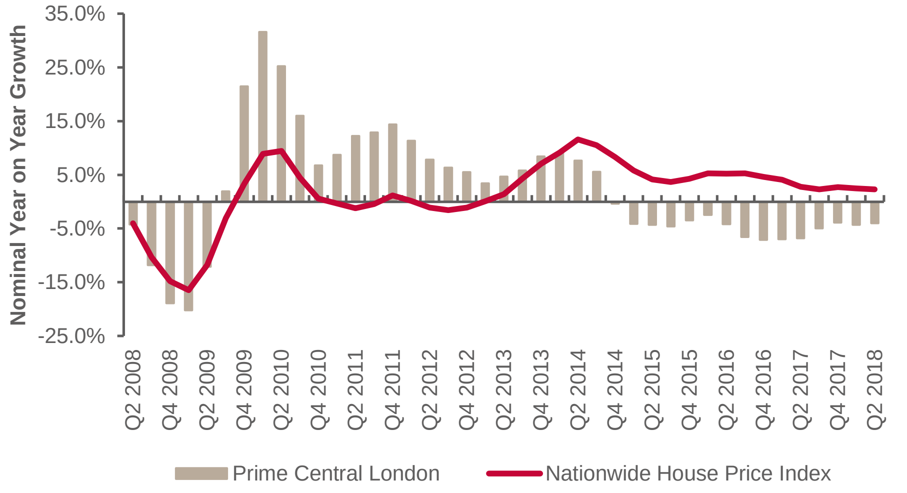
Real average weekly earnings (total pay) rose by 0.2% in the three months to May 2018, compared to the equivalent period in 2017.
Source: ONS

Property market pricing

According to the Nationwide House Price Index, UK property prices grew 2.3% in the year to Q2 2018. Y-o-Y growth over the same period shows that on a regional basis the best performers have been: East Midlands (4.5%), West Midlands (4.3%) and Wales (4.1%). This level of growth is much lower than the best performing regions last quarter. Despite historically having one of the strongest growth rates in the UK, London continued to have the weakest growth in the country for the quarter (-1.9%) and is the only region to have experienced negative growth in Q2 2018.

National house prices are now 15.7% above the 2007 peak with London prices still 53% above the 2007 peak.

Figure 1
UK house price growth vs Prime Central London (PCL)



Source: *Nationwide House Price Index, Volterra*

UK property prices grew 2.3% Y-o-Y to Q2 2018
Source: Nationwide HPI

Regional residential sales transactions

Table 1. Number of registered properties sold for H1 2017 and H1 2018

Region	All Property H1 2017	All Property H1 2018
East Midlands	23,343	23,464
East of England	30,931	29,483
Greater London	29,616	27,818
North East	11,883	11,819
North West	34,203	34,488
Scotland	46,513	43,565
South East	44,405	41,919
South West	30,038	28,960
Wales	13,963	14,111
West Midlands	25,191	25,493
Yorkshire and Humber	25,191	25,528

Source: *Dataloft, Land Registry H1 2017 data as at 11th July 2017 and H1 2018 data as at 16th July 2018; Registers of Scotland H1 2018 as at 1st August 2018. Please note Land Registry data has a six-month data lag unlike Registers of Scotland, which reports actual transaction figures at time of reporting.*

National house prices are now 15.7% above the 2007 peak
Source: Nationwide HPI

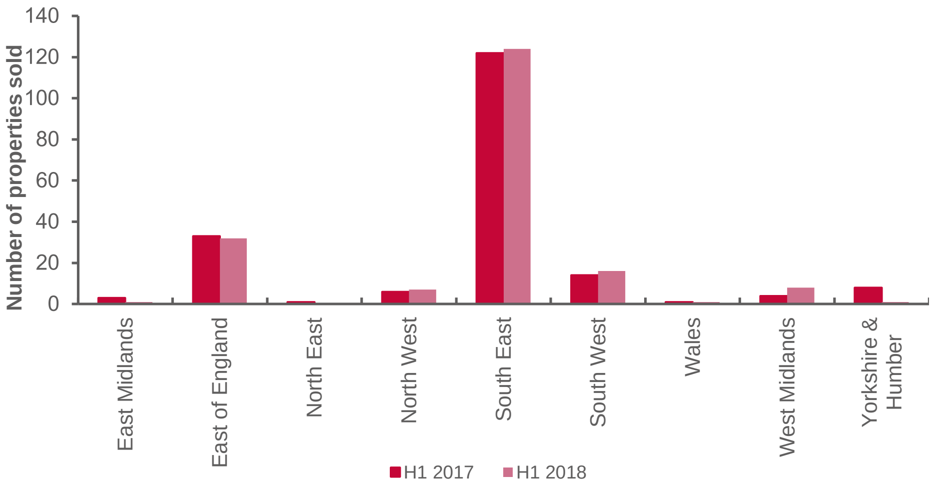
Country house highlights

The largest numbers of detached homes sold over £2 million excluding Greater London were in the South East and East of England in both H1 2017 and H1 2018. The South West, North West, and West Midlands rounded up the top five regions for the largest number of transactions for detached homes sold over £2 million compared to 2017.

Looking at our buyer profiles for this market, there has been a small increase in buyers from Western Europe, Asia, Middle East and North America, while the dominant buyer continues to be from the UK.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in H1 of 2017 and H1 2018



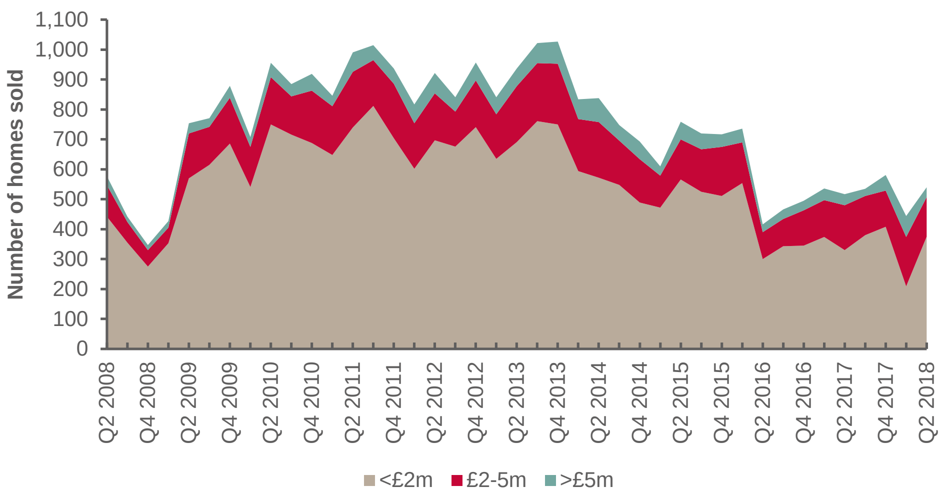
Source: *Dataloft, Land Registry Q1 2017 data as at 11th July 2017 and 2018 data as at 16th July 2018*

Prime Central London residential sales market

Overall, transaction levels have seen a 4.4% increase compared to Q2 2017. This uptick in volumes is a positive sign for the market. However, this increase has masked the fact that the £2m-£5m and £5m+ brackets experienced -12.0% and -10.8% (respectively) Q-o-Q decreases. But it should be noted that transactions in PCL are dominated by the sub £2 million bracket, accounting for circa 70% of total transactions.

Figure 3

Historic number of sales in PCL for properties over £2 million



Source: *Dataloft, Lonres.com, Strutt & Parker as at 6th July 2018*

"Since the chilly temperatures and snow that we saw in the early spring, the sun has been positively shining across the UK and the property market has been getting gradually warmer too. Transaction levels have been steady throughout April, May and June in comparison to last year. Homebuyers have got used to the climate of political instability, which seems here to stay, and they are no longer using Brexit or tax changes as an excuse for not making a move. However, the number of buyers registering is dwindling, although those that are contacting us are more focussed on their search, thereby sustaining momentum."

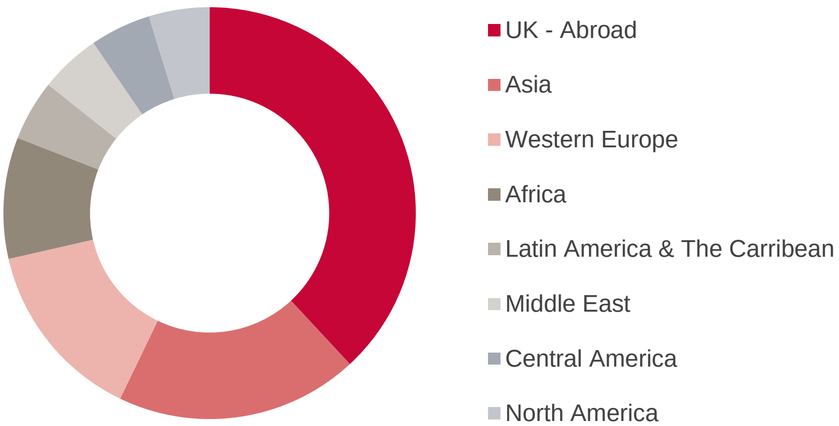
Guy Robinson

Head of Residential Agency

As the weakness in Sterling following Brexit continues and with the global view that the UK remains a safe haven, PCL continues to attract overseas purchasers albeit at slightly lower level than historically. Also it is with interest that we continue to see an increase in UK buyers who currently live abroad purchasing property in PCL, although it should be noted this remains at very low levels.

Figure 4

Known PCL buyer nationalities for Q2 2018 (excluding UK domestic market)



Source: *Strutt & Parker*

Greater London residential new homes

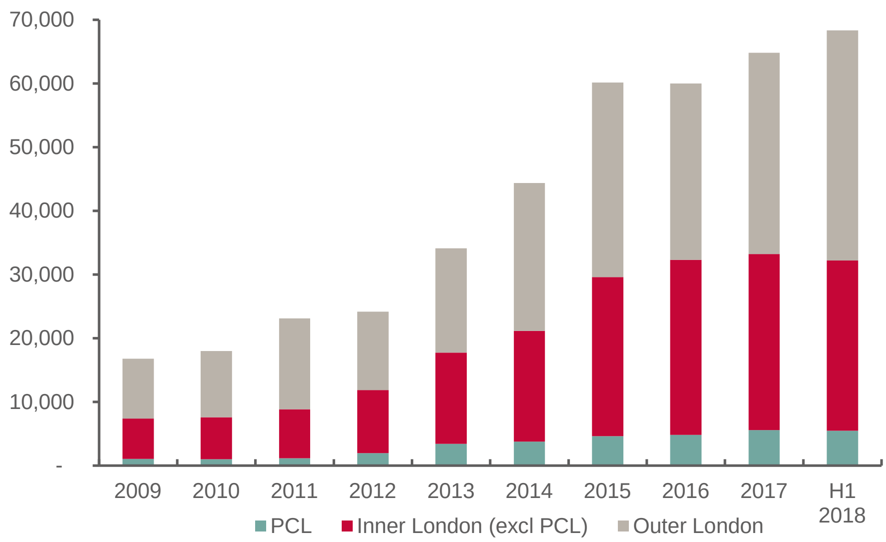
In Q2 2018, across Greater London, on the construction side, there are just over 68,300 units where construction has physically begun. This is 5% more than the end of 2017.

Construction completions for the first half of 2018 was just over 10,000 units with 5,200 new homes sold in Q2 2018, according to Molior, and nearly 40% of these sales being for the build to rent (BTR) sector.

The average pricing for new homes across London is £890 psf, which is 2% down from 2017, which was £900 psf.

Figure 5

Number of units under construction in schemes of 20+ private units in Greater London



Source: *Molior, Strutt & Parker as at 30th July 2018; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster; Inner London defined as Local Authorities of Camden, City of London, Hackney, Islington, Lambeth, Southwark, Tower Hamlets, Wandsworth; Outer London defined as remaining 22 Greater London boroughs*

"Transaction volumes in the PCL market remain low, but we have seen a slight improvement in sales since 2016. We are seeing competitive bidding for some stand-out properties. Larger family homes that might have been on the market for 12 months already are now moving and being picked up by families who have sat on the fence since Dec 2014 when major stamp duty increases were imposed. They are now moving as they realise there's no point waiting any longer as government is unlikely to change their stance on these higher level taxes and people can see the sense in buying now to lock in interest rates while they are still low."

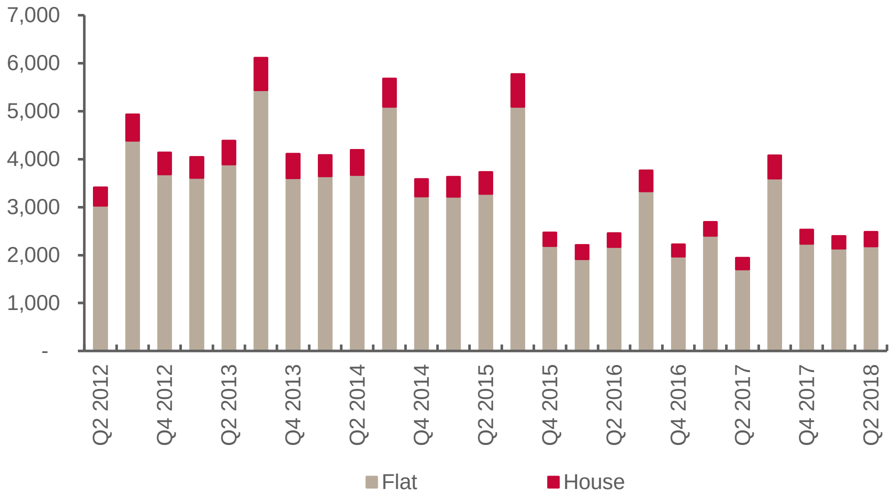
Charlie Willis

Head of London Residential Agency

Prime Central London lettings market

The take-up of new rental tenancies across PCL increased by 27.7% in Q2 2018 compared to the same period last year and is down 16.1% on the five-year average for the second quarter.

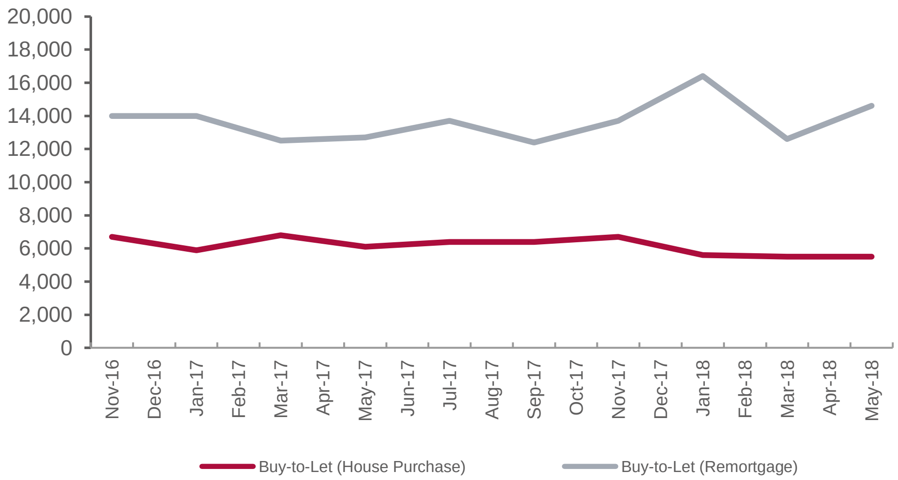
Figure 6
New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 31st July 2018*

According to UK Finance, there were 5,500 new buy-to-let house purchase mortgages completed in May 2018 (most recent data released) showing a Y-o-Y decline of 9.8%. Additionally, there were 14,600 new buy-to-let remortgages completed in May 2018, resulting in a Y-o-Y increase of 15.0%. Overall, the Buy-to-Let market looks to be relatively stable, albeit with subdued levels of new uptake, due in part to the impact of recent legislative and tax changes.

Figure 7
Number of New Residential Loans (monthly)



Source: *UK Finance – Mortgage Trends Update 12th July 2018*

"Whilst lettings values have remained static in PCL since 2017, properties in the £700 to £1,000 per week bracket continue to show real movement. At the other end of the market, super prime is also doing well, and we are seeing appetite for properties at £4,000 per week and over. The properties that are sticking are those in the mid-range which are in need of refurbishment. Although we are forecasting 0% growth in lettings prices for the rest of 2018, there are always exceptions to the rule and turnkey properties in amazing positions continue to achieve good rents."

Kate Eales

Head of Residential Lettings

UK Average Rent: £924pcm
Source: HomeLet

Outlook & forecast

Now that there have been some initial agreements reached on Brexit, attention can move towards trade negotiations. The route Britain takes with these issues will have large implications on the nature of Brexit and the future strength of the UK economy. The fundamentals of the UK economy remain broadly positive, but sentiment remains very cautious.

Total transaction levels for England and Wales look to be relatively equivalent to this time last year. However, in PCL despite transactions picking up over the course of 2017, they continue to be low by historic standards. With substantial economic and political uncertainty continuing, it doesn't look likely that this will change any time soon.

The forecasts for UK and PCL performance have remained the same. In PCL the best-case scenario of the falls seen in the first half of 2018 being recouped during the second half of the year, thus finishing with 0% growth over the course of the year. The risk remains on the downside however, with the downside risk scenario of -5% growth for 2018. Realistic pricing and the continued attractiveness of Sterling will continue to be key factors affecting market activity levels in the higher price sectors. We expect this stagnation in prices to persist for the remainder of 2018 with the possibility of further negative growth as both globally and domestically the economy and political environments remain volatile. From 2019 onwards it is extremely difficult to forecast this market with any certainty but we would expect some bounce back once more stability has returned.

Table 2. Residential price forecast Q2 2018

Sales	2018	2019	2020	2021	2022	5 Year to 2022
Prime Central London ***Best case***	0.0%	4.0%	5.0%	6.0%	6.0%	23.0%
Prime Central London ***Downside risk***	-5.0%	0.0%	1.0%	2.0%	2.0%	0.0%
UK	2.5%	2.5%	4.0%	4.0%	4.0%	18.0%

Lettings	2018	2019	2020	2021	2022	5 Year to 2022
Prime Central London	0.0%	1.5%	2.0%	2.5%	2.5%	8.5%

"We continue to hold our residential house price forecasts for sales and lettings as the wider economic and political uncertainty remains. We maintain that from 2019 onwards it continues to be extremely difficult to forecast the housing market with any certainty, but we would expect some bounce back and a return to growth once more stability has returned to the UK."

Vanessa Hale

Director, 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 2018. 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. Registers of Scotland does not have a data lag at end of quarter compared to Land Registry data and therefore transaction figures at end of quarter for Scotland may appear abnormally high in comparison. 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.