GARRINGTON

LONDON MARKET REVIEW

Summer 2016

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BREXIT SPECIAL

The enormity of the UK's decision to leave the EU, and the intensity of political reactions that followed, has inevitably focused attention on the immediate consequences of that one 'Black Swan' event. It would be hard to overstate the significance for the long-term political and economic future of the UK, while implications for the housing market may take months or years to be fully understood. In this report, we have 'zoomed out' and tried to set Brexit into a wider perspective.

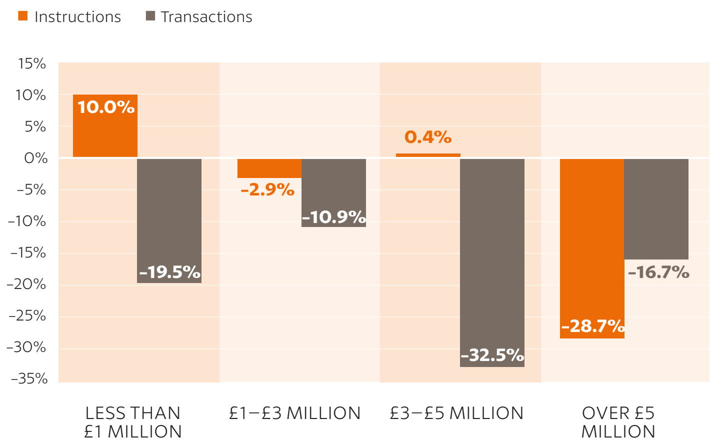
London residential property

While prime central London (PCL) is expected to feel the brunt of reduced confidence and weakened demand following Brexit, demand had already been undermined by a series of stamp duty changes disproportionately affecting high value and investment properties.

Despite a rush of buyers in March to beat the 3% stamp duty surcharge for second homes and investments, transaction volumes in the six months to the end of May were 17.5% down on the previous equivalent period. The hardest hit segment of the market was properties priced at £3–£5 million, where the volume of transactions fell 32.5% in the same period. Of all the sub-markets, Mayfair experienced the steepest decline.

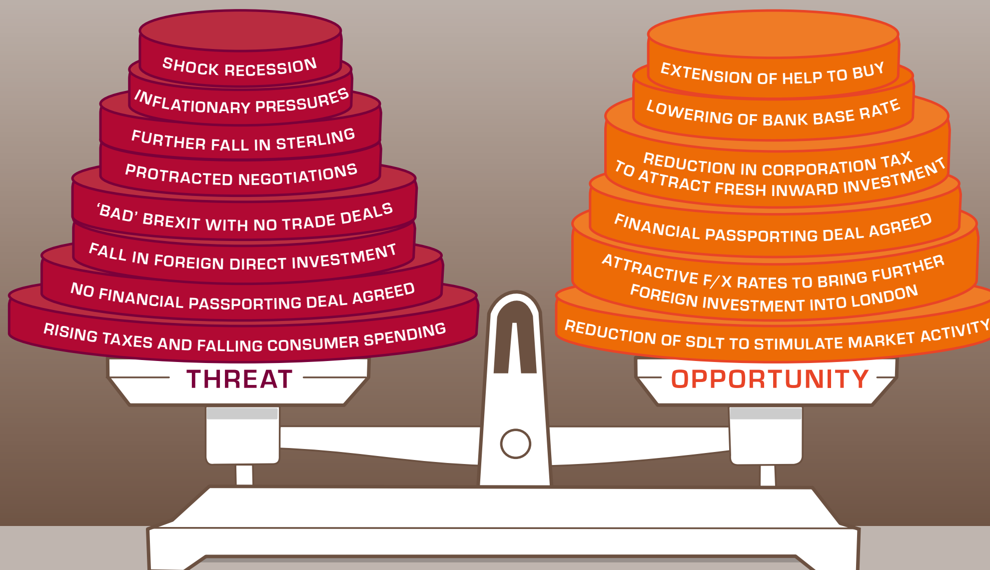
Comparison of instructions versus transactions in PCL

December 2015 – May 2016 compared to the six months previously (June – November 2015)



Source: LonRes

Perhaps surprisingly prices held up despite sales volumes falling. In fact, average prices per square foot actually edged upwards in the six months prior to the referendum. This is almost certainly explained by supply constraint – when supply is low, it doesn't take much demand to create competition. However, the higher priced properties were again hit harder. In the £3–£5 million bracket, average prices per square foot dropped by 6.4%, suggesting that, for this segment of the market, supply exceeded demand.



HOW CAN POLICY REDRESS THE BALANCE?

Brexit unleashed an array of threats to the UK economy – and to its housing markets. The work will now begin to hold those threats at bay during what could be a protracted period of negotiations to leave the EU. We can expect the government to announce a succession of policy measures in the coming months, designed to support and boost the UK housing market.

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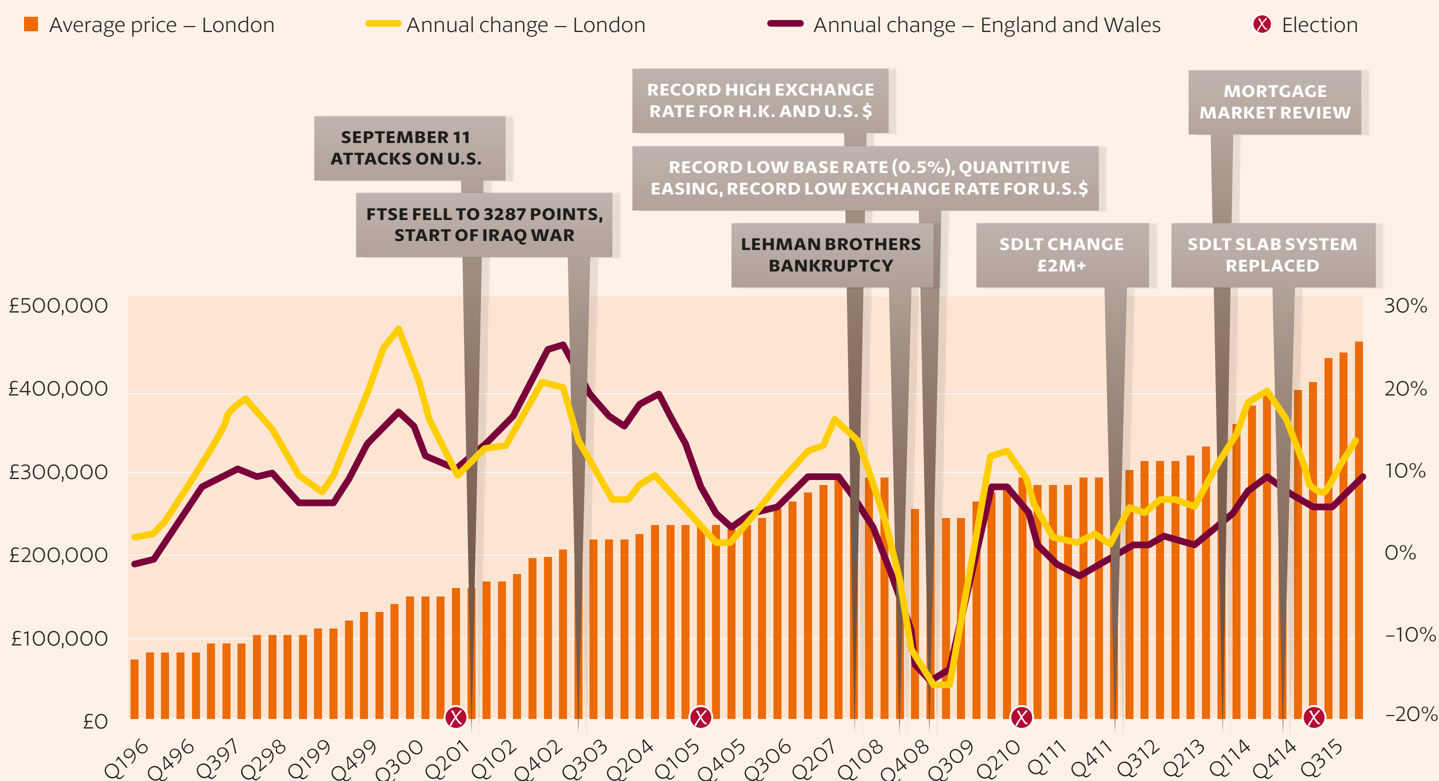
WHAT DOES HISTORY LEAD US TO EXPECT?

Looking at the past to plan for the future

LONDON RESIDENTIAL PRICE CYCLES 1996–2016

History shows us that, while the rate of growth has fluctuated, the price of London property has risen almost without a break for the past 20 years. Even under the extreme circumstances of the Global Financial Crisis the prime London market proved highly resilient, bouncing back strongly after a short period of weakness.

A property bought in Kensington and Chelsea in the trough of the market in 2009 rose steeply in value by 31% in just five months. Seven years later, the average price of a Kensington and Chelsea property has more than doubled, underlining how periods of volatility can create opportunity for property buyers considering medium to long-term ownership.



Source: Land Registry

Where to from here?

Some downward pressure on prices is inevitable as uncertainty takes its toll on confidence. However, we do not expect significant price falls unless a rise in forced sellers causes stock levels to increase rapidly. Buyers who are prepared to commit under these conditions will find less competition, more choice and will be in a position to benefit from the upside, as and when confidence returns.

Any price weakness will attract opportunistic investors expecting that history will repeat itself and prices will rebound on the first signs of renewed confidence. In the short term, we expect some interest from overseas investors taking advantage of the currency situation. In the longer term, we are confident that London's attributes as one of the most admired and liveable cities in the world will continue to draw overseas buyers attracted by its job opportunities, its world class education, its arts, heritage, restaurants, entertainment and, above all, its political and economic stability.

However, in relative terms, overseas investors represent a relatively small proportion of buyers, even in prime central London. In recent times, domestic buyers, taking a long-term view on home ownership, have proved more willing to accept the increased purchase costs arising from stamp duty and we expect them to make up a growing proportion of demand in the coming months. This will focus activity in the lower or mid-price brackets – though any downward pressure on prices at the top end will work in their favour, narrowing the gaps on the housing ladder and making their next step-up more attainable.

"It is too early to reach sweeping generalisations about the whole of the market. However, there can be no doubt that the London market has become further polarised by the Referendum result and, this in turn, has created both threats and opportunities for different types of buyers."

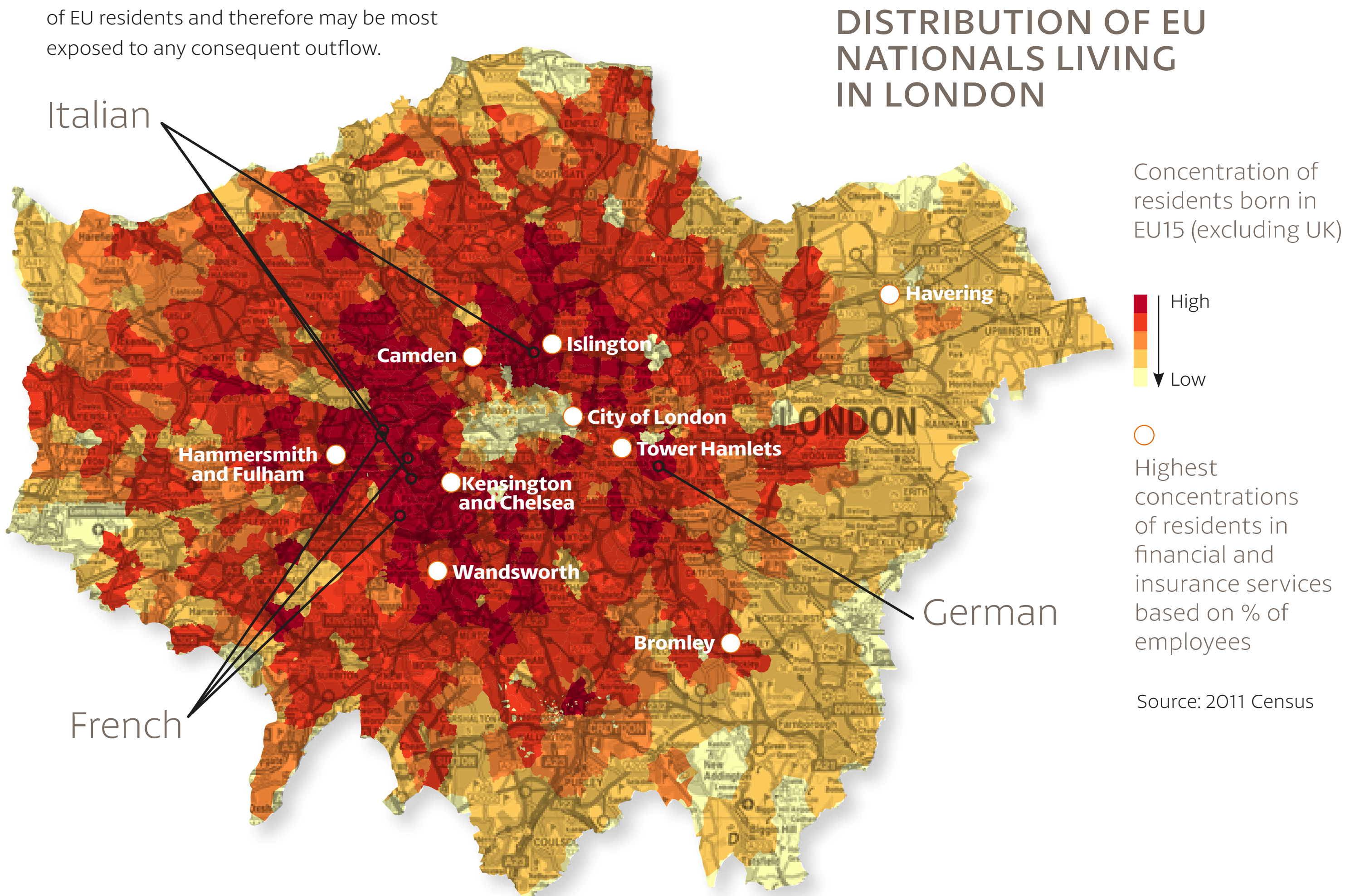
JONATHAN HOPPER, MANAGING DIRECTOR

AREAS EXPOSED TO BREXIT THREATS

What if EU Nationals leave London?

While there is a long way to go in negotiating the terms of the UK's exit from the EU, there are significant risks to the labour market which could impact on demand for housing. The two key risks are the potential ending of the free movement of labour and the loss of passporting. The first would make it far more difficult for businesses to recruit EU nationals and the second would prompt some companies to relocate or reduce the size of their EU headquarters in London. We have evaluated which of London's housing markets have the highest concentrations of EU residents and therefore may be most exposed to any consequent outflow.

Just under 2 million EU nationals lived in the UK at the time of the 2011 census. 71% lived in London and a further 714,849 have arrived since then (Department of Works and Pensions). The heatmap below shows where residents from the original EU 15 have tended to cluster. Kensington and Chelsea has the highest concentration, accounting for 18.5% of its population (as at 2011).



Concentrations of financial sector employees

While London's status as a global financial centre is probably secure, its role as Europe's financial centre is in question. IHS Markit's Purchasing Manager's Index reports that growth in the UK's service sector hit a joint 38-month low in June, indicating a slowdown before the Brexit vote. Financial services jobs look under threat should the UK lose its 'passporting' rights, with companies developing plans to relocate employees to Europe if this occurs. In the meantime, jobs creation is likely to be put on hold while uncertainty prevails. Within London, the City of London, along with the Boroughs of Kensington and Chelsea and Westminster have the highest concentrations of residents in financial and insurance service sector jobs.

Highest concentrations of residents in financial and insurance services based on % of employees

Within London Boroughs		Outside London Boroughs	
City of London	22.5%	Brentwood	13.2%
Kensington and Chelsea	21.5%	Rochford	12.0%
Westminster	17.0%	Southend-on-Sea	11.1%
Tower Hamlets	15.0%	Basildon	9.5%
Wandsworth	10.8%	Castle Point	9.5%
Bromley	10.2%	Chelmsford	9.5%
Camden	10.0%	Tunbridge Wells	9.3%
Havering	9.9%	Reigate and Banstead	8.9%
Hammersmith and Fulham	9.9%	Bournemouth	8.8%
Islington	9.0%	Sevenoaks	8.7%

Source: 2011 Census

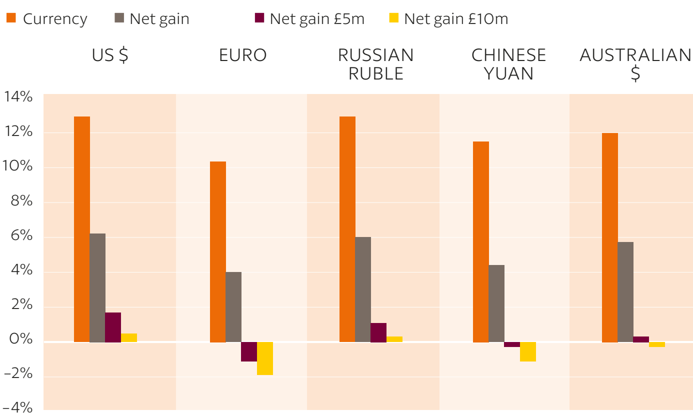
FOCUS ON INVESTMENT

In the aftermath of the Global Financial Crisis back in 2009, overseas buyers fuelled the recovery in prime London and prices rebounded quickly. As the pound dropped sharply against the dollar and other currencies, overseas buyers found central London properties considerably cheaper than just a few months earlier. There has been much speculation since the Referendum that the same is about to happen in London and that overseas buyers will flock to capitalise on gains made available through falls in the value of sterling. Indeed, between 23rd June and 6th July the pound dropped by 13% against the dollar and 11% against the euro.

The central London residential market in 2016, however, is very different to 2008/2009. There are now much higher stamp duty liabilities for top-end properties, which have been further inflated by the 3% 'additional property' surcharge from April. The momentum to invest in central London property had already been dampened in the run-up to the vote and, despite the advantage of currency changes, stamp duty costs look set to dilute or completely erode any gain.

Currency gain since 23rd June

Adjusted for stamp duty costs at different property price points (including 3% surcharge)



Source: Garrington Research using Bank of England, showing difference between 23rd June and 6th July

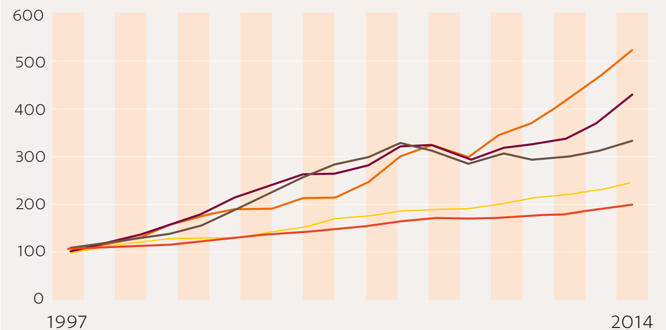
At the end of January 2009, the currency gain for US buyers compared to just six months earlier was 32%. At the same time, a flat 4% stamp duty fee on any properties sold over £500,000 meant that the net currency gain after stamp duty costs were taken into account was still 28%. This meant that a £1 million property cost $1.42 million after stamp duty, compared to just over $2 million six months earlier.

At present, a £1 million property would cost 13% less in monetary terms on 6th July 2016 compared to 23rd June 2016. However, after allowing for all stamp duty costs including the 3% surcharge, the net gain is just 6.5%. In the upper price bands, the gains made by most major currencies are largely wiped out after stamp duty costs. Given the above, it is unlikely that there will be a repeat of the unprecedented surge in demand as witnessed in 2009. Instead, it is more likely that a steady flow of international buyers will return to the London market, many of whom were previously put off by the significant rise in stamp duty costs. With this transaction cost now largely offset for foreign buyers, London's investment credentials are once again appealing.

Exposed or underpinned?

While overseas investment has been a factor fuelling the growth of central London property values after the Global Financial Crisis, the recovery was also underpinned by a strong London economy. Even as the UK suffered a deep recession, London's economy continued to expand, driven by its financial services industry and fast-growing tech sector. As seen in the chart below, London's economy effectively decoupled from the rest of the UK. This higher level of economic output has supported job creation and corporate investment, which have supported the property market. Clearly the result of Brexit negotiations will have important implications if London's economy and housing market are to continue to outperform the rest of the UK.

HOUSE PRICES: Kensington and Chelsea — London — England and Wales — London GVA — UK GVA excluding London



Source: Land Registry, ONS (GVA plus taxes, excluding subsidies equals GDP), comparing each measure from 100 in 1997

Garrington work on behalf of private and/or corporate clients who want to buy, rent or invest in property both in London and throughout the UK.

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Garrington
53 Davies Street
London
W1K 5JH

Tel +44 (0)20 7099 2773
Fax +44 (0)20 7099 2779
info@garrington.co.uk
www.garringtonlondon.co.uk