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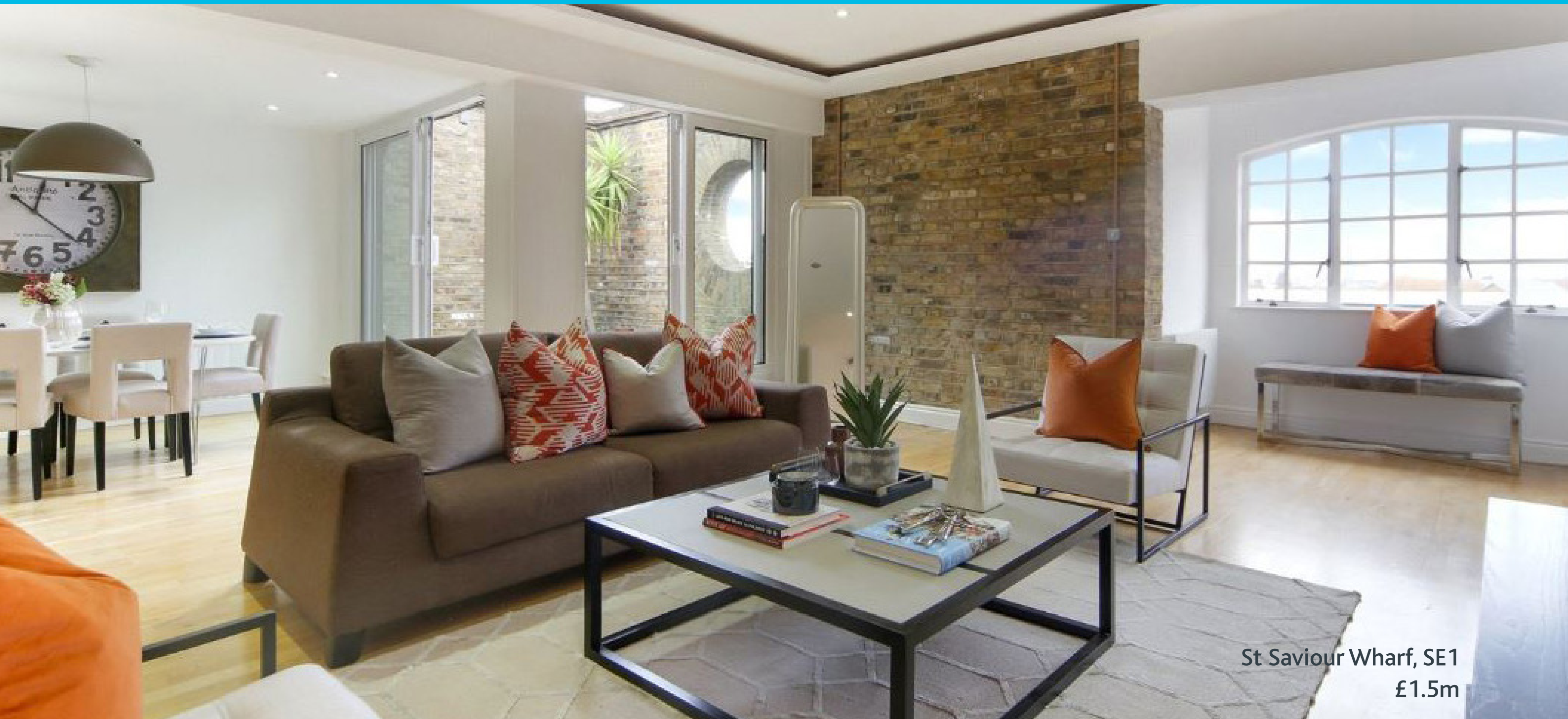

St Saviour Wharf, SE1
£1.5m

London, Winter 2018/19

RESIDENTIAL MARKET OUTLOOK

RESIDENTIAL SALES MARKET

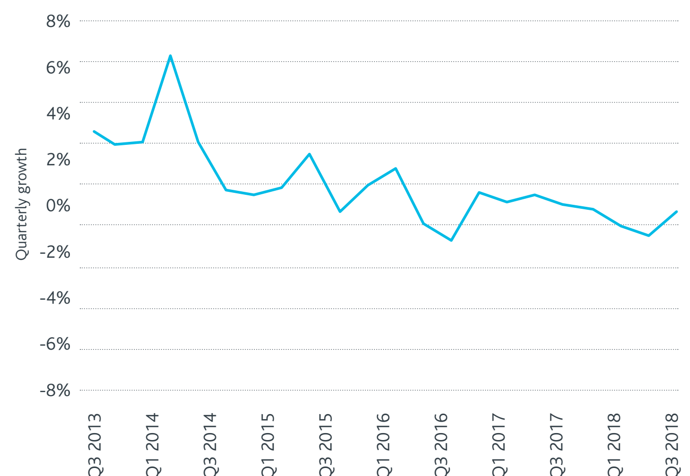
Capital values continue to fall
Average capital values in prime Central London continue declining (although at a slower pace), achieving £2.78 million in the end of the third quarter – a decline of 1.3% and 13.8% lower than the Q3 2015 market peak.

On an annual basis, our data shows that average prices are down 6.8%, with no sub-markets registering any value increases over the last 12 months. Even locations in the core Central London areas that surround the London's golden postcodes have not been immune to this trend (4.6% drop on the same period last year).

Supply remains tight
Aside from the lack of motivated sellers in the market, a tight supply pipeline has also helped to insulate the market to an extent. That said, with much of the new stock planned for London sitting at the luxury end of the price spectrum, demand from domestic buyers remains unmet.

Some developers are shelving plans amidst the London-wide sentiment and the weakened appetite for luxury home purchases, particularly amongst the international cohort, many of whom are now taking a wait and see approach.

Performance of values across prime Central London



Source: Cluttons

This is being driven by the prospect of better value in three months' time, rather than concerns around Brexit itself. London's position as a global safe haven and a property investment magnet remains intact and unchallenged.

Not all developers are scaling back projects, however. Where prices are reflective of market conditions and are perceived to be good value, schemes are still selling at a good pace. This applies to both small and large projects. In Wapping for instance, the 1,300 unit London Dock development is still enjoying rapid uptake of units, while the more boutique Red Lion Court scheme saw more than a fifth of all units selling in Q3 alone (Molior).

Across London as a whole, 65,818 units are currently under construction (Molior). In prime Central London, the number of homes under construction at the end of Q3 2018 stood at 3,466, up 1.6% on the end of last year. However, the number of new build sales across London remains weak, -11% on the same period last year.

Best in class homes continue to drive the market

On the demand side, there has been a notable fall in transactions across almost all price bands (annual decline of 21%); however, at the same time, there is one segment that exhibits a positive trend. Sales in the luxury segment (homes priced over £10 million) increased by 29% compared to the previous year, mainly driven by the fact that significant price drops across prime Central London have created a perception of fair value, and this helps lift deal volumes in the upper echelons of the market.

In general, there is a notable increase in transactional activity for best in class homes, that continued into the last quarter of the year. Similarly, where sellers are receptive to negotiating asking prices, deals are rapid.

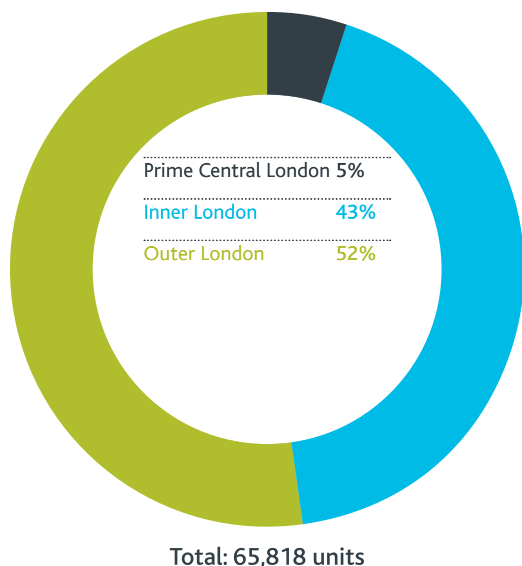
It is worth pointing out that one of the key differences in the current market, when compared to challenges of 2007/08, is the lack of motivated sellers, which has been a tremendous cushion for the market. Price falls would have otherwise undoubtedly been far more substantial than those recorded since the peak of the current cycle.

While anxiety around job security and questions around the economic health of the UK are driving the postponement of some purchasing decisions, for other domestic households, life carries on. Our network of Central London offices continues to see majority of demand at around the £1 million mark, however in the past months more demand was registered at over £3 million.

Market correction to continue into 2019

At this stage, the main barrier to an improvement in the market is Brexit and the associated uncertainty about Britain's relationship with the EU once we depart next Spring. At the same time, important fundamental issues such as persistent affordability challenges, an ever-evolving residential tax regime and pressure on domestic buy-to-let and international investors has left the market in a relatively consistent state of decline.

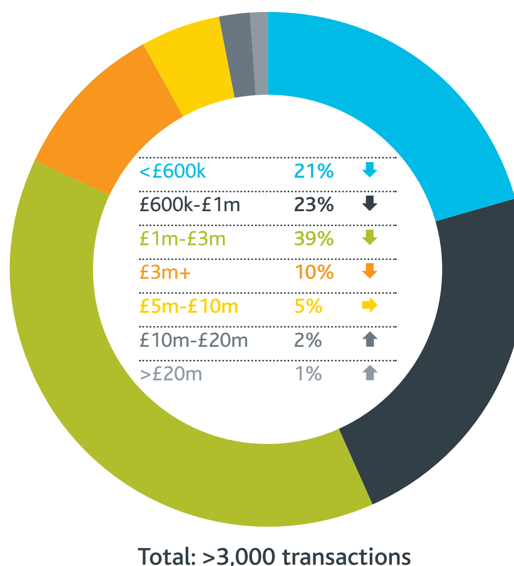
Structure of stock under construction, 9M 2018



Total: 65,818 units

Source: Molior
Note:
There was a total of 65,818 units under construction in London in Q3 2018.

Transactions volume by price band in prime Central London, 9M 2018



Total: >3,000 transactions

Source: Land Registry
Note:
Direction of arrows refers to a change in a respectice transactions volume.
There were more than 3,000 transactions registered in the first nine months of the year. This number is likely to be revised upwards due to the data lag.

Our forecasts for the residential market assume a soft Brexit and we expect an 8-10% drop in capital values in 2019 across prime Central London. This is down on our initial forecast for the year, with the downgrade being driven by the expectation of a more subdued economic picture over the next two to three years, which is largely a result of market-wide uncertainty.

With that in mind, we expect average growth for values in prime Central London, between 2019 and 2021, to be a negative 2%.

On the positive side, our view is that the greatest potential for stability, or indeed marginal growth, exists only in those prime Central London pockets where prices have fallen by 15% to 20% over the last 24 months, creating a perception of a fair value. Cluttons' residential index highlights several areas where the correction has been the highest since Brexit, such as Belgravia (-18.9%), Notting Hill (-18.1%) and Holland Park (-17%), implying that these submarkets could be among the first ones within prime Central London to stabilise.

As it stands, however, capital values across prime Central London are down by 11.6% across and 5% lower in Core Central London, when compared to two years ago, suggesting that the market is yet to bottom out.

Market correction in prime Central London

	Capital value change since Brexit
Belgravia	-18.9%
Notting Hill	-18.1%
Holland Park	-17.0%
Kensington	-16.6%
Marylebone	-13.7%
Chelsea	-13.3%
Hyde Park	-12.8%
St. John's Wood	-11.4%
Knightsbridge	-10.6%
Mayfair	-10.6%
Covent Garden/Soho	-9.6%
South Kensington	-9.4%
Westminster	-5.7%
Regent's Park	-3.4%
St. James's	-2.0%
Prime Central London average	**-11.6%**

Source: Cluttons

RESIDENTIAL LETTINGS

Rental values remain stable
Rental stability across prime Central London persists, with values remaining stable once again in Q3 2018. This leaves average weekly rents just shy of £1,400. On an annual basis, rents are now 0.6% lower than this time last year.

Rental values in core Central London have increased marginally (0.1%), with six submarkets posting growth during Q3: Clerkenwell (+0.9%), Shad Thames, South Bank, Shoreditch, Kings Cross (+0.4% each) and Islington (+0.1%). Elsewhere, we recorded no movement in rents. This leaves rents in core Central London, on average, 0.1% down on this time last year.

The Brexit Clause
Despite the flat conditions, best in class properties, once again, continue to command the highest rents, while properties lacking modern amenities, or those not refurbished recently struggling to let.

While tenants remain budget conscious and firmly in the driving seat, some markets are exceptions to this rule, such as Wapping, Canary Wharf and Shad Thames, where demand remains strong at all price points. In these locations, void periods are lower than other parts of Central London, underpinned by strong demand levels from workers based in the City or Canary Wharf.

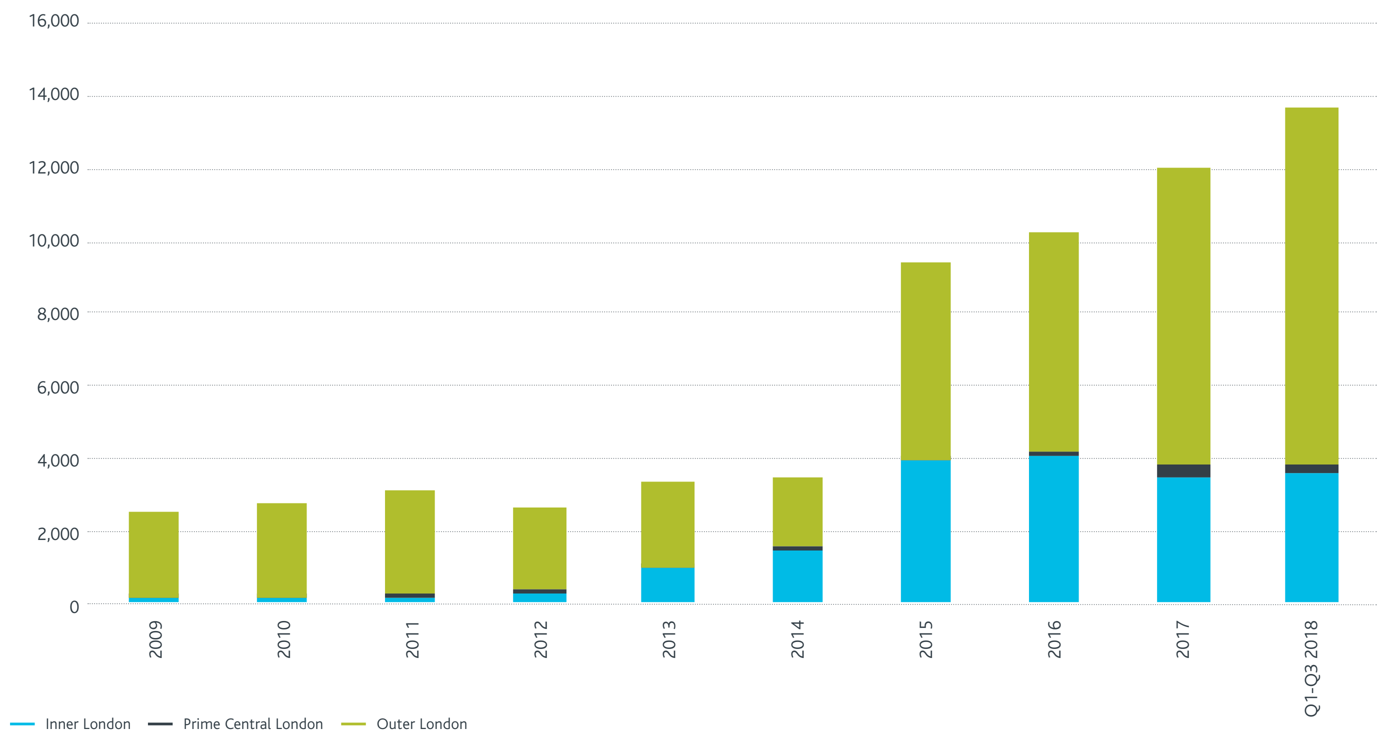
This suggests a degree of resilience, however, many tenants in these markets are seeking 6-month break clauses. This is being driven by the London-wide sentiment of uncertainity, which means landlords need to be flexible on lease terms in order to secure a let.

Build-to-rent activity on the rise
Elsewhere in the lettings market, the build-to-rent (BTR) sector continues to gain momentum, with the first half of 2018 seeing 3,000 units commencing construction in London (Molior).

Unsurprisingly, the majority of BTR activity remains confined to outer London boroughs such as Croydon and Hounslow, where lower land values make BTR schemes far more viable than prime Central London, which accounts for less than 3% of the total BTR starts so far this year.

The total London BTR stock under construction stands at 13,664 units, ahead of the total figure for 2017. While it is clear that tighter lending criteria and the phased removal of mortgage interest relief for those on buy-to-let (BTL) mortgages has had a significant dampening effect on growth in the sector, some keen investors are finding other routes to market.

BTR construction volume in London, 2009 - 9M 2018



Source: Molior

Mortgages for Business, for instance, recently reported a 58% increase in the number of BTL mortgages being taken out by limited companies rather than private individuals, which is becoming increasingly more tax efficient. In parallel, Mortgages for Business suggested that the number of BTL lenders in the market has nearly doubled to 22 over the last 12 months.

Despite positive trends in the market, the BTR sector is yet to gain favour amongst institutions in a meaningful way. This has been evidenced recently by the recent failure of Quintain to find a buyer for its £3.5 billion BTR portfolio in Wembley. Indeed, here too, the uncertainty thrown up by Brexit means that investors are unable to fully crystallise long term investment strategies.

Fundamentals remain strong and positive outlook looking ahead

The fundamentals in the lettings market remain strong in general, particularly in London where insurmountable affordability issues, mean that renting for longer is increasingly acceptable and a sought after lifestyle choice.

These factors have had a clear impact on the rental market's performance, which has enjoyed a far greater level of stability than the sales market.

A further layer of complexity in the form of Brexit means that some households are unwilling to commit to a purchase until there is clarity on Britain's post Brexit EU relationship.

Overall, bearing in mind all of the above factors, we expect the stability in the rental market to persist, with a marginal 1.3% decline in average rents across prime Central London forecast for 2019, followed by 2.0% and 2.4% growth in 2020 and 2021 respectively. This would result in an average growth over the next 3 years of 1.9%.

This return to 'normal' is very much predicated on a soft Brexit and no surprise shocks to the economy.

Cluttons' definition of prime Central London

Belgravia, Chelsea, Covent Garden/Soho, Holland Park, Hyde Park, Kensington, Knightsbridge, Marylebone, Notting Hill, Regent's Park, South Kensington, St John's Wood, St James's, Westminster

Forecasts

VALUE FORECASTS

	2019	2020	2021	2019-2021
Prime Central London sales	-10.0%	3.0%	1.0%	-2.0%
Prime Central London lettings	1.3%	2.0%	2.4%	1.9%
Greater London	1.3%	3.6%	3.6%	2.8%
UK	4.8%	3.7%	3.5%	4.0%

Source: Cluttons, Experian

"The London market still faces significant challenges in terms of affordability, buy-to-let investors and outdated infrastructure.

These factors are putting pressure on prices and the reality is that the sooner sellers take the pain and adjust prices down, then demand will start to increase, and the market will start to go up as more buyers emerge."

James Hyman, Head of residential agency

"With more than 40% of households renting in London, of which nearly two thirds rent by choice, more people are in search of homes rather than short-term stop gap accommodation.

As the result, rents are more likely to show an upward trend on the back of continued demand for quality stock."

Zoe Innes, Head of residential lettings

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