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London, Winter 2015/16

RESIDENTIAL MARKET OUTLOOK

House prices climb to a fresh record high
The annual rate of change in the 12 months to the end of Q3 climbed to 4.3%, up from 3.3% a quarter earlier, leaving prime Central London values at a fresh record high and within touching distance of £2.3 million. Rotherhithe/Surrey Quays (4.5%), Mayfair (4.1%) and Kensington (3.4%) were the best performing submarkets during the third quarter.

Across London as a whole, the picture has been similar, with the Land Registry reporting growth of 1.8% during the third quarter, which now leaves average house prices in the capital just shy of £500,000.

During the third quarter however, house price growth across prime Central London slowed sharply, dipping to just 1.3%, compared to a rise of 2.6% in Q2. The slowdown reflects a tapering off in the level of transactional activity, which in turn is linked to the severity of stock shortage in the secondary market.

However, the underlying issue of affordability in London, combined with an undertone of nervousness linked to a weak global economic picture, is also contributing to the slower rate of house price acceleration. In addition, as previously reported, the Stamp Duty adjustments made earlier in the year have impacted the pace of high value transactions. The London-Help-to-Buy announced during the Chancellor's Autumn Statement is however likely to address the affordability issue in the capital to an extent.

Stock levels remain low in markets perceived to be more affordable
Across Islington, Shad Thames, Clapham and Blackheath, stock levels have continued to dwindle as buyers home in on areas of the capital that are still perceived to be affordable and offer better value for money.

In Islington for instance, average house prices stood at £1,175,000 at the end of Q3, significantly lower than the prime Central London average. As a result, we have experienced a rise in the number of sealed bid offers, with the period between a property being listed and a deal being sealed shrinking rapidly as the supply dearth lingers. The presence of desirable schools and the ease of access to the City mean that many buyers still perceive the area to be below its full price potential, which is continuing to fuel interest in the area.

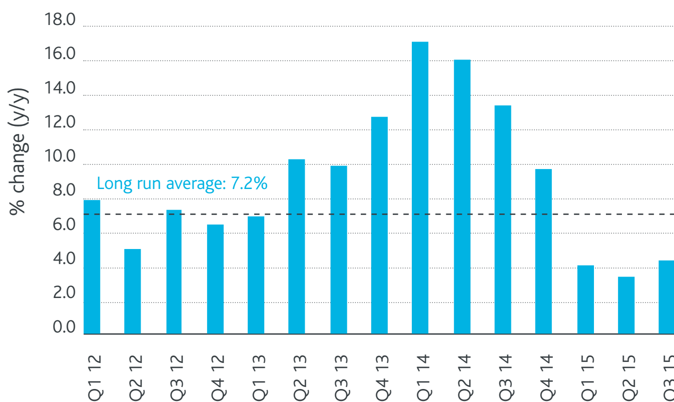
Prime Central London residential market in numbers

House price growth during Q3 2015

Annual house price growth (Q3 2014 – Q3 2015)

Source: Cluttons

Prime Central London house price performance



Source: Cluttons

Submarkets in and around Shad Thames and South Bank are experiencing a similar trend, with demand remaining centred on properties between £750,000 and £2 million, with a particular 'sweet-spot' around the £1 million mark. However, properties priced between £3 million to £5 million have seen exceptionally strong demand in recent months and are bucking the trend of the general slowdown at the top of the market, driven by the Stamp Duty changes. This is particularly true in areas such as SE1 and E1W as buyers still perceive homes in these locations to offer better value for money compared to new build stock.

Average price of a flat in key submarkets during Q3

Location	One bedroom flat	Two bedroom flat
Clapham	£525,000	£825,000
Islington	£475,000	£800,000
Hyde Park	£650,000	£1,500,000
Chelsea	£892,500	£2,525,000

Source: Cluttons

In addition, offers are now within 2% of asking price, which highlights the appeal of the area. And with prices hovering around £1,500 psf, a two bedroom riverfront property can still be purchased for £800,000. It is worth noting that riverfront homes in Shad Thames command a premium of up to 50%. Despite this perceived affordability, nearly a quarter of first-time-buyers buyers registering with our South Bank office are receiving help via family funds. The remainder of the buyer pool consists of 'downsizers', looking for a Central London base, while the vast majority of buyers are City-based workers.

Further afield in Clapham and Blackheath, both of which sit just outside our prime Central London boundary, stock levels remain close to record lows, with instruction-led-demand persisting. Young professionals, mainly from a finance and banking background, form the backbone of demand in these two submarkets, with budgets generally sitting between £650,000 and £850,000. The lure of perceived affordability and the village feel of these peripheral prime Central London locations is underpinning buyer demand and further denting the already limited supply of secondary stock.

Stock relief unlikely
We previously reported on the surplus of stock across the prime Central London lettings market, which has hampered rental value growth and has in fact forced rents down in some submarkets. The glut of lettings stock has led some landlords to consider exiting the market; a trend we have begun to record in markets such as Chelsea and Belgravia.

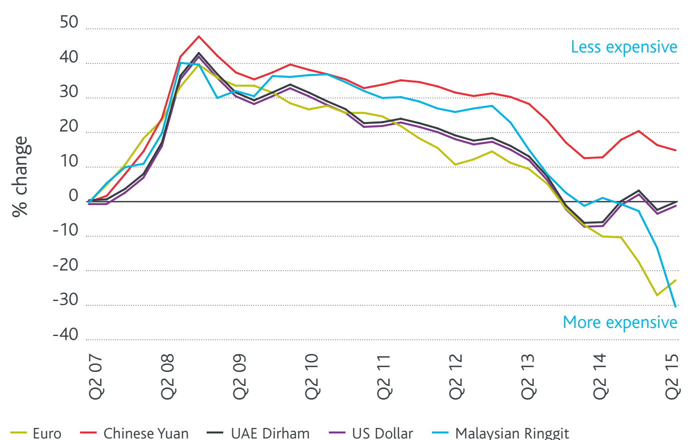
This trickle of lettings stock drifting on to the sales market is a trend we expect to persist, particularly as the number of buy-to-let new-build flats rises.

Strong short term growth outlook, but risks mounting
Despite this, it is our view that the supply-demand imbalance in the secondary market is unlikely to reverse in the near term and will continue to be a critical driver behind capital value rises. And although the Stamp Duty tax regime has undoubtedly curtailed the volume of deals at the top of the market, we expect the impact of the change to gradually dissipate over the next 12 to 18 months. The same is true of the 3% Stamp Duty rise announced in the Autumn Statement for buy-to-let and second home purchases. These are likely to be taken in most investors' strides, particularly for those who are determined to secure a London residential investment asset.

The downside risks however appear to be mounting, with the looming EU referendum in 2017 the most significant risk to the London housing market. Should the UK vote to leave the EU, the impact on GDP growth and the value of sterling is likely to be quite substantial, with both likely to come under significant downward pressure. Furthermore, the ending of free labour movement from the EU may curb demand in both the sales and lettings markets as the rate of household creation is likely to dip.

This "doomsday scenario" is too early to call, but is something we are monitoring closely. The biggest threat to the market is of course the uncertainty that will be created in the lead up to the referendum and depending on the outcome, the uncertainty generated in the aftermath will undoubtedly stall the prime Central London residential market further.

International buyer currency advantage (relative to Q3 2007 market peak)



Source: Cluttons, OANDA

A lesser risk continues to brew in the form of new-build stock, a large volume of which continues to flow on to the off-plan resales market as buyers, particularly those of an international flavour, try to exit the market as currency advantages, especially for those from emerging markets, fade.

The threat of an interest rate rise has diminished once again, with no upward movement likely until late summer, or early autumn, next year. We are forecasting a 25 basis point rise every six months, with our model suggesting a topping out at 3% sometime in 2020. The slow pace of the increase should offer some comfort to mortgaged households. Still, any sudden upward trajectory in base rates is a significant threat to buy-to-let landlords, particularly those operating on very fine margins as a result of mute rental value growth in the prime Central London market recently. In fact, the Bank of England warned in November that any slowdown in house price growth might trigger a wave of distressed sales, exacerbating any potential downturn.

Furthermore, national data from the Council for Mortgage Lenders shows that the volume of buy-to-let mortgages has risen 40% since 2008, while owner-occupier mortgages are up just 2% over the same period.

For now however, we expect house prices across prime Central London to end 2015 6% up on last year, with growth of 5% expected in 2016. Barring any negative impact from the 2017 in-out EU referendum, cumulative growth to 2020 should reach 22%.

This growth will of course be supported in part by the launch of the London-Help-to-Buy scheme, which will see the government offering a five-year interest free loan to first-time-buyers of up to 40% of the property's value. This landmark change to the successful Help-to-Buy scheme will genuinely put the home ownership dream for first-time-buyers in London within easy reach in many submarkets.

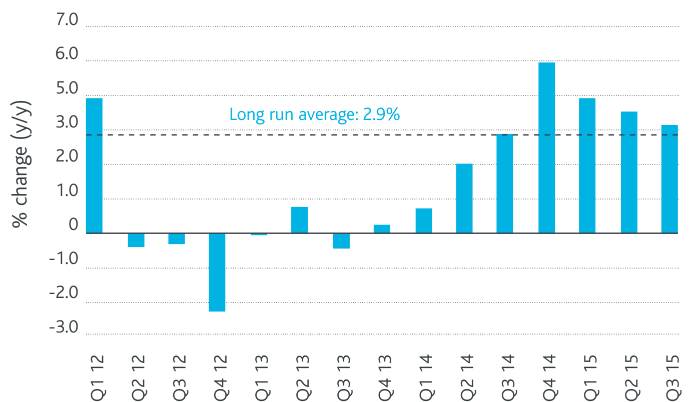
Rental value growth stalls

Following 1.1% growth during Q1 and a further 1.2% rise in Q2, rental value growth slowed to just 0.6% across prime Central London during the third quarter. The slowdown eased the annual rate of change, which slipped to 3.8% at the end of Q3, from 4.3% during the second quarter. Kensington (5.1%) was the best performing submarket during the quarter, while Wapping (-2.4%) was the weakest performing.

Overall, anecdotal evidence suggests that buy-to-let stock continues to flow onto the lettings market, helping to nudge supply further ahead of demand, which is driving down rents across many areas of the prime core. As a result, landlords continue to hold rents steady at renewal. Renewals are, on average, 25% higher than 2014 across all our Central London offices – a record high.

Conversely, away from prime Central London, markets such as Clapham and Battersea are experiencing a severe shortage of stock as tenants drift further afield in search of better value for money, particularly those saving to buy in an environment where deposit sizes continue to balloon. Landlords in these submarkets are able to secure token uplifts at renewal.

Prime Central London rental value performance



Source: Cluttons

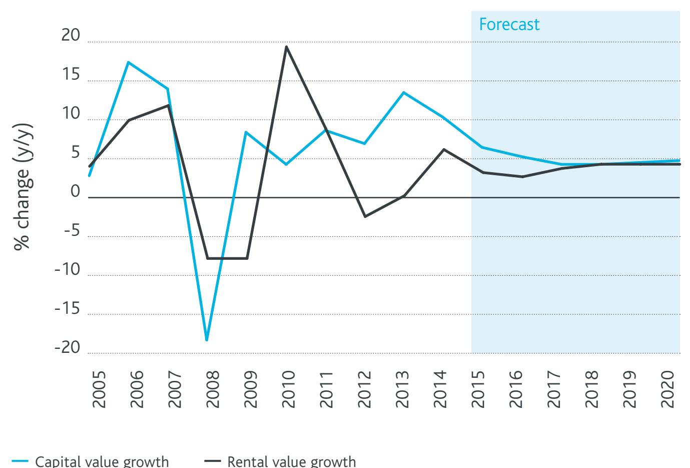
Weaker outlook for lettings market in 2016

With rents being forced downward in many submarkets, our expectation for growth in 2015 has moderated to just over 3%, from 3.5% to 4% earlier. And with the sharp upturn in stock on the market, tenants are increasingly finding themselves spoilt for choice. This is resulting in rent reductions of up to 5% or 10% for properties that are returned to the market as landlords attempt to minimise void periods.

Furthermore, with aspiring households drifting away from the prime core as they attempt to build deposits to purchase, domestic budgets are also declining, particularly for properties around the £400 to £500 per week mark. This is significantly lower than the average weekly prime Central London rent of £1,107.

As a result, it is our view that rents will rise 3% to 3.5% in 2016, before edging upwards slightly to between 3.5% and 4% per annum between 2017 and 2020. This of course assumes no negative impact from a potential Brexit.

Prime Central London growth forecast



Source: Cluttons, Experian

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