Residential update
Prime Central London

UK Residential Research | *April 2017*

Both sales and lettings markets in Prime Central London have had positive starts to 2017. However, not all the news has been good. Prices increased while transaction levels remained low in the sales market. In the lettings market, activity rebounded to a two year high but rental values have yet to harden. The sales and lettings markets are still adjusting to new conditions and it may be another quarter or two before they fully acclimatise, especially now that a General Election has been called in June.

Neil Chegwidden
Residential Research

Sales market
Price growth

+0.7%
Q1 2017 **v** Q4 2016

-0.5%
Q1 2017 **v** Q1 2016

Lettings market
Rental growth

-1.5%
Q1 2017 **v** Q4 2016

-8.5%
Q1 2017 **v** Q1 2016

Sales market
Sales transactions

-17%*
Q1 2017 **v** Q4 2016

-44%*
Year to Q1 2017 **v** Year to Q1 2016

Lettings market
Lettings transactions

+3%
Q1 2017 **v** Q4 2016

+5%
Year to Q1 2017 **v** Year to Q1 2016

*Source: JLL, Land Registry, Lonres. *JLL estimate*

JLL Prime Central London research covers mainly second-hand property in the prime postcodes: SW1, SW3, SW5, SW7, SW10, W1, W8 and W11.

Prime Central London Sales market

- *Prices up in Q1*
- *Transaction volumes still low*
- *Demand and outlook improve*

Improving optimism

Optimism in the Prime Central London sales market has improved during the first quarter of 2017 with prices rising in all but the upper echelons of the market.

However, turnover is still subdued compared with 3-5 years ago following the two rounds of stamp duty changes. And whilst the market has adjusted to the changing conditions, we believe there is still a little way to go before everyone involved becomes fully acclimatised.

The biggest hurdle yet to jump is shifting vendor's expectations on price. Many are still too optimistic with both valuers and purchasers asking vendors to consider lowering their asking price.

Tentative price rise

Importantly, prices increased on average during Q1 2017. The 0.7% uplift was the first quarterly rise since Q3 2014 and marks a turning point for the market. Price growth in the year to Q1 2017 was still negative at -0.5% on average.

0.7%

Uplift in sales prices during Q1 2017

Prices increased most at the lower-end of the market but still fell at the upper-end.

In the sub £2m market, for example, prices rose by 1.8%, increased by 0.8% in the £2-5m price bracket and nudged up by 0.1% between £5 and 10m. Properties above £10m, however, continued to fall – down a further 1.3% in Q1.

The sub £2m market has been the most robust throughout the past two years with the stamp duty reforms less impactful at lower price points. This continued during Q1 2017.

The price rise in Q1 followed two quarters of static prices and now means that prices in this segment of the market are higher compared with a year earlier – up 1.1% on average.

On an annual basis, however, prices are still lower in all price brackets above £2m.

Demand improves

Demand has increased in Prime Central London during the first three months of the year.

The number of international buyers in particular has risen following the weakening of the pound after the Brexit vote. A number of overseas purchasers are now looking to grab the opportunity to buy given that price falls have largely played out and in the expectation that sterling will appreciate in the medium-term. Domestic demand is quieter.

Overall, however, the level of demand is notably lower than it was 3-5 years ago. This is a clear reflection of the stamp duty changes and has often led to few active bidders per property, especially on homes priced above £2m.

As a result, the balance of power remains firmly with buyers, despite the pick-up in demand.

New level for transactions

Following two quarters of increasing transactions after the stamp duty and EU referendum affected Q2 2016, we estimate that the number of transactions fell back again in Q1 2017.

The volume of sales typically falls by up to 10% in the first quarter of the year but this year's estimated 17% drop is higher than usual.

This will come as a disappointment for market participants given the brighter mood and the bottoming out of price falls.

In terms of transactions, the market is yet to find its new level given the turbulence of the past two and a half years.

In bare statistics, the number of sales in the year to Q1 2017 was a startling 44% lower than a year earlier and the lowest annual total since Q2 2009.

These comparisons, however, are rather unfair as Q1 2016 was bolstered by pre-stamp duty reform activity which also contributed to the starkly weaker activity in Q2.

However, and despite the slightly unjust comparison, the volume of annual transactions is now 62% below the 2007 peak.

We expect transaction volumes to increase during 2017, but it is likely to take quite some time before the new normal for the Prime Central London sales market is established. The big question is at what level will it settle?

Supply still low

The slower sales market over the past two years has not led to too much of an excess of properties on the market.

This is largely because many vendors have withdrawn their homes from the market. With few forced sellers in this high-value enclave of London, many have simply not wanted to sell their prized possession in such conditions, preferring to wait until the market brightens.

Although we expect some will choose to re-market their properties during this stabilisation phase, more are likely to wait until conditions and pricing improve further. This implies that available supply will remain quite constrained for much of 2017, thereby providing further support for prices.

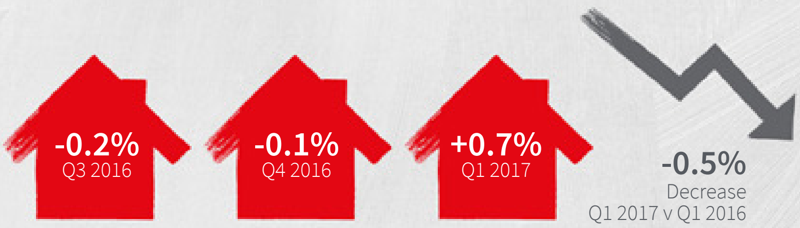
Outlook

The call for a General Election in June will create another period of uncertainty for the Prime Central London residential market although the short lead time will minimize the pre-election impact. If the election result yields a stronger hand for the party in power then the greater political and economic clarity will be positive for the residential market.

If the Conservatives retain power, turnover should improve notably during the remainder of 2017, following a realisation that the bottom of the market has passed and that pricing has fully re-aligned. Importantly, market conditions should feel a good deal more positive come the end of the year.

Sales prices rise in Q1

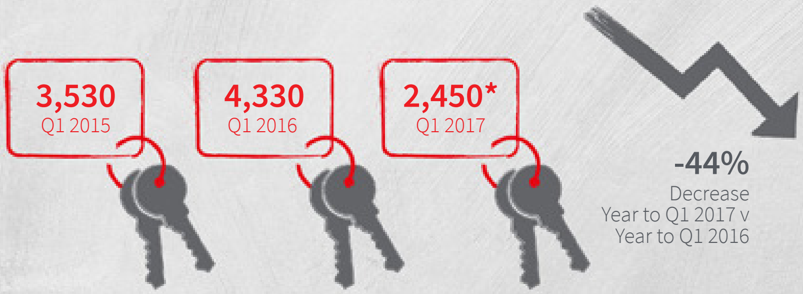
Price growth in quarter



Source: JLL

Transactions notably lower than year earlier

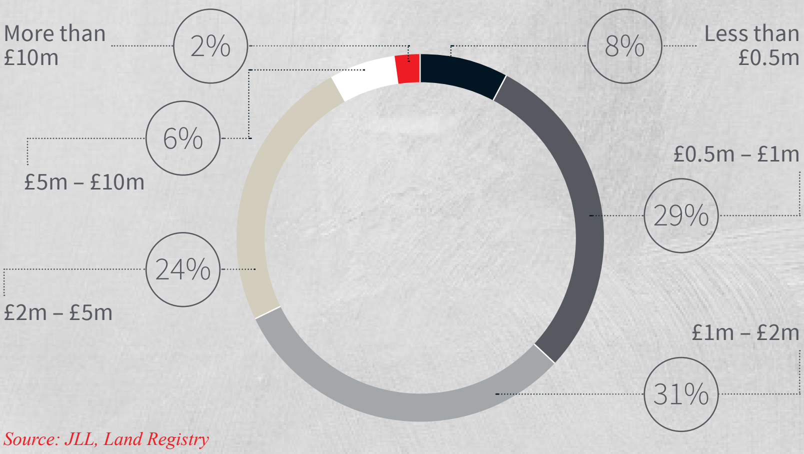
Number of transactions during year



*Source: JLL, Land Registry. *JLL estimate*

Purchases below £2m are more than two-thirds of market

% of transactions in year to Q4 2016



Source: JLL, Land Registry

Richard Barber

JLL Sales

We are encouraged by the activity we have witnessed throughout Q1.

The number of transactions has been helped by more realistic pricing, sellers acquiescing to the new tax regime and weak sterling, which has driven international demand.

Transactional volumes remain relatively subdued, particularly at the top-end of the market. However, sentiment is certainly improving.

Provided the after-effects of Article 50 are not too dramatic, we expect to see a steadily improving outlook over 2017, especially once the General Election is over.

Prime Central London

Lettings market

- *Lettings activity at two-year high*
- *Rents fall again in Q1*
- *Oversupply still an issue*

Signs of improvement

The Prime Central London lettings market has endured a difficult 12 months but there are now signs the market is picking up.

Both levels of demand and transaction volumes have increased during Q1 2017. However, rental values continued to fall as the number of properties on the market remained high relative to demand.

Transactions increase

Activity in the Prime Central London lettings market has improved steadily over the past year following two years of subdued transactions.

Quarter on quarter lettings volumes can fluctuate quite markedly but a sound performance in Q1 2017 lifted the annual number of transactions to 9,550 - the highest level since Q3 2014.

The number of lettings in the year to Q1 2017 was also higher than the preceding year, increasing by 4.7%.

4.7%

Increase in transactions in year to Q1 2017 compared with previous year

During Q1 alone, the number of lettings was 2.9% higher than in Q4 2016.

Demand robust

Tenant demand improved slightly during Q1 2017 relative to Q4 2016. However, the overall level of demand remains below pre-EU referendum volumes as Brexit continues to exert its influence.

One and two bedroom apartments remain the most sought after property types with demand particularly strong for these units within new developments. And with several new developments due to come to market in Prime Central London during the course of 2017 we expect interest to remain high throughout the year.

Strong demand for new property has been an emerging trend over the past year as tenants seek the lifestyle and amenities which these new schemes offer.

A few of the schemes that will see at least some units complete during 2017 include Chelsea Waterfront, Kensington Row, Chelsea Barracks and Holland Park Villas.

Tenant supremacy

In the main, tenants are aware that they have the upper hand at present and are exerting pressure on landlord's resolve on rental levels. But with plenty of properties to choose from, landlords are frequently accepting offers so as to reduce voids.

Demand at the upper-end of the market, above £3,000 pw, has been strong for the past year and increased further in Q1. Many of these renters are using the lettings market as a temporary stop while waiting to buy their ideal property in the sales market.

Higher levels of stamp duty have accelerated this trend with purchasers no longer happy to make multiple moves in the sales market, preferring to bide their time in the lettings market.

Oversupply continues

Despite the improved level of demand and an active Q1, there remains an excess of available supply compared with demand.

The two and three bedroom flat markets, typically between £1,000 and £3,000 pw, have the greatest oversupply of available properties. But an excess of rental properties is evident across all prices and property sizes.

A number of new developments completing this year will not help the broad supply picture. However, the few hundred completions represent only a small proportion of the 9-10,000 lettings a year in Prime Central London implying that the market impact will be minimal.

Rental falls diminish

Despite the improving conditions, rental values declined by 1.5% across Prime Central London during Q1.

This was the fifth consecutive quarterly fall with rental values now 10.7% below their recent Q2 2015 peak.

Encouragingly, the 1.5% decline in Q1 was shallower than the 3.1% decline in Q4 and the 1.9% and 2.3% falls seen in Q2 and Q3 respectively.

For the second consecutive quarter rental falls were evident across all price ranges and property types. Smaller flats and houses witnessed lower price declines during Q1 but the difference compared with larger properties was only marginal.

8.5%

Fall in rental values in year to Q1 2017

Over the past year the upper-end of the market has experienced higher falls. Average price declines have been 9-11% above £2,000 pw compared with 6-9% below this level.

H2 2017 looking brighter

We expect the Prime Central London lettings market to continue its realignment in the short-term until the excess of properties on the market diminishes further.

Rental values may therefore fall once again in Q2 but we anticipate that rents will begin rising again during the second half of the year.

Rental values fall, but have stabilised since Q4

Rental growth in quarter

-2.3%
Q3 2016

-3.1%
Q4 2016

-1.5%
Q1 2017

-8.5%
Decrease
Q1 2017 v Q1 2016

Source: JLL

Lettings transactions rise

Number of transactions during year

9,250
Q1 2015

9,120
Q1 2016

9,550
Q1 2017

+4.7%
Increase
Year to Q1 2017 v
Year to Q1 2016

Source: JLL, Lonres

Market under £1,000 pw dominates transactions

% of transactions in year to Q1 2017

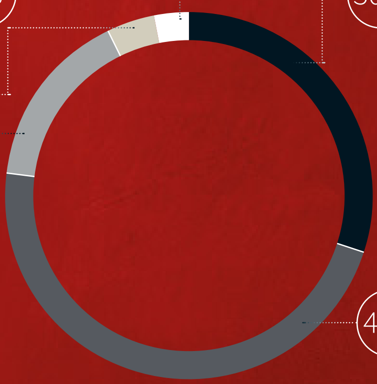
More than £3,000 pw 3%

£2,000 – £3,000 pw 4%

£1,000 – £2,000 pw 16%

Less than £500 pw 30%

£500 – £1,000 pw 47%



Source: JLL, Lonres

Lucy Morton
Residential Lettings

Given the ongoing uncertainty, particularly around Brexit and the triggering of Article 50, it is encouraging that transaction levels have improved in early 2017. This boost to the market has helped to put many investors' minds at rest - for the time being at least.

It is undeniable, however, that Brexit continues to have a detrimental effect on the Prime Central London lettings market. Tenants now firmly hold the upper hand despite the availability of properties diminishing.

The two and three bedroom flat markets presently have the greatest oversupply of available properties. But we expect the escalating preference for corporates to house senior executives in pied à terre apartments, rather than to relocate whole families into larger flats and houses, will help to rebalance this segment of the market during the course of 2017.

The start of the year has certainly been encouraging, but further realignment between supply and demand is needed before the market returns to a firmer footing.

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