UK Residential – Autumn 2018

REPORT
Savills Research

Prime UK Residential

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Changing shape

Our new five-year forecasts reveal interesting patterns in prime property

The shape of things to come

There is no getting away from it. We have prepared this report at a time of heightened political and economic uncertainty. It would be an understatement to say it makes forecasting a tricky process. The terms of the UK's divorce from the EU are yet to be agreed. The domestic political landscape is unsettled. There is a range of scenarios for exchange rates, interest rates, economic growth and wealth generation.

It would be easy to write off the prospects for price growth in the prime housing markets. Yet, much of the uncertainty has been present since the day of the Brexit vote. The prime housing market may not have flourished. But neither has it wasted away.

As Frances Clacy explains (p6), the market has been price sensitive and become much more needs-based, especially given the increased costs of buying from successive stamp duty changes. But where sellers have priced stock to reflect these costs and underlying buyer caution, it has continued to sell.

Last year, we envisaged these fickle market conditions would remain until a Brexit deal was done. We pencilled that in for 2019/2020. Thereafter, we expected a return to price growth, albeit weaker than in previous cycles. That prognosis accounted for rising interest rates and a higher tax environment.

Now, we are pushing back that recovery to reflect the likelihood of an extended transition period once the Brexit deal is hammered out. We cannot be sure talks will follow this path. But a no-deal Brexit would do little for either the UK or the EU. That alone is likely to oil the wheels of negotiation.

Assumptions settled, we tend to start our forecasting in central London. It is only one part of the prime housing market jigsaw, but by putting together its pieces, it is easier to tackle the rest.

As Katy Warrick (p8) says, when prime housing in central London has looked like good value, it has historically bounced back at pace. A general election in 2022 could interrupt this, while the recent announcement of further stamp duty costs for overseas buyers at the Conservative Party conference is likely to temper it.

Market conditions will change over the next five years. The patterns of the prime housing market might not be easy to predict but, taking the medium-term view, there is a place for cautious optimism.

Mat Oakley (p16) reminds us that, on the evidence of office take up, the city will remain "a major part of large companies' European and global networks".

So, our central London forecast has an interesting shape. In turn, that shape affects the pattern of our forecasts for other prime property in London and the UK.

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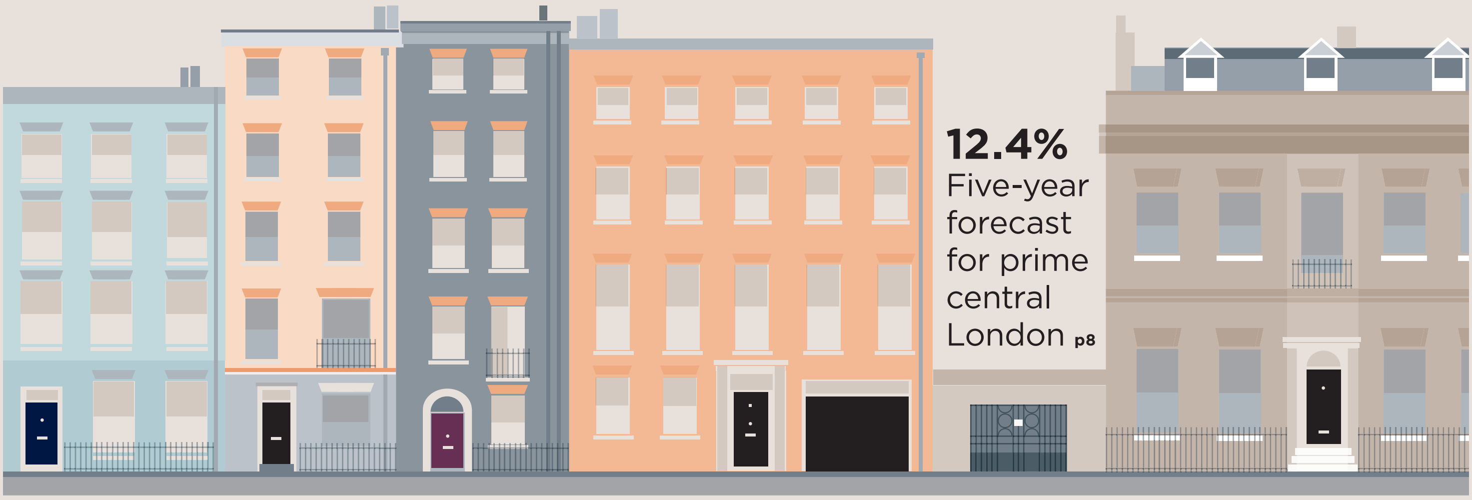

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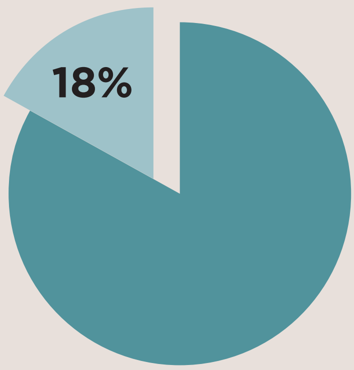

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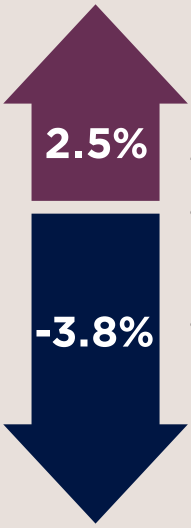

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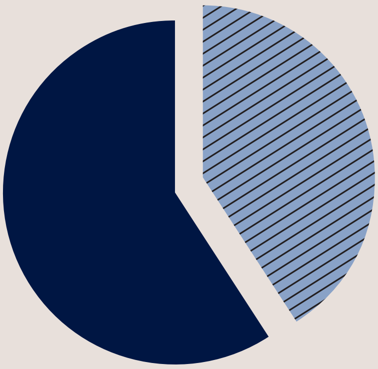

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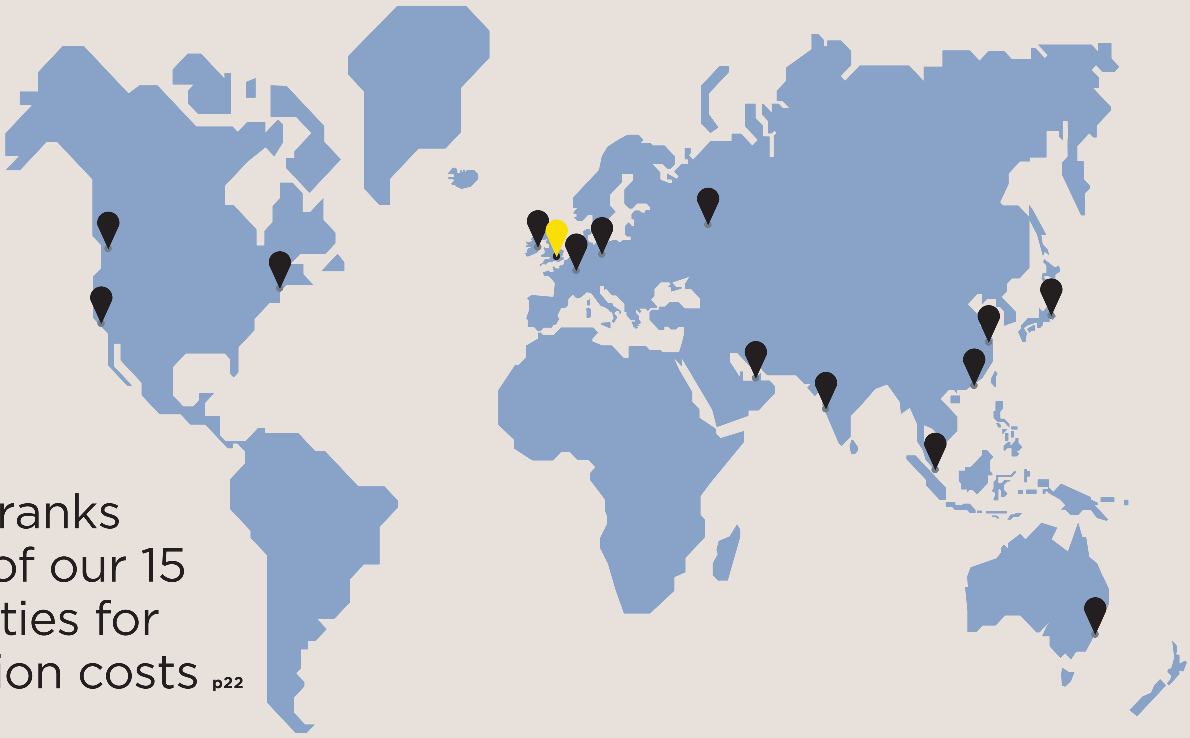

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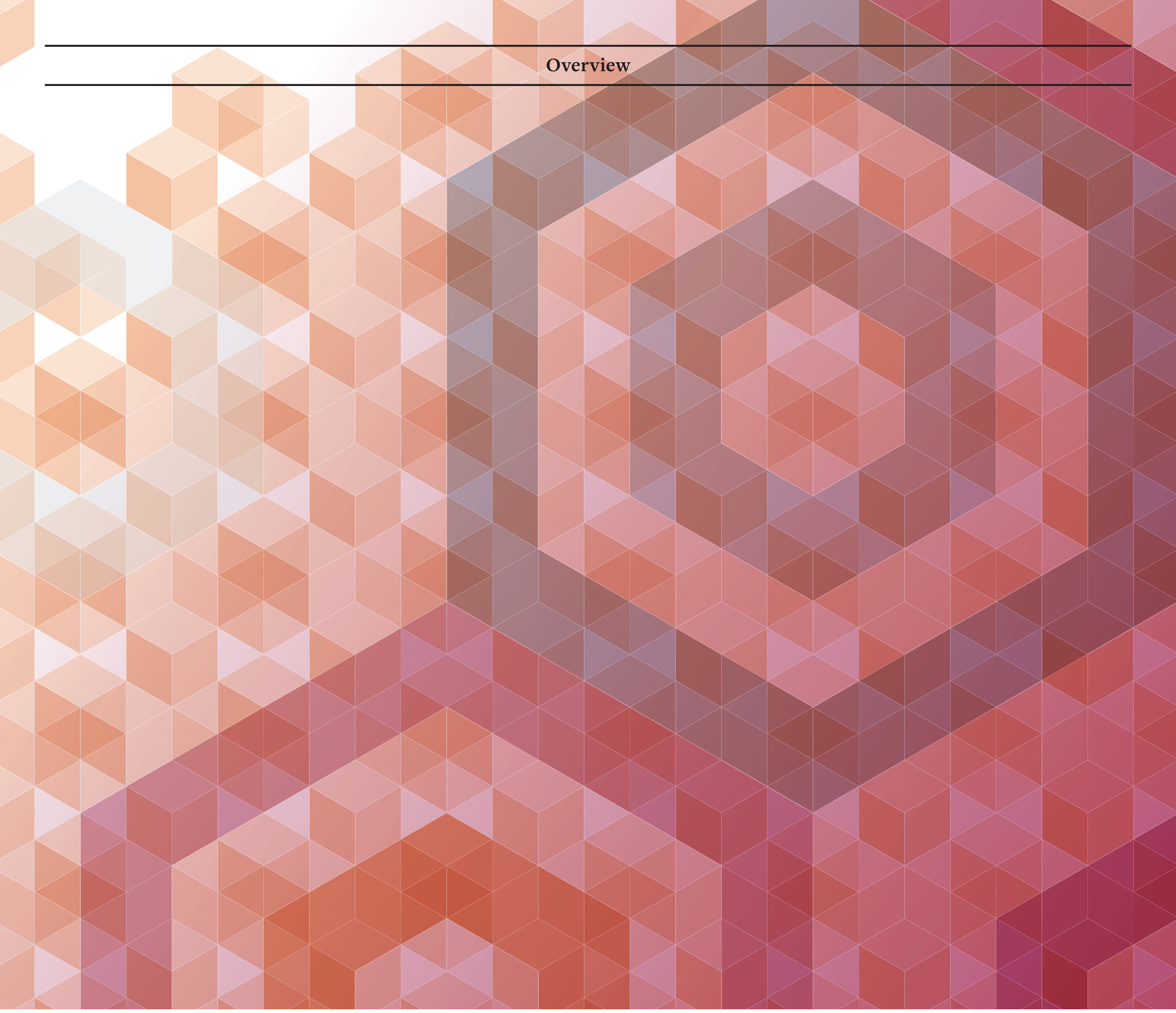


Changing patterns

Although the prime market remains subdued, there are interesting trends across the UK, not least with the shifting pattern at the top end of the market

Words Frances Clacy

It's almost four years since the then chancellor George Osborne introduced new rates of stamp duty, which increased the tax burden for buyers of property worth £937,500 or more. The move caused a correction in prices at the top end of the residential markets – over the past four years, prices have fallen by 18.3% in prime central London. Subsequent political events (see sidebar, right) have caused further disruption and uncertainty.

There have, however, been some nuances within the market that can sometimes be overlooked when discussing headline averages.

Starting at the top

In prime central London, higher-value properties have experienced more substantial price falls since 2014 than those of lower value – those worth more than £10 million have fallen by more than 20% over the period.

But in the past year, this pattern has shifted. Price falls are beginning to ease at the top end of the market – a signal that the most expensive property has begun to find its level and values may be bottoming out.

Into the regions

The story is slightly different for the prime regional markets. As they are generally of lower value, stamp duty changes have had less of an effect. Indeed, around 60% of Savills sales in the regions now incur lower levels of stamp duty than they would have done before the changes. This has meant that transaction levels have been much more robust than in London, although in

Regional variation Price movements of prime residential property in the past year and since 2014 (to September 2018)

	Prime central London	Other London	Suburban	Commuter zone	Wider South England & Wales	Midlands/ North	Scotland
Annual growth	-3.8%	-3.1%	-2.8%	-1.6%	-1.2%	2.5%	2.0%
Four-year growth	-18.3%	-7.6%	-3.2%	3.8%	6.9%	6.1%	4.0%

Source Savills Research

the past two years there have been more subdued headline levels of house price growth.

The prime regional markets generally have a higher proportion of mortgaged buyers so are more sensitive to the availability and cost of borrowing. Increases to regulation and tighter lending criteria have curtailed buyers' spending power. That is likely to be squeezed a bit further by gradual increases to interest rates.

Contrasting fortunes

The prime markets furthest from the capital have held up more strongly, particularly over the past year. In the Midlands and North, prime prices are up by 2.5%, while they have increased by 2.0% in Scotland.

But London's prime suburbs and immediate commuter zone have been impacted by lower levels of wealth leaving the capital. As such, prices in these markets have fallen by between -2.8% and -1.2% during the past 12 months. The value gap between London and its surrounds has, however, maintained a source of demand from those looking for space and value. Similarly, while the prime regional city markets have performed well over the past five years, levels of growth have begun to ease as neighbouring village and rural markets begin to look like good value.

Maintaining a sense of realism

Importantly, transactions continue to take place when stock is priced correctly and vendors are realistic about what they're likely to achieve in a more difficult market. Likewise, the acknowledgement that the market is likely to remain subdued – at least in the short term – should bring buyers' and sellers' expectations more in line.

A LONG TIME IN POLITICS

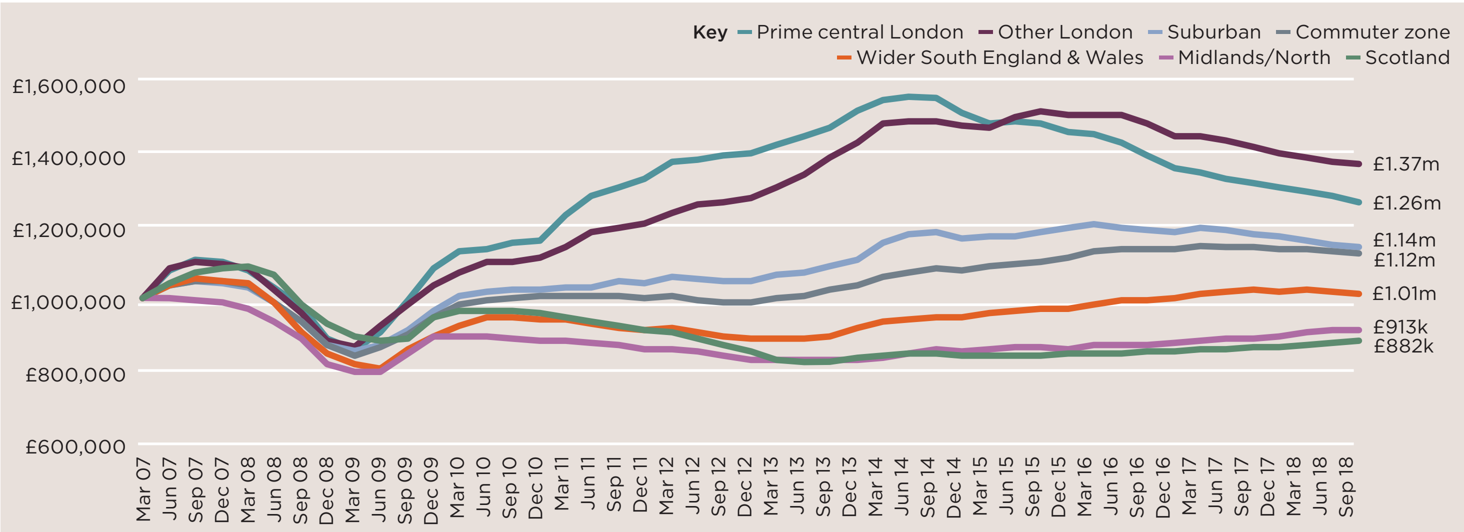
2015: Following the Conservatives' majority win, a degree of confidence returns to the market. Price falls in prime central London begin to ease while low levels of growth are seen in outer prime London.

2016: The UK votes to leave the EU. Uncertainty over the political and economic climate means prime London prices begin to fall at a sharper pace.

2017: Further disruption is caused by the snap election, which results in a minority government.

2018: As the UK continues its negotiations for leaving the EU, uncertainty leads to a more muted market.

Prime performers Price movements by region for a property worth £1 million in March 2007



Source Savills Research

When the fog clears

An uncertain global and domestic political climate has led us to push out the recovery in the prime central London market by a further 12 months

Words Katy Warrick

The unknowns of today look (unfortunately) like the unknowns of 12 months ago. And therein lies the problem. Last year, we concluded it was unlikely that the stellar house price growth of the past would be sustained during a period of rising interest rates, increasing returns on other assets, the unwinding of quantitative easing and greater taxation.

However, we did forecast price growth at above the rate of inflation. This was on the basis that London would maintain its world city status and its underlying appeal to a growing pool of global wealth.

The unknowns, then and now, relate to when London will look like identifiably good value and when the current fog of political and economic uncertainty will clear.

The current view

Our forecasts continue to reflect all of these principles. Global wealth creation remains strong; the pool of global ultra-wealthy individuals is expected to increase by 40% over the next five years and Brexit has not changed the fundamental reasons why people invest in London. Office take-up suggests London remains attractive to a range of wealth-generating businesses.

The tax environment remains less appealing than it was five years ago. Indeed, those hoping for a stamp duty cut at the top end of the market have instead seen proposals for a further surcharge on overseas buyers. However with similar, often more draconian, measures in a number of competing markets, the tax regime for prime London property remains competitive with other world cities (see page 22).

Quantitative easing has now started to unwind and global interest rates have begun to rise. Increasing returns from other asset classes, particularly safe-haven investments such as gilts and bonds, are expected to continue and compete with the prime central London market for investment.

However, this is only part of the story. Those buying the most expensive homes in central London are often driven by the appeal of owning a piece of prime real estate as a trophy asset and so are less concerned about rental yield and total return. >

“Brexit has not changed the fundamental reasons why people invest in London”

But 2018 hasn't quite panned out as we thought, and price falls have continued for longer than we expected.

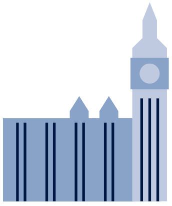
At the end of the third quarter of the year, the rate of price falls were slowing and transaction levels appeared to have stabilised. But this is not enough to suggest the market will return to growth in the short term. Sentiment is likely to take a dip in the last quarter of 2018 in the wake of the announcement of more taxation for overseas buyers. Added to which, perceptions of political uncertainty remain high, restricting the market's capacity for a bounce-back in values.

More specifically, the expected timings of Brexit have been pushed out. Last year, we predicted that Brexit uncertainty would rumble on, but assumed we could all breathe a sigh of relief as negotiations concluded in 2019.

Following the lack of progress with negotiations, and the resignation of high-ranking ministers in protest at the Government's preferred negotiation position, it appears Brexit and the accompanying domestic political uncertainty will continue to hang over the market.

That has caused us to delay the expected recovery in the market by a further year. But this comes with a caveat. There is an unusually wide range of potential scenarios around Brexit, domestic politics, fiscal policy and comparative returns. Each is able to impact on the extent and timing of any recovery, as we explore below.

Recovery rate How the key factors could influence a return to growth

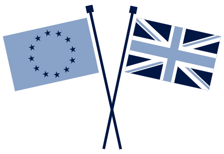


Domestic politics

No one can argue that the UK political environment is anything but uncertain. We have assumed that a minority Conservative government will remain in power until the next planned general election in 2022, given the Fixed-term Parliaments Act.

With the prevailing uncertainty, not least around the future leanings of the main political parties, we believe the uncertainty caused by the election will result in a softening of price growth, as potential buyers choose to exercise more caution.

In the absence of evidence to the contrary, we have assumed that a minority Conservative government will continue thereafter. A left-leaning government could increase the perceived risk of further wealth taxes, dampening demand for prime central London property.



Brexit

We have assumed that we end up with a softer Brexit, whereby we retain trade links with the EU and economic activity is not radically impacted.

However, this is just one scenario. The range of possible deals is varied and complex and the possibility of failing to reach any deal by 2019 cannot be ruled out.

All we can say with certainty is that a harder Brexit, in which we revert to WTO trading rules, would have a more significant impact on the UK's economy. Though offset partly by the prospect of weaker sterling, that would, in all likelihood, further temper any recovery in central London values.

Timing is also key. Currently, a transition period has been agreed until the end of 2020 (in the event of a deal being reached). In this period, we expect uncertainty to persist, though the degree to which this occurs depends on the progress made. We assume that by the end of 2020 we will have more clarity on what the deal looks like.

If details are agreed in advance, certainty will return to the market and we could see price growth return to the prime market sooner.

Taxation

All of the evidence suggests that price falls in central London have more than compensated for the increases in stamp duty since 2014. However, our agents frequently report it as a continued damper on market activity, compounding buyer caution. The announcement of a surcharge for overseas buyers of between 1% and 3% should signal the end of the assault from this particular tax.

While, in totality, property taxes in London are still not out of kilter with competing world cities, wider changes to the tax environment do impact on sentiment. A good example is the recent changes to inheritance tax for non-doms. This shows how a greater focus on wealth taxes could impinge on London's attractiveness as a place for private investment.

Prime central London forecast 2018-2023

Our forecasts use the following assumptions

The general election in 2022 is close run, assuming the main political parties maintain the same broad policy agendas currently adopted. A Conservative minority government remains throughout the forecast period to 2023. The London economy grows by 11% over the period of the forecast. Employment in the financial and insurance sectors is retained at circa 350,000 over the forecast period and job losses are contained to no more than 20,000. Bank base rates increase to 2.6% by the end of the forecast period. The UK's trading relationship with the EU remains largely as it is today. The only changes to stamp duty are the introduction of an overseas buyers levy at no more than 3%.

2018

-5.0%
Prime central London has fallen 3.0% during the first nine months of 2018. Further falls are expected in the final quarter in response to ongoing Brexit uncertainty and proposals for an overseas buyers stamp duty surcharge.

2019

-1.0%
We assume a withdrawal from the EU, without full detail, in 2019. Our expectations of what will be clear before the transition period starts are much lower than previously.

2020

0.0%
Continued uncertainty prevents any recovery in values. We assume that detail of how Brexit will work will come through 2020, with an agreement at the end of 2020.

2021

6.0%
Some certainty returns to the market with an agreement in place. We assume a relatively soft Brexit retaining links to the EU. Property looks good value (in £ and $/€) and London's status as a global city is still attractive in comparison with other locations. Despite the changed tax environment, London remains competitive on the global stage with regard to the overall tax burden.

2022

2.0%
Heightened political uncertainty is expected to curtail price growth on the basis of a close-run general election.

2023

5.0%
No longer at peak political uncertainty, growth returns to the market, albeit still below long-term trend due to rising global interest rates and returns from other investment assets. This will constrain further growth.

5 years to end 2023

12.4%
Our forecasts reflect the heightened political uncertainty caused by Brexit – the timeline of Brexit being extended and the lack of confidence in either political party, as well as global interest rates rising.

Definition of prime This market consists of the most desirable and aspirational property by location, aesthetics, standards of accommodation and value. Typically, it comprises properties in the top 5% of the market by house price.

The road to recovery: are we there yet?

Activity is picking up across all prime regions outside of London, in part due to realistic pricing. But high taxes and uncertainty remain a drag on progress

Words Kirsty Bennison

Across the UK, any conversation about the local prime housing market will inevitably centre on two common themes: taxation and uncertainty.

However, step beyond central London – to the townhouses, farmhouses and manor houses that make up the prime market across the rest of the UK – and the residential market is influenced by very different drivers and buyer profiles.

Prime London's wealth belts

More dependent on domestic wealth generation and access to borrowing than prime central London, the other prime London markets are more traditionally associated with full-time, owner-occupier demand. In central London, only one-quarter of buyers of prime housing use a mortgage. Across these other prime London markets, it's more than half.

The buying power in these markets is linked to wealth generation from high-value sectors of the capital's economy, such as, but not confined to, the financial and insurance sector.

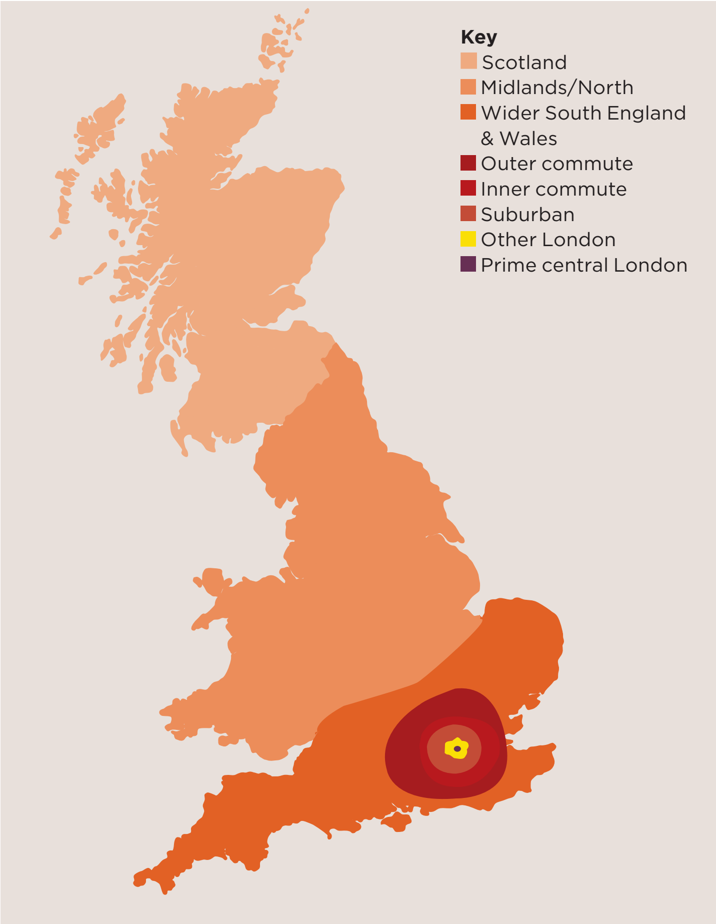
London's evolution as a Tech City is likely to help underpin demand. However, the outlook for other prime London is reliant, to a large extent, on the capital maintaining its status as a global financial centre.

Although business confidence remains comparatively weak since the Brexit vote, our view is that office-based employment in London will continue to grow for the foreseeable future, as Mat Oakley, Head of Commercial Research, Savills, explains on page 16.

Prime regional markets

Beyond the capital, there has not been the same downward pressure on prices. Yet there remains a lack of urgency among buyers. There are early indicators

Regional split Defining the UK's prime markets



Source Savills Research

that activity is beginning to pick up across all the prime regions, in part as a result of more realistic pricing.

Prices in the capital's commuter belt are unlikely to see much growth until confidence returns to the London market.

The market beyond this is less affected by the stamp duty changes and not as reliant on equity coming out of the capital. The wealth generated in the local economy and, in some cases, demand from second-home buyers, are stronger drivers of price growth.

Outlook for the next five years

We expect the prime markets of London to return to growth as the uncertainty clears. However, given the changed economic and tax environment, it may not be the kind of double-digit growth that we have seen when markets have bounced back in the past. In the meantime, the market will remain price sensitive and driven by needs-based purchases.

But buyers will not put major financial decisions on hold forever. When confidence returns, a renewed flow of buyers will feed demand in the key commuter markets and beyond. When that will be, though, is hard to predict.

In the market beyond London, the relative value offered in most prime regional markets compared with the capital is likely to underpin future price growth.

To summarise, we don't expect much upward pressure on house prices. High taxes are still acting as a drag on the market. The continued uncertainty is impacting buyer appetite. The price gap will drive demand into the commuter zone and beyond as confidence returns. In the meantime, realistic pricing is key.

> **"In the meantime, the market will remain price sensitive and driven by needs-based purchases"**

Five-year forecast The value offered in regional prime markets will underpin growth

	2019	2020	2021	2022	2023	5-year
Prime central London	-1.0%	0.0%	6.0%	2.0%	5.0%	**12.4%**
Other London	-1.0%	0.0%	3.5%	1.0%	3.5%	**7.1%**
Suburban	-1.0%	0.0%	3.5%	1.5%	4.0%	**8.2%**
Inner commute	0.0%	0.0%	3.0%	2.0%	4.0%	**9.3%**
Outer commute	0.0%	0.0%	3.0%	3.0%	4.5%	**10.9%**
Wider South England & Wales	1.0%	2.0%	3.0%	3.5%	4.5%	**14.8%**
Midlands/North	2.0%	2.0%	3.0%	3.5%	4.0%	**15.3%**
Scotland	2.0%	2.0%	3.0%	3.0%	3.5%	**14.2%**

Source Savills Research **Note** These forecasts apply to average prices in the secondhand market. New build values may not move at the same rate

The prime market in Edinburgh is at a 10-year high

Hunting for premiums

The prime market may lack urgency, but premiums are out there. You just need to know where to look

Words Kirsty Bennison

A consequence of the current market conditions is that buyers are becoming ever more selective. This is enabling a number of factors to attract a premium.

One is quality. There's a gap between best-in-class properties and the rest. Buyers who have sufficient equity to make the move are looking to get the best location for their money, avoiding fringe areas and concentrating on established prime locations. Low levels of stock have fuelled the flight to quality in the Midlands, the North and Scotland, in particular.

Prime markets in Edinburgh and Glasgow are having their best market conditions for 10 years. Transaction levels have also increased. In the year to June 2018, there were just over 5,000 transactions above £400,000 across Scotland, the highest ever annual number at this price point. In the pockets of stronger activity, there are instances of competitive bidding for the best properties in the best locations.

Traditional stock has always attracted high demand, whether in urban or rural areas. For many, access to transport, amenities and good schools are essential. As such, the prices of prime properties in cities and towns have risen by 13.4% over the past five years. Prime period homes across the country have sustained growth of 9.4% over the period.

At the top end of the market, the ongoing appeal of trophy homes in central London's most exclusive locations has held up transaction levels. Although

Return on investment Five property attributes that attract a premium

Waterfront
Premium: 13.3% for England and Wales (secondhand sale price of properties within 100m of the coast versus those within 1km) Premium: 14.6% for the Thames (secondhand flat sale price within 100m of the Thames versus those within 1km). Ranges from 28.4% in south west London to 15.6% in east London.

Schools
Premium: 16.3% (Outstanding versus Good primary schools) Premium: 30.2% (Outstanding versus Requires Improvement primary schools). Based on secondhand sale price of properties within 2km of the different Ofsted-rated schools.

Listed buildings
Premium: 44.8% Based on secondhand sale price of properties within areas with the top 10% highest density of listed buildings relative to the population versus county, for England and Wales.

National parks and Areas of Outstanding Natural Beauty
Premium: 48.3% for national parks/AONBs versus average of county they sit in across England and Wales (secondhand sale price). Premium: 41.3% for national parks, 51.1% for AONBs.

Best in class
Premium: 11.4% (immaculate versus good) Premium: 26.5% (immaculate versus moderate) Premium: 31.7% (immaculate versus poor). Based on average prime £/sq ft for properties in different conditions from our prime London index.

Properties, clockwise from top left: Chelsea Harbour, London; Cirencester, Gloucestershire; Petworth, West Sussex; Chelsea Barracks, London; Dulverton, Somerset

the value of these properties has fallen 18.4% since the peak of the market in 2014, it continues to attract significant investment. More than £500 million was spent on secondhand properties above £20 million in the first half of 2018 with recent sales in the most desirable and established locations attracting significant investment.

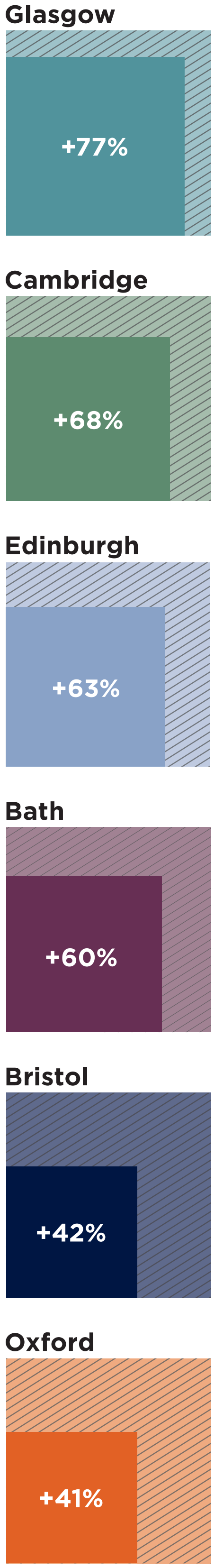
It is not just in central London where demand for high-value properties remains. Country estates form a unique set of assets for a buyer, which are attractive for investment or lifestyle reasons.

For the best-in-class estates, the total value is usually more than the sum of its parts which creates a profitable marriage value. In 2017, there were 47 £5 million-plus estate sales where the land area was at least 200 acres. Together, those assets had an aggregate value of £406,445,000.

Attracting a substantial premium can also come down to other appealing features. A waterfront setting, for example, can add almost 15% to a Thames-side property. We look at this and other factors above, while our research into the premiums of urban over rural living is illustrated on the right.

URBAN UPLIFT

The difference in average price (£/sq ft) for city properties compared with those in the surrounding area

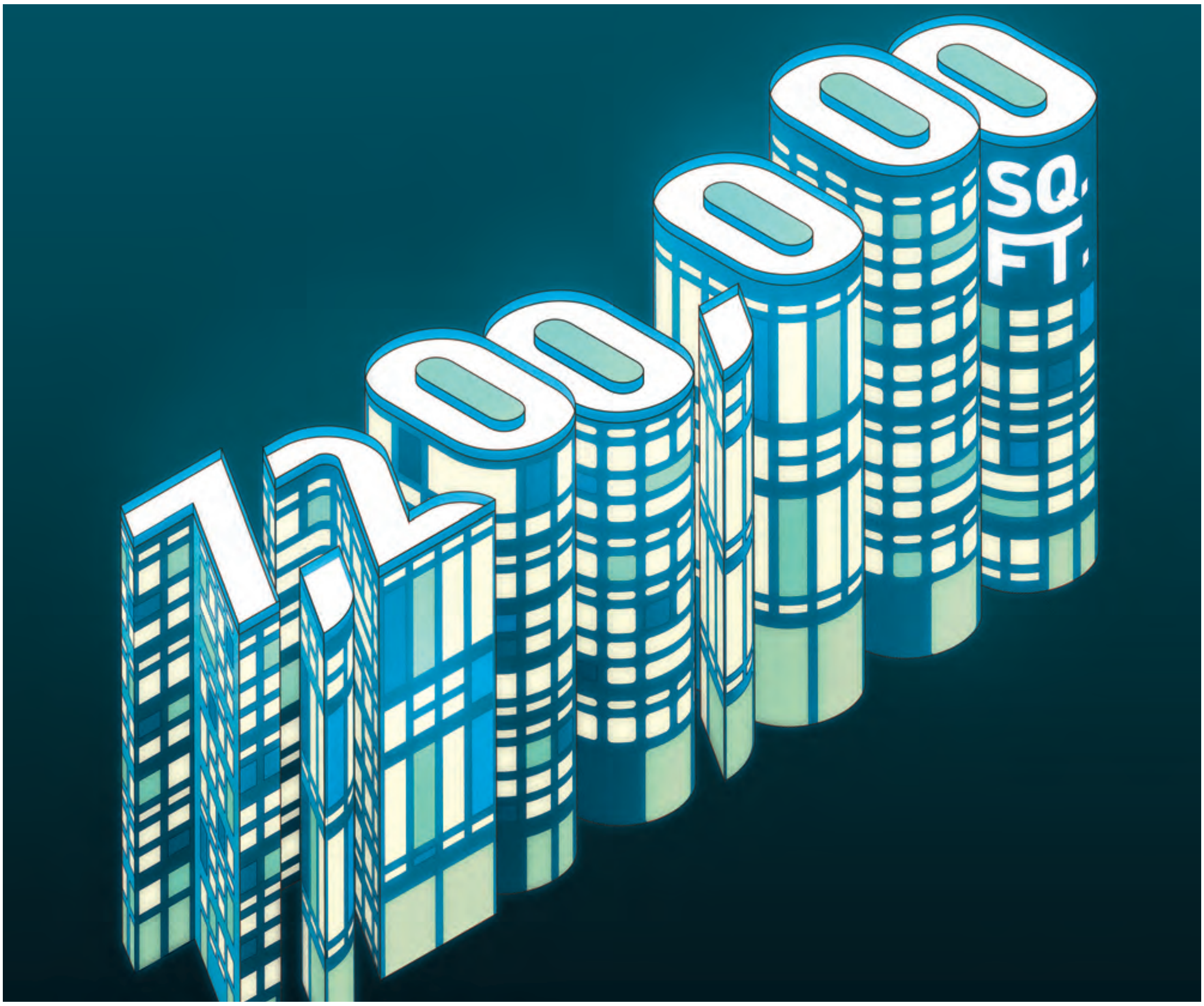


Source Savills Research

Driving demand

While headlines are dominated by economic uncertainty, office take-up in central London suggests there is ongoing housing demand from those in key employment sectors

Words Mat Oakley



There is an active need for more than 7.2 million sq ft of office space in central London

With business confidence remaining comparatively weak since the referendum on the UK's membership of the EU, it would be reasonable to assume that expansion plans were being dialled back and demand for office space would be cooling. However, while the take-up of office space in the central London office market did fall year on year in 2016, the story in 2017 and 2018 has been very different.

Last year, the total amount of office space let across the City and West End totalled 12.6 million sq ft, the highest level of take-up for 20 years.

Another sign of confidence in London's future was the type of companies that took space, and the length of commitment. In 2017, the largest letting in the City of London was 564,000 sq ft, at 21 Moorfields, to Deutsche Bank. This was significant on two levels. A German bank was committing to a large new headquarters, and it was doing so on a pre-let of a building that will not be delivered until 2021.

Business confidence for London

Given that much of the post-referendum speculation about London's future has focused on the prospects of jobs in banking and financial services leaving the capital, it may also come as a surprise that businesses from that sector acquired 2.4 million sq ft of office space in central London last year. This represented 15% of the total.

Other business sectors that acquired a significant proportion of office space were the serviced office sector with 19% of the total, and the creative and technology sector (26% of the total).

These trends have broadly continued into 2018 with the amount of office space leased in the City of London and West End reaching 5.6 million sq ft at the half year. This is marginally up on the total at the same point last year and bodes well for the London office market.

This year has seen a slightly different tone around who has driven demand. During the first six months, the largest deal in the City has been the 600,000 sq ft at Royal Mint Court for the new Chinese Embassy.

This made the public sector the largest acquirer of office space, although insurance and financial services companies have also taken 825,000 sq ft of office space (21% of the total).

Forecast for growth in office-based jobs

In the West End, the rise of the global tech titans has continued with Facebook's pre-let of 600,000 sq ft of office space in King's Cross. Once Facebook, Google, Amazon and Apple have moved into the office space that they have acquired in recent years, they will occupy more than 4 million sq ft in central London, room for nearly 40,000 workers. What is perhaps even more relevant in the context of Brexit, is that the majority of this new office space has been acquired since the referendum.

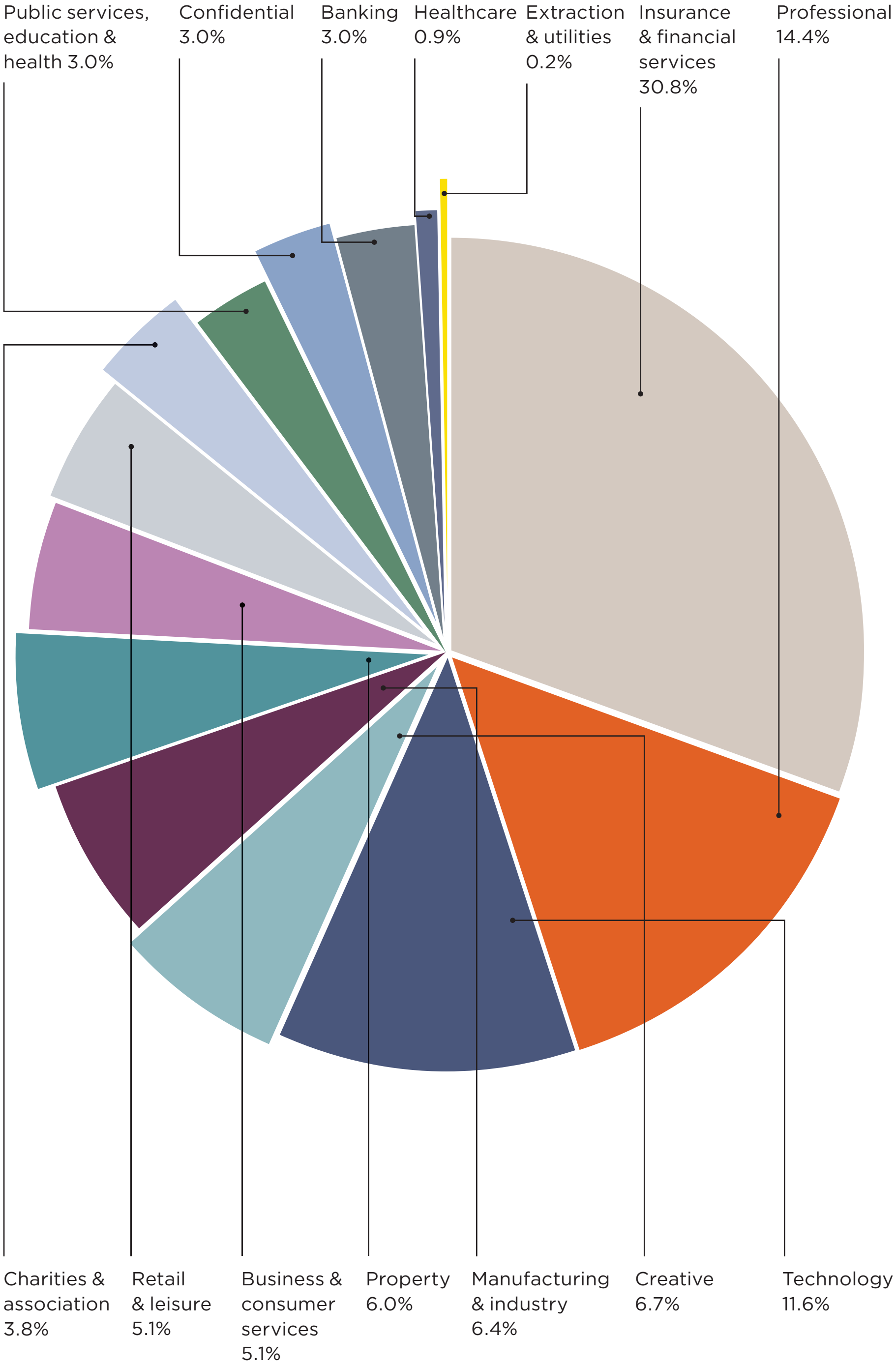
Looking ahead, the story on business expansion and demand for office space in central London appears equally positive. At present, there are active requirements for more than 7.2 million sq ft of office space from companies as diverse as the European Bank for Reconstruction and Development, Merck, and Samsung. Some 34% of these requirements are from businesses in the banking and finance sectors, and 19% of demand is from the technology and creative sectors.

While the mood music around a hard Brexit has definitely picked up pace over the summer, it is apparent from both the recent trend in office take-up and the level of requirements, that office-based employment in London will grow for the foreseeable future.

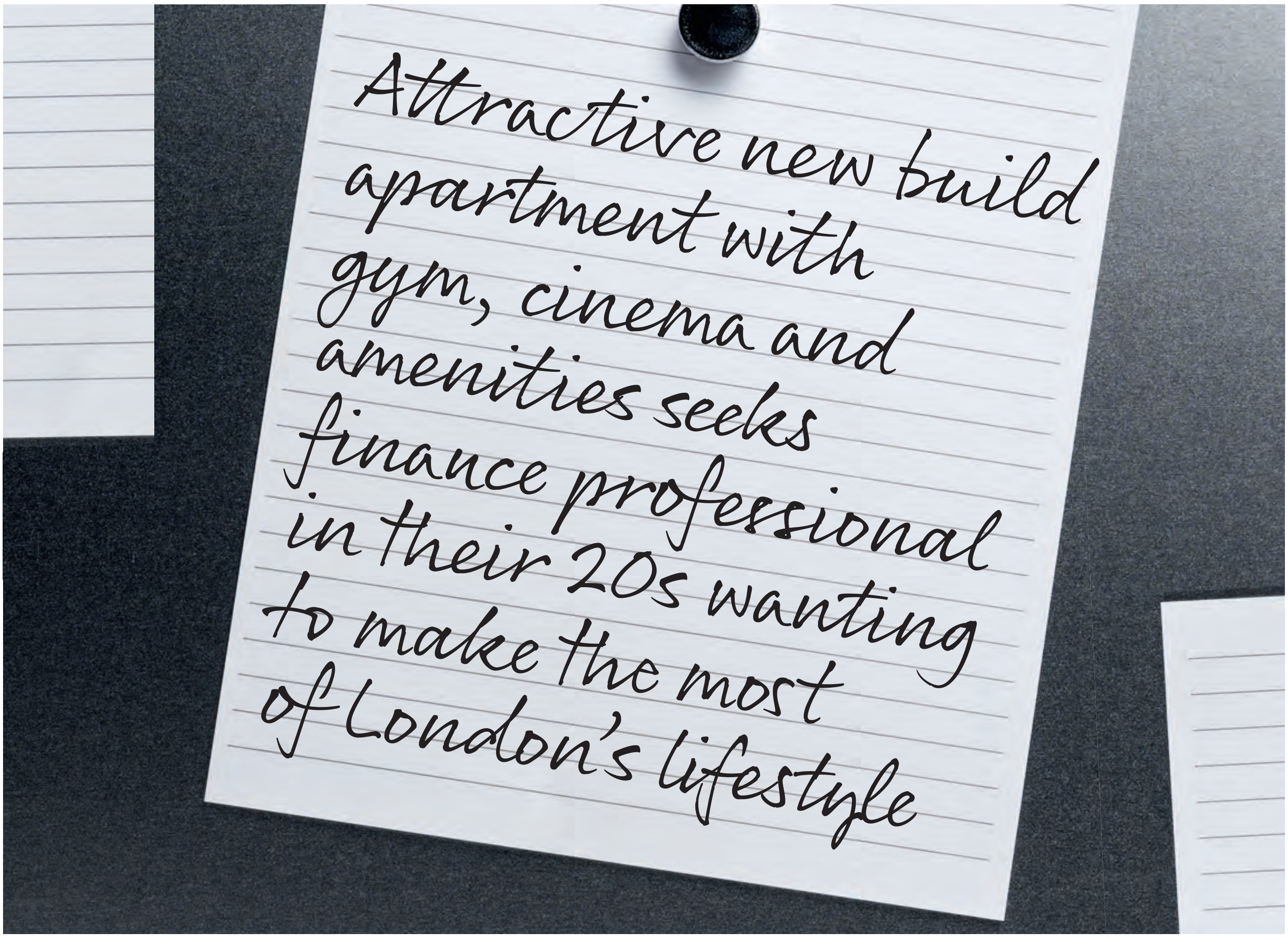
Businesses are more cautious than they were five years ago. However, larger companies are planning through the period of Brexit uncertainty and taking a view that London will remain a major part of their European and global network regardless of Brexit.

> **"Businesses are actively looking for 7.2 million sq ft of office space across central London"**

How to slice 7.2 million sq ft The requirements, by business sector, for central London office space



Source Savills Research



Recognising the perfect tenant and what they're looking for enables landlords to capitalise on demand and maximise premiums

Words Gaby Foord

Landlords of prime properties have had their challenges over the past few years. Rents across the prime London market have been in gradual decline. Over the third quarter of 2018, rents remained flat in central London, leaving them down 3.8% over the past year. Across the commuter belt, they have fallen by 2.0% over the past year.

The 3% stamp duty surcharge for additional homes, together with limited tax relief on mortgaged payments, has already caused some landlords to rationalise their portfolios. Yet overall, there continues to be high levels of supply across large sections of the market. And this sits against rising new build completions in the capital, many of which will hit the rental market.

That means existing landlords of prime property are competing for tenants. And they are doing so in an environment where renting appears to be becoming much more of a lifestyle choice.

That begs the question as to whether the profile of a new build tenant differs from someone looking for a secondhand property? And should that impact on what a landlord looks to offer to remain competitive?

Common drivers

There are a number of areas where the profile of prime tenants shows precious little difference. In both the new build and secondhand prime lettings markets there are high proportions of international tenants, particularly in the central London market.

Similarly, lifestyle relocation is now the primary reason for renting among about one-third of tenants across the prime London market as a whole. This suggests that the fundamentals of what attracts people to live in London – the strong educational offering, the language and the cultural experience – remain strong.

In the recent past, the secondhand market has seen a prominent uptick in the proportion of these lifestyle-motivated renters – growing from 26% of that market in 2015 to 41% in the first half of 2018.

At the same time, new build properties have attracted more renters moving because of employment relocation. Some 40% of tenants of these properties have stated this as their major reason for renting since 2016. The largest proportion of these tenants work in the finance and insurance sector – and with those coming to London more inclined to rent – this share of the market has steadily increased since the EU referendum, growing from 33% in 2016 to 37% in the first half of 2018.

How are tenants changing?
Where tenants across the prime new build and secondhand market differ most significantly is in age. The new build rental market tends to attract younger renters, as well as students – 42% of tenants since 2016 have been aged under 30.

Because of this, new build tenants are more likely to be established and experienced renters. The proportion moving from the owner-occupier sector has been decreasing steadily since 2015 (where they accounted for 30% of tenants) to just 14% of tenants in the first half of this year.

Such tenants are often drawn to the ease of new build, as well as the amenities that are often associated with them, such as on-site gyms and concierge services. New build schemes in areas such as Wandsworth, Camden and Ealing that can offer these have been particularly attractive to this demographic.

By contrast, secondhand property tends to be favoured by slightly older tenants, with a third aged over 40. They are more likely to be renting with children, and favour more central markets such as in Kensington and Chelsea.

Outlook
Against the context of these tenant profiles, it is important to consider what is expected to happen to supply in these different parts of the market

Ongoing pressure on buy to let means we will probably see landlords continue to re-evaluate their portfolios. This should limit the amount of secondhand stock coming to the market. In particular, the search for yield could impact the availability of larger family homes to rent.

Considering the demographic of these renters, the properties located close to the best schools and areas of culture will see the strongest demand.

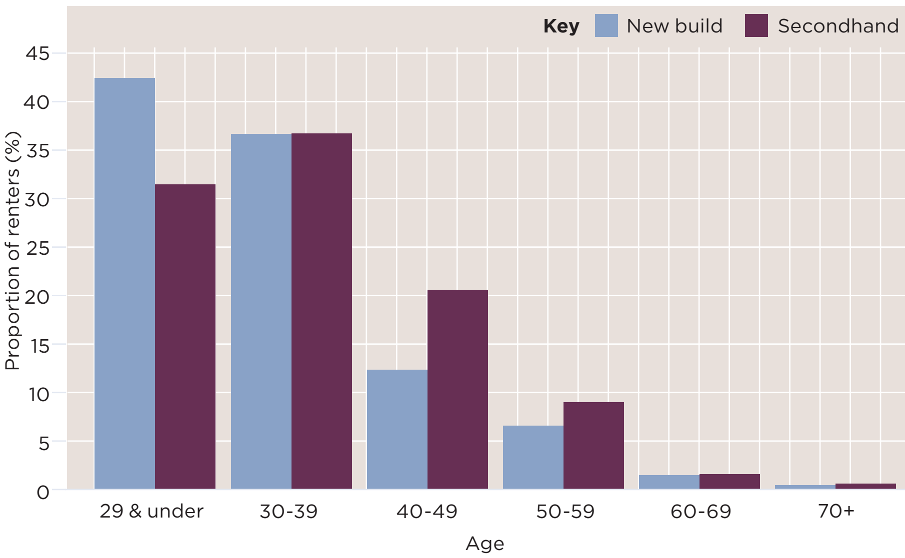
In the prime new build market, levels of completions are likely to peak over the next two years and, though much of this stock will have been sold off-plan, there will be units coming into the rental market. This is likely to limit rental growth and provide more choice for tenants drawn to new build. Therefore, to stand out, it will be important to offer something new or different in terms of amenities, specification or connectivity.

We are forecasting that rental value returns are likely to be lower than capital value returns for prime London landlords over the next five years. That means landlords will generally need to be flexible in their terms and realistic on their asking rent. But by understanding what tenants are looking for, they will give themselves the best opportunity to find that elusive gap in the market.

> **“New build properties have attracted more renters moving because of employment relocations”**

Younger renters are attracted to the amenities associated with new build, such as concierge services, on-site gyms and residents' areas

Age profile New build appeals to younger renters

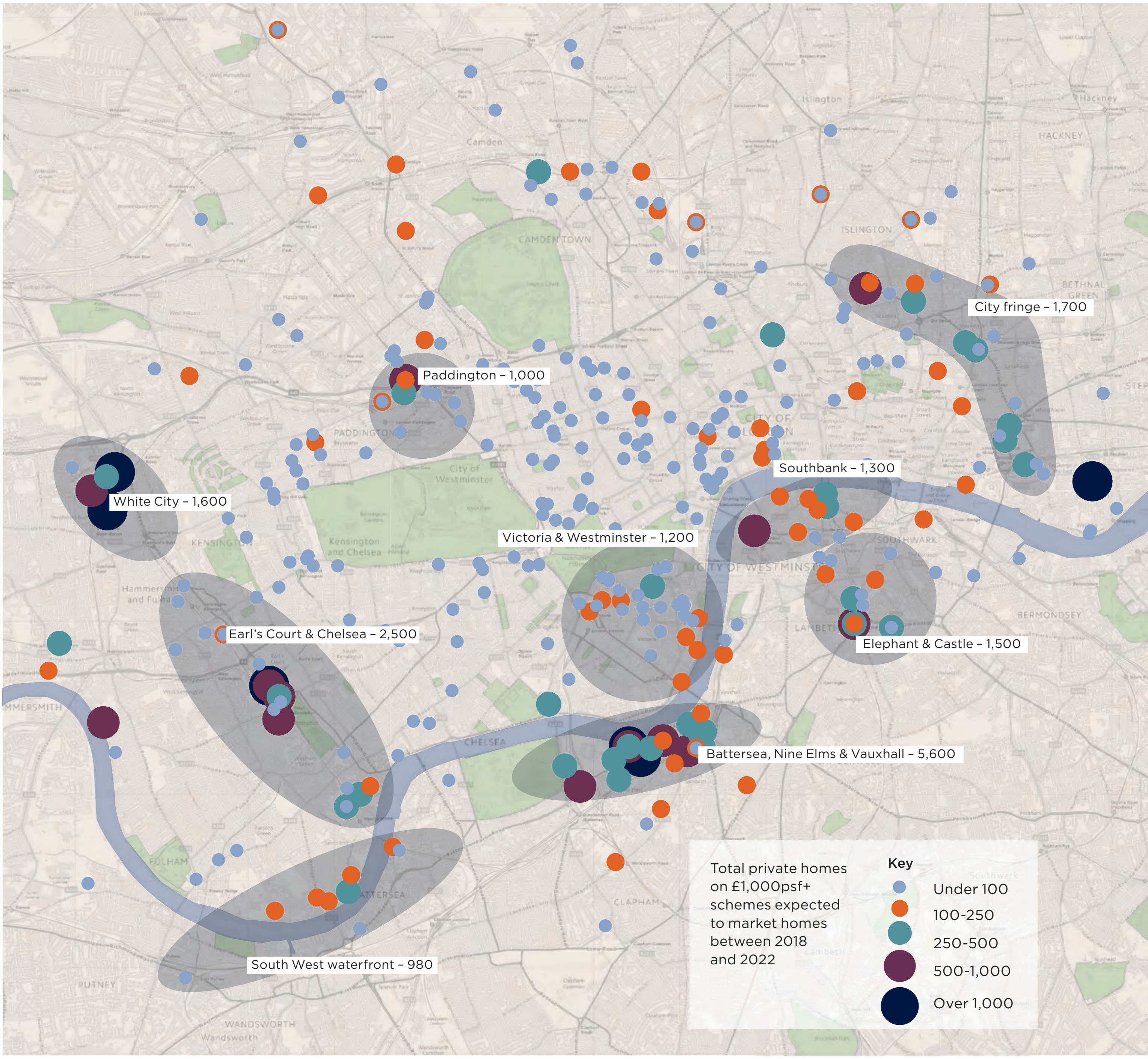


Source Savills Research

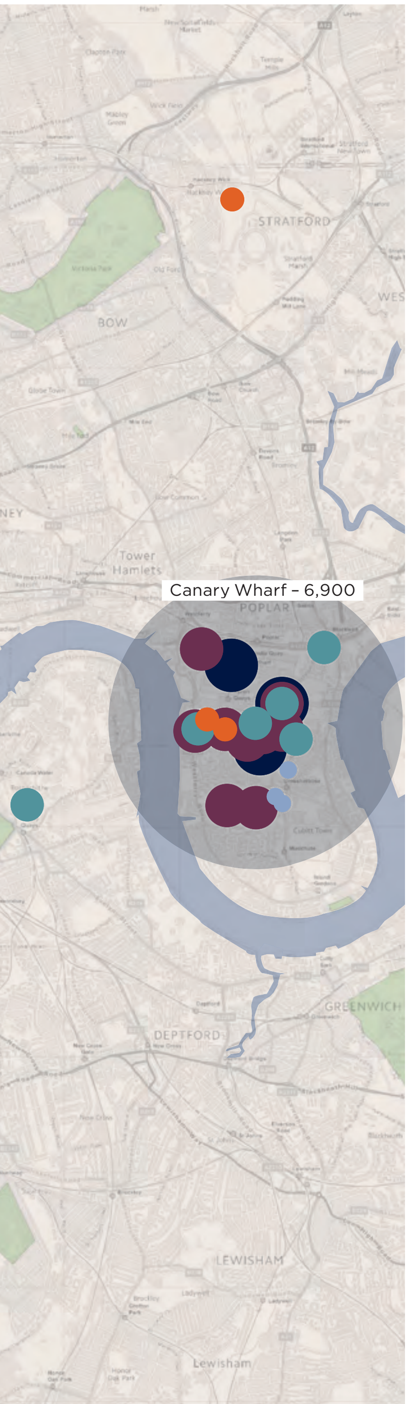
Neighbourhood watch

Of the new prime London homes expected to market over the next five years, 70% are concentrated within 10 clusters. Here's how the market is evolving

Words Gaby Foord



New build numbers London's new prime homes range from bespoke schemes of fewer than 100 units to towers of more than 1,000 units, such as in Canary Wharf and Nine Elms. These 10 clusters will deliver 70% of the city's stock



Source Savills Research

How is the prime London new build market changing?
Sales of new build homes continue to take a larger share of the market. In the 12 months to June 2018, 18% of £1 million-plus sales were new build, up from 5% a decade ago, according to Land Registry.

What's driving this change?
More completions mean more choice, with most units selling off-plan. During the 12 months to Q2 2018, there were just over 5,500 prime completions – almost three times as many as in 2014. We've also seen buyers looking for properties of the highest specification and offering the best amenities. New build is often best placed to satisfy this demand.

Is the market at risk of oversupply?
Although there has been an increase in completions, we've also seen prime sales hold steady. Importantly, the number of prime developments starting construction has begun to slow. So, while there were two prime starts for every sale in 2015 (fuelled by starts of tower schemes that cannot be phased), in the 12 months to Q2 2018, the level of sales exceeded the number of starts on site; a sign of a more stable market. Likewise, many of those units which are now completing have already been sold off-plan, hence why sales are remaining steady.

Are buyers still buying off-plan?
Yes, but there's a trend for buyers purchasing closer to completion. In 2015, the average prime buyer was purchasing a home (more than £1,000 psf) around 2.5 years before practical completion. By the first half of 2018, that was down to just over one year. This trend is particularly prominent for domestic buyers and those purchasing their main residence rather than an investment or second home.

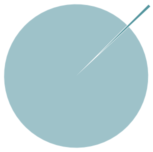
Looking ahead, what do developers need to consider?
Over the next two years, we expect the level of completions to peak, with an annual average of 8,500 prime completions in 2019 and 2020. While we expect the proportion of these units that are unsold upon completion to remain at around 10%, the actual number of units will, of course, be higher. To remain competitive with high-quality secondhand stock, developers must be pragmatic in their pricing and offer a diverse range of product to appeal to a variety of buyers.

What does the prime London supply pipeline look like over the next five years?
Of the total number of private homes over £1,000psf expected to market over the next five years, 70% are concentrated within our 10 clusters (see map). These range from bespoke schemes of fewer than 100 units to towers of more than 1,000 units, such as in Canary Wharf and Nine Elms.

Significant progress has been made in some of these locations in terms of creating a sense of place. Previously known as a transport hub and office location, Victoria has emerged as a true mixed-use destination. Meanwhile, White City is back on the map thanks to sales successes at Television Centre, the new Soho House and the Westfield extension. And Nine Elms is finally coming to fruition – securing major commercial tenants and introducing a thriving cultural programme at Battersea Power Station, and a flourishing rental community at Embassy Gardens. It is these kind of successes which underscore how new developments are transforming London.

“Significant progress has been made in these clusters to create a sense of place”

Vancouver recently increased its overseas buyer levy to 20%



0.7%
Annual property tax in London. In New York and San Francisco, it's 4.3% and 5.9% respectively

The bigger picture

Look beyond the purchase price for a more realistic view of buying prime property around the world

Words Paul Tostevin & Lucian Cook

The costs associated with buying, holding and selling property vary across the world, particularly for foreign buyers. In some of the most globally invested cities, additional taxes have been levied to try and cool demand.

In London, this is in the form of higher rates of stamp duty. For overseas buyers, this has been accompanied by greater exposure to capital gains tax and inheritance tax, to level the playing field with domestic buyers. It has also been supplemented by measures such as the snappily titled Annual Tax on Enveloped Dwellings, that are targeted at those seeking to shield their assets from the full scope of the UK tax regime.

But where does this leave prime London property in a global context? Is it over-taxed compared with its peers?

To understand this, we analysed 15 world cities on a like-for-like basis (see note below) to illustrate what the costs of ownership and disposal might be over five years.

London's position on the global stage
London property may have seen tax changes over the past few years, but it remains significantly cheaper than Vancouver, Hong Kong and Singapore, all of which have levied substantial additional stamp duties on overseas buyers. Such policies have also been pursued, though not as vigorously, in Sydney where there is a surcharge purchaser levy of 8%. This puts in context the recent proposals for a similarly targeted stamp duty levy of between 1% and 3%. The UK government expects to raise up to £120 million from this levy, a fraction of the £1.9 billion which the wider-reaching 3% surcharge on additional homes generated in the 2017/18 fiscal year.

Though the costs of buying are some way ahead of old world cities, such as Paris and New York, costs of disposal, primarily agency fees, are lower than in these locations.

More noticeably, annual taxes are a fraction of those in most other locations. In London, they are just 0.7%. In the US, relatively high annual property taxes make longer holds more costly. In New York and San Francisco, for example, property taxes amount to 4.3% and 5.9% of the property's purchase price, over a five-year hold.

That leaves London ninth in our list of 15 competing cities. For a $10 million property, total costs go from 13% to 16% of the property value, pushing it to eighth in the list. Even so, it suggests that once tax changes have been absorbed into the market, they do not make London look uncompetitive in relation to other international markets.

Could London taxes change?
The stamp duty system in the UK has gone through major reform over the past five years. Having seen a period of cuts for the bulk of the UK housing market and hikes for the most expensive properties, it seems likely that the current system will be allowed to bed in.

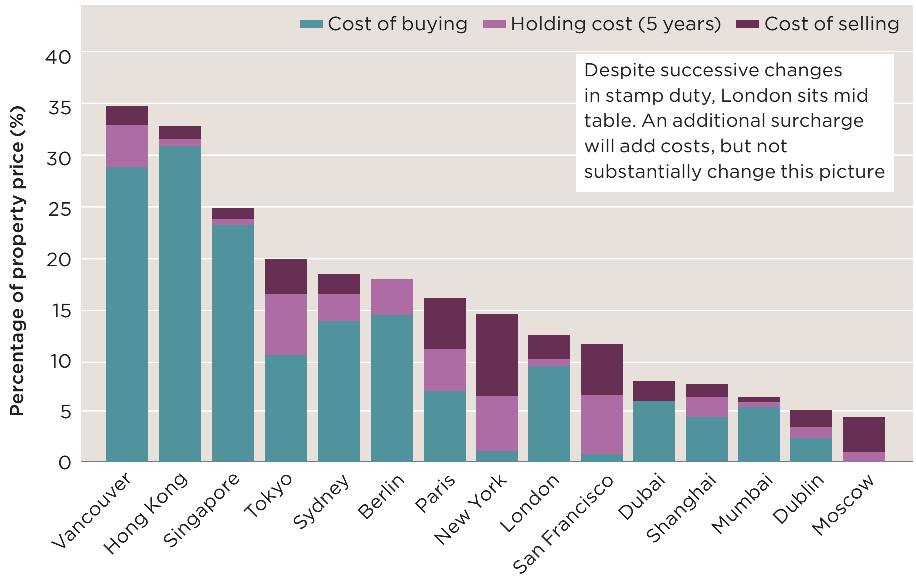
In London, the council tax system is widely regarded as outdated. Yet there is little consensus as to what it should be replaced with or indeed what the purpose of reform would be. Largely, this is because, at heart, it is a local tax that happens to be based on historic property values.

The Labour Party and Liberal Democrats have historically put forward proposals for so-called mansion taxes to overcome the perceived inequities in the system. Difficult and costly to implement, they could create almost as many problems as they are designed to solve.

That suggests we have seen the bulk of changes likely under the current government administration. A change in government could alter that, but even in this scenario the effectiveness of wealth taxes will be heavily debated.

> “In the US, relatively high annual property taxes make longer holds more costly”

Buying and selling a $2 million property



Source Savills Research

Note Our scenario assumes a non-resident overseas buyer purchasing a $2 million property (which in the UK equates to £1.5 million). This is for use as a second home for less than nine months of the year over a five-year hold. No capital growth has been applied, avoiding the complication of having to forecast that for each city.

Savills Research
We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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