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Our greatest challenge remains the constrained levels of good quality stock: On buying prime property in the current climate

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London's high-end neighbourhoods are being sustained by international equity, short supply, and a more robust response to market sentiment, explain *Sophie & Richard Rogerson.*

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With a scintilla of good news in July's inflation figures, the UK's mainstream residential property market may just breathe a sigh of relief over the summer months. If the Bank of England decides to raise its base rate by only 25bps in August and September, and then pauses for the remainder of the year, UK mortgaged households may feel they can ride out the current interest rate storm.

With commentators predicting rates could start to fall as early as 2024, the worst-case scenario modelling should be avoided, with an overall correction in the market of just 8-10% from peak to trough, representing less than half the post pandemic growth. The question is whether one swallow really can make a summer?

All eyes will be on the Bank of England and on July's CPI figures, which are released later in the month. Observing inflation figures in markets that appear to be ahead of us in this current cycle (such as the US, New Zealand, Canada and Australia), there is reason for cautious optimism.

Prime protection

Turning to London's prime and super-prime markets, the inflationary figures have less of an immediate impact. Given the prevalence of cash buyers (71% of the market currently) and international buyers (able to take advantage of sterling's weakness) our market is not controlled by affordability constraints in the same way. Instead, we are sustained by international equity, a restricted supply of good quality stock and a more robust response to market sentiment.

Over the last decade, the performance of London's prime markets has diverged from the UK mainstream. Whilst central London has seen growth of circa 10% since 2010, the mainstream market has grown an astonishing 78%. This is just one of the factors supporting the narrative that London's prime markets are more cushioned than the mainstream markets and likely to be the first to rebound. Other factors include: the ongoing currency discount for international buyers (suggesting a buying discount of 40+% since 2014); the global prime property boom which has left London in its wake (Dubai a runaway winner with 148% growth); and the dramatic fall in the new build pipeline in London (down 83% since 2016) which currently provides more than 20% of supply in the prime and super-prime markets and which is forecast to run out in five years time, thereby putting further downward pressure on an already stock-constrained environment.

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Whilst London has seen a fall in transactional volumes year-on-year in H2 2023, we have to contextualise that, propelled by the post-Covid property boom, 2022 was the highest year on record for £5m+ transactions since records began back in 2006. As such, transactions in 2023 are broadly in line with volumes in 2021 and well ahead of 'normal' pre-pandemic averages. By constantly comparing current figures against post-pandemic data, we ignore the more relevant and normalised comparisons to be made with the pre-Covid era.

Notwithstanding the record transactional volumes in recent years, average values in prime central London have barely changed, with indices registering notional 1-2% growth depending on who you consult. This pattern continues with +/-1% value growth so far in 2023. As ever, the average statistics bely the reality for 'best-in-class' properties which have seen extraordinary price growth in certain areas (as much as 30%) in the last few years. The indices also exclude transactions in the new build developments from their data which means the vast premiums being achieved for super-prime apartments (habitually trading for over £4,000/sq.ft. and occasionally for in excess of £10,000/sq.ft.) are not reflected in the round.

In terms of buyer demand, we haven't seen a particular slowdown so far this year, with the usual movement of families from North America and Europe driving the agenda alongside motivated domestic buyers with a need to make a move for schooling or other lifestyle reasons. Anecdotally, the selling agents also acknowledge that there are enough extremely good cash buyers in the market to more than meet demand, although they remark that there has been a notable fall-off in discretionary international buyers who seem to have arrived late into London this year.

Our greatest challenge remains the constrained levels of good quality stock, with sellers extremely reticent to approach the market amidst fears that this is a dreadful time in the cycle to sell. With limited options at all levels of the market, those looking to downsize, upsize or 'rightsize', can't find anything to buy from a cursory look online, and so they choose to stay put. Reluctant sellers are also able to fall back on a buoyant lettings market, where tenancy terms of 3+ years have become the norm, and owners can achieve record rental premiums without much effort.

Reluctant sellers are also able to fall back on a buoyant lettings market

With the moat bridge firmly closed, our role is to patiently and creatively unearth opportunities for our clients, often forensically trawling through historical trading data, and using long-established industry relationships to open doors. And in some ways, that's the easy bit! Sensitively bringing the people and the personalities together, agreeing commercial terms and encouraging a sale ahead of schedule, requires credibility, discretion, tenacity and a proven track record for representing and transacting for the best buyers in the market.

Projections & Politics

Looking forward, Savills have been projecting growth in the prime markets since before the pandemic, stating that growth is a "when not an if" event. However, this growth has been consistently deferred by events be it Brexit, Corbyn, Covid and of course for the past 18 months, the war in Ukraine. Initially, growth of 7% was expected in either 2022 or 2023, followed by strong year-on-year growth of circa 4% thereafter, providing cumulative growth of 23% over 5 years. Following the disastrous mini-budget in October 2022, figures were revised downwards to growth of just 13.5% over 5 years.

Whilst our market may be more immune to interest rate rises and inflationary pressures, it is without doubt susceptible to changes in sentiment, especially those caused by political uncertainty. So, as we enter the next election cycle, and with property and wealth high on the agenda, we suspect that meaningful growth will be postponed once again to 2025 at the earliest. Labour have already committed to abolishing the current non-dom regime, with little (if any) clarity on what will replace it, although a transitional regime seems a likely option. Whilst some changes to the non-dom regime might be welcome (for example encouraging arrivals to invest their money into UK enterprises), the uncertainty of an inevitable policy change is not welcome. If we are right to believe Labour do not have a policy ready to go, then a new regime is unlikely to materialise (following consultation and implementation) before 2027 – this remains a very complex area of law interwoven with a vast array of tax treaties and hidden consequences, not to mention legacy structures. Labour has also suggested raising the non-resident SDLT surcharge, whilst the Conservatives retraction of the Investor Visa last year slowed the move to London for some prospective buyers.

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In the longer term, the sustaining power of London's fundamental appeal, coupled with the lack of meaningful growth since 2013 and the stunted new build pipeline (which is just 17% of what it was in 2016 and will further constrain stock levels), point towards a return to growth once the election-cycle has concluded. In the meantime, transactional volumes are likely to remain subdued with average values remaining flat (distorting the reality of an ever-present flight to quality).

Summer sojourn

Perhaps thankfully, a 'period adjournment' is an established part of the UK political summer calendar, and so for now we have a period of relative quiet before the election salvos resume once more. In mirror image, the London market has also quietened as sellers and buyers (and their agents!) head to Europe to enjoy their summer breaks. Meanwhile, walking through the streets of Mayfair this morning and Portobello this afternoon, we are pleased to confirm that London is very much alive and kicking with joyful visitors from all over the globe. Indeed, on the buy-side, there is little time for a summer recess with client transactions at various stages of the process continuing at pace!

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