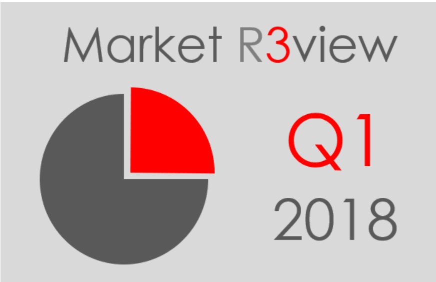
■ anna.barker@r3location.co.uk
■ 44 0 7920 027 658
■ www.r3location.co.uk



R3Location
Reliability Reputation Relationships

# MARKET R3VIEW Q1-2018




## Overview

To mark one year since the triggering of Article 50, R3Location is deviating slightly from its usual format for Quarterly updates to provide a broader, higher level analysis of the rental market in London.

- **Global trends:** this newsletter will first focus on showing how global trends in the last 12 years have affected the London Prime Residential Market;

- **Looking ahead:** before taking a look at how the current macro-economic trends are beginning to shift the tide back towards a slow period of slow, sustained rental growth.

## Global Trends

### London as a global City

London is one of the most diverse capital cities in the world and the largest city in the United Kingdom with 30% of its 8.63 million residents born abroad. Its population rises to over 10 million during the day as commuters make their way into the City. The Global Financial Centres Index (ranking of the competitiveness of financial centres) has ranked London first ahead of New York (in second place), HK (third) and Singapore (fourth); and has done so consistently over the last few years.

As such, the rental market in London, and, in particular Prime Residential Rents, are closely tied to the ebbs and flows of global trends. **Figure 1** puts this specific Market into historical perspective.

### A bubble forms

***Apr 06 – Jun 08: +12.6% rental increase***

A period of moderate expansion starting in 2001 gathered pace towards the second half of the noughties. The bubble in home prices that began in the late 1990s continued, fuelling employment growth in construction, financial services, and other sectors related to housing. 2007 saw the largest number of expatriates moving to London in over 10 years. Sustained high level of demand pushed rental levels to steady quarterly increases of just under 2% over 9 quarters. Like most bubbles, it wasn't to last.

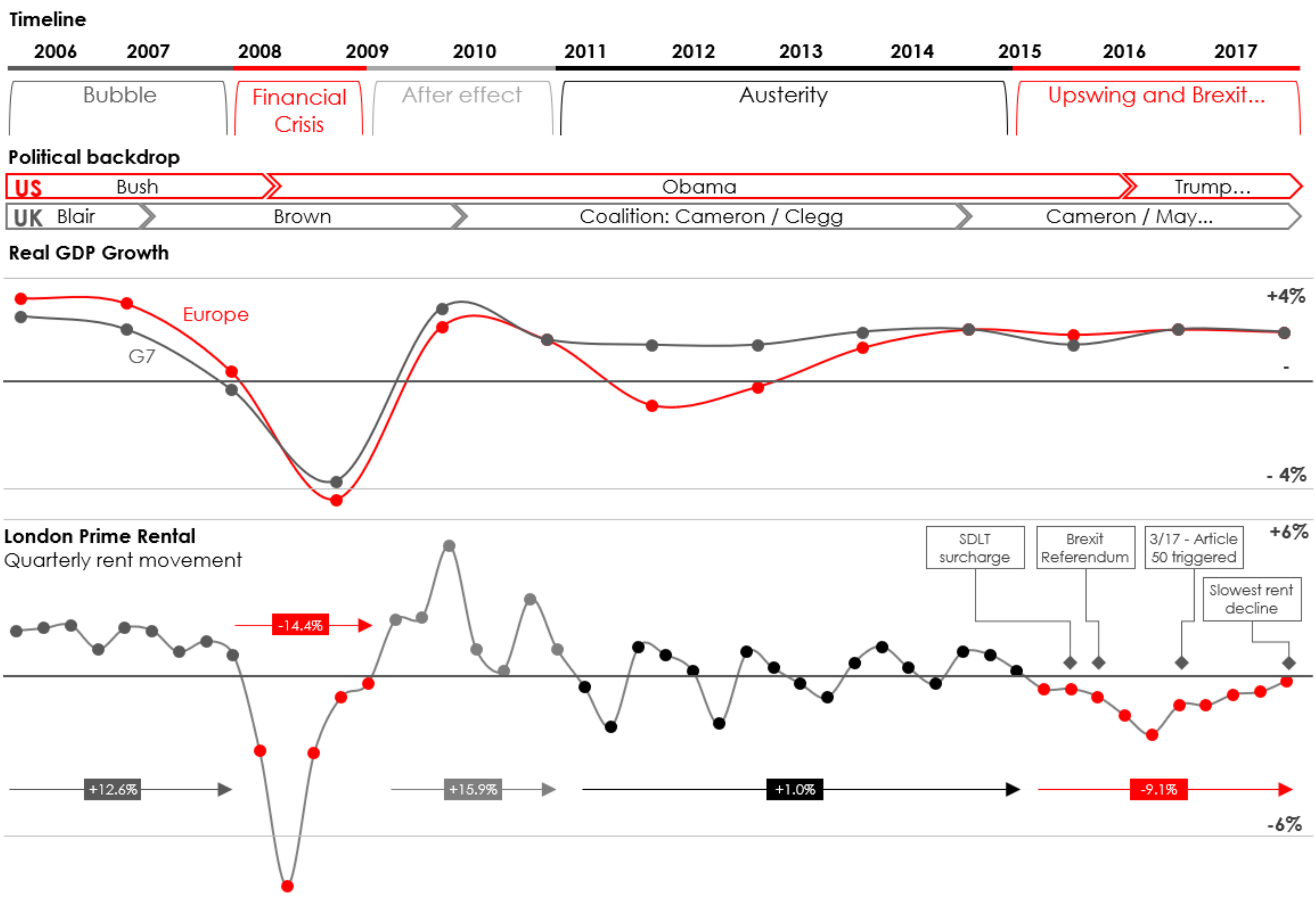
### Financial Crisis

***Jul 08 – Jun 09: -14.4% rental decrease***

The tipping point began late 2007 by a large decline in US home prices after the collapse of a housing bubble in the US,

**FIGURE 1 - Prime London Rental**

The Prime Residential London Rental Market in historical perspective



■ anna.barker@r3location.co.uk
■ 44 0 7920 027 658
■ www.r3location.co.uk



R3Location
Reliability Reputation Relationships

leading to mortgage delinquencies and foreclosures and the devaluation of housing-related securities. It soon became a full blown global financial crisis with the demise of Bear Stern, which was heavily involved in securitizations, and shortly after, Lehman Brothers in September 2008. The Financial Services world came to a global halt. The standstill had a direct impact on demand in London sending rental level plummeting back by some 14.4% over 5 consecutive quarters.

## Too Big To Fail Doctrine

***Jul 09 – Sep 11: +15.9% rental increase***

This global market collapse gave support to the "Too Big To Fail" doctrine. Following sustained rescue plans by major economies, including provision for more liquidity to the financial system, recapitalisation of banks and guarantee of bank debt, the world slowly reversed a global recession. Improved confidence led to a re-alignment of the London Prime Rental Market to pre-crisis levels.

## Austerity

***Oct 11 – Sep 15: +1% rental increase***

This repositioning was followed by a long period of stagnation where nothing much happened. The Economy was generally sluggish, with many Governments implementing austerity programmes to reduce budget deficits arising as a result of the Financial Crisis and its massive bail-out aftermaths. Over 17 long quarters, the prime residential rental market in London displayed minor upwards and downwards fluctuations – with demand and supply generally steady, and larger companies still reluctant to commit to re-invest in global mobility programmes for their workforce, across all regions, including Europe.

## Leading towards Brexit

***Oct 15 – Dec 17: -9.1% rental decrease***

And Europe is what defined the period from the time the Conservatives secured an unexpected majority in the 2015 general election. To fulfil a manifesto pledge, a referendum on the UK's continuing membership of the EU was announced in February 2016, held in June 2016 and Article 50 triggered in March last year. This, however, was probably not the main driver behind the sustained quarter by quarter decline in rental levels in London. **Marco Previero**, Director at R3Location says: "*In April 2016, a Stamp Duty Land Tax surcharge was introduced, and it was to have a more material impact on the rental market by slowing down sales, and in doing so, increasing the supply of rental properties against historical averages*". This, in turn, with demand remaining relatively stable, pushed rents downwards.

# Looking ahead - 2018

## Slowest fall in rental levels

As indicated above, over the last 3 years, a high level of supply has continued to put pressure on rents. This is now slowly reversing as the SDLT surcharge has been absorbed back into property prices. The imbalance of supply versus demand is redressing and the last quarter has seen the slowest decline in rental level since December 2015.

## An active rental market

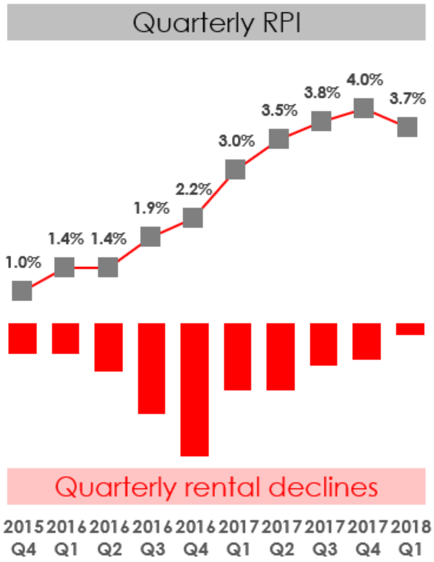
Lower stock levels will put upward pressure on rent levels in 2018, but it is not the only driver. The market remains active on the demand side too, despite Brexit and possible future uncertainties relating to it. A leading data agency has recorded 5% increase in overall tenancies agreed in 2017 against the same period in 2016 and enquiries and viewings are up in double-digit growth year on year. With limited stock supply, popular properties are still those in good conditions and in the most sought after locations. It is worth noting that Prime Residential London remains a fragmented market with different neighbourhoods and different rent brackets performing in different – sometimes opposing - ways.

## Is RPI finally levelling up?

Indications by the Bank of England that interest rate rises continue to be on the horizon will correlate to upward pressures on RPI. **Figure 2** shows quarterly RPI changes since December 2015. This steady increase followed a period of low RPI and there are signs that, notwithstanding further inflationary pressures, RPI seems to be levelling up with February 2018 seeing the index fall back down to July 2017 level of 3.6%. "*RPI generally dictates the rental increases inherent in lease renewals*", says **Anna Barker**, Director at R3Location, "*and the increase in this index over the last 7 quarters represents future rental increases on current tenancies*". And actual rents paid do generally influence the asking price of future rentals – but not as much as general economic trends do.

**Figure 2: RPI All Items**

RPI All Items: Percentage change.




## The next 12 months

So what's in store for rental levels going forward? Opinions differ here with two leading Estate Agents suggesting an ***increase*** of 0.5% and ***decrease*** of 3% respectively in Prime London Residential Rents over the next 12 months. The reality will be somewhere in between. Less second-hand stock as a result of a resurgent sales activity will put pressure on rents. More stock is needed to counteract the increase in demand the London Market is experiencing of late. New developments coming to completion after delays arising from Brexit may help, but a shift to Landlords being in the driver's seat is now apparent. How long it will last will very much depends on some of the key aspects of Brexit, though forecasts are increasingly suggesting that London is likely to be less impacted as a result of exiting the EU than the UK as a whole.

## References

**London's Economy Today (GLA) –** Issue 186 February 2018

**Knight Frank** – London Residential Review Spring 2018

**Knight Frank** – Prime Central London Index February 2018

**Savills –** Residential Property Forecast Report (November 2017 – Pushed to the limits)

**Financial News London** (fnlondon.com) Asset management article 21 March 2018

**Office of National Statistics** – February 2018

**FTI Consulting -** Brexit in the Boardroom: The View from Business – February 2018

**IMF** (imf.org) – IMF Data mapper