PRIME CENTRAL LONDON PROPERTY REPORT - JUNE 2009

"The groundhog is like most other prophets; it delivers its prediction and then disappears".

Have We Seen The Bottom Of The Market?

More and more commentators are declaring the bottom of the market. Admittedly the message is cautiously optimistic, but the worst is definitely over they say... and if not there is only another 10% maximum the market can fall, so the risk to the downside is limited. Buy now is the very clear message.

The evidence seems to back the bulls' argument:

Gazumping is back. I personally know of two people who have suffered this frustration (Unsubtle plug alert!! We have never been gazumped in eight and a half years of acquiring properties for clients - Unsubtle plug alert!! (No doubt we will soon be gazumped after this shameless plug.))

Figures from the Council of Mortgage Lenders showed that gross mortgage lending in June jumped 17% to £12.3bn, up from £10.5bn in May. This is still very low compared to a couple of years ago, but the trend is up.

The Royal Institution of Chartered Surveyors' monthly survey for June found that more surveyors expected price rises than falls - the first time there has been a positive balance in over two years.

The Land Registry announced that house prices had risen for the first time since the start of 2008.

Savills reported that average values rose by "4.3% in the second quarter of 2009, effectively wiping out the falls seen in the first quarter. However, this still leaves values 20% below their 2007 peak."

"Price increases have been exacerbated in areas where pent-up buyer demand has been chasing constrained stock levels. In the South West London sector, for instance, a short supply of quality houses led to price rises of 6.4% this quarter."

Knight Frank reports:

"The final element supporting prices has been supply. For some time estate agents have been complaining about a lack of available stock. This issue is now becoming critical to the performance of the central London residential market."

"The volume of properties available in central London in July was down 34% compared to the same month a year earlier. The number of properties coming forward for the autumn market is showing no improvement – with the pipeline of new properties coming to the market down 42% over the same period."

"Coupled to the fact that the prime markets in London have seen a virtual cessation of new development, new starts were down 60% in Q2 year-on-year, it appears that tight supply will be with us for some time to come."

Hamptons International said asking prices were rising in Chelsea, Knightsbridge and Kensington. These areas saw prices rise between 5 and 9 per cent in the first six months of 2009, compared with the same period last year.

Hamptons said there were nine buyers for every seller last month, compared with five a year ago.

“The rise in prime London asking prices is attributable to a more acute imbalance between supply and demand, coupled with rising consumer confidence, as illustrated by the growing number of applicants,” said Marc Goldberg, head of sales at the agency.

In addition the amount of overseas money flowing into the London market has increased with Knight Frank reporting:

“Confidence in the market is witnessed by the growth of applicant demand, up 37% year-on-year in Q2. Overall demand growth is important, but we ought to also consider the composition of this demand. UK buyers within the £1m+ market in London have typically comprised c. 65% of the market in recent years. In Q2 this year this share dropped to 57%.

The three biggest overseas markets in Q2 2008 were European (37% of all overseas buyers), Russian (19%) and North American (13%). In Q2 this year these figures slipped (to 34%, 14% and 10% respectively) as we saw a doubling in the proportion of overseas demand from Africa, Asia, Australia, China, the CIS (Kazakhstan, Azerbaijan and Uzbekistan), and the Middle East.”

What are we seeing?

Despite my bearish views on the market Mercury has also been taking on new clients from the UK and overseas. Now this is obviously great news, but is a crushing blow to my ego: Before they join Mercury, clients always ask me what I think will happen to the market. The answer is always the same: “I have no idea, but my view is that the odds are stacked in favour of the market going down” and then I list the usual suspects:

- Rising Unemployment
- Lower wages – lower bonuses, etc.
- We are still way above long term average house price to earnings’ ratio
- Rental yields are poor due to an oversupply of rental property
- Restricted Lending
- Increasing taxes

Although they know my views, they still want to proceed. The obvious point is that everyone's situation is different and one has to make one's decisions accordingly. Sometimes it is simply due to the fact that they want a home and are not particularly concerned about the market. Other clients from overseas have been taking advantage of sterling weakness.

However, a growing number of my clients are becoming more concerned about inflation.

This could be the big danger. Now there are plenty of sound arguments to suggest that deflation is and will continue to be a problem. Studies by the IMF have shown that after banking crises recessions are longer and deeper. Quantitative easing will also not necessarily be inflationary as the banks do not release the extra money into the system as they have to repair their balance sheets. This is highlighted by the lack of mortgage products available and the near total reluctance to grant buy-to-let mortgages. Indeed the extra £50billion of quantitative easing that has just been announced would suggest that all is still not well.

The important thing to remember is that no-one knows what will happen. Despite the best thought out arguments and in depth analysis we are in unprecedented territory. Interest rates have never been this low and the US & UK governments are pumping extraordinary amounts of money amounts of money into the system. Anything could happen.

Consequently some clients are looking to buy prime central London property as a hedge against rampant inflation.

Personally, though, I am still extremely wary of this bounce.

It is based on a low number of transactions, which will naturally exacerbate any movement in the statistics, and an incredible lack of supply. This lack of supply is the direct result of low interest rates, which is making mortgage repayments affordable and reducing the number of forced sellers.

Although the trend is most definitely heading up at the moment one must remember that in 1989-1995, a six year period of declining house prices, there were 23 months of price increases with 48 months of decreases while three

months were flat. It is therefore highly unlikely that we have seen the end of the house price drops in the space of only 22 months.

In addition, inflation (and worse stagflation) is not necessarily good for the property market.

Rental returns will be even worse especially if unemployment continues to increase. If we do suffer inflation, interest rates will make those who are heavily indebted struggle whether employed or not. The crash of 1990's was partly due to inflation and the high interest rates that accompanied it. One must also factor in the loss in real rather than just nominal terms.

The risks are still heavily geared to the downside. This will manifest itself differently for different people and price ranges.

For example, the £10m + market is the least vulnerable in many ways to economic shocks as owners tend not to be forced sellers. There are exceptions, but this is generally true. Therefore if the market does drop further, then transactions will grind to a virtual halt as owners will not want to realise losses. The biggest danger for this market is likely to come from *invasive tax & other policies that make London a less attractive place in which to live or own property*. The danger of this should not be underestimated and will be discussed in the future.

£1m market and below is the most vulnerable to economic issues as the owners are more reliant on mortgages and their jobs. Values will also be impacted by the excessive number of buy-to let properties that do not make any financial sense. At some stage the landlords will capitulate unless there is an astonishing economic recovery. Unfortunately, as Savills reports: "The sector most associated with high-level corporate lettings continues to be hit most strongly. There was a quarterly fall of -4.2% in rents in the core area of Knightsbridge, Chelsea, Mayfair and Belgravia. Average rents in this area are now down 19.1% from their peak."

Indeed any property owners who are highly indebted compared to their income, no matter what price range, have cause to be nervous. As long as you do not have to sell your home then the shenanigans in the market are largely irrelevant. However, if you suddenly lose your job or find that your bonus is

non-existent for three or four years (almost the same as losing your job in financial terms) then there will be a problem.

I can only stress again that I am looking at the likeliest of scenarios with the information available. These are not predictions. It is not impossible for the market to continue to head higher, but then nor is it impossible for the market to drop another 25%. Indeed this scenario is far more likely than some would have you believe.

In the meantime, I look on nervously. Am I right to stay out of the market? Are the optimists right? Am I making an expensive error?

Questions, questions, questions. If only I could find a reliable groundhog.

Best regards,

Jeremy McGivern

p.s. Please email Jeremy@mercuryhomesearch.com if you have any specific questions about the prime London market that you would like answered in this report.

p.p.s. If you would like to contact Mercury Homesearch to discover how we can help you acquire the finest home or investment your property can buy please call +44 (0) 800 389 4280.