THE UK PROPERTY MARKET: AS SAFE AS HOUSES?

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2016 was the year in which being a celebrity carried a serious health risk. One theory is that, faced with the prospect of performing at President Trump's inauguration, many celebrities simply lost the will to live.

Whilst not quite a matter of life and death, 2016 also presented a number of challenges for property investors. Brexit, a weak pound, a change in Prime Minister and additional property taxes have created the perfect storm of uncertainty in the UK property market.

What does this mean for UK property prices in 2017?

Well, pending the outcome of the UK's Brexit negotiations, it means more uncertainty in the market. Is that bad? Not necessarily.

Uncertainty and nervousness inevitably lead to price reductions, especially at the top end of the market. According to Rightmove, asking prices at the top end of the London market have dropped by 8.7% in the past year. Conservative investors, such as some pension funds, may take the money and run in order to reduce their exposure to the property market.

Why would I invest in a falling market?

Well, let's look at some figures from the last crash in 2008. Have London house prices recovered to their pre-2008 levels? Have they ever?!

London house prices started surging again in March 2012 and are now more than 50% higher than they were before the 2008 crash. In 20 years, the average London house price has increased by 518%. In several London boroughs, prices have increased by 700%. A recent survey by JLL predicted that prices in a third of London boroughs would hit an average of £1,000,000 by 2032.

With property investment, the longer term view is usually the right one.

Whilst the rest of the UK has not kept pace with the capital's growth, a shortage of supply coupled with the desirability of London living means that it has produced remarkable gains for property investors. The housing shortage will not be solved overnight, so the fundamentals mean that any dip in the capital's prices is likely to be temporary.

In the short term, a weakened pound offers an opportunity for overseas investors to save a significant sum on property purchases, often covering the costs of Stamp Duty Land Tax (SDLT) through fluctuations in the currency market.

Hasn't the increase in tax killed residential investment?

In 2016, buy to let investors saw an increase of 3% on SDLT payable on the purchase of a second residence. That said, some of the price adjustments in the housing market indicate that sellers are absorbing at least part of these costs by accepting lower offers.

Whilst SDLT rates for companies are higher, there are exemptions from the higher rates of tax. For example, on a purchase of a £500,000 residential property by a company, the highest rate of SDLT can be reduced where the property is being purchased in the course of a property rental business or by property developers or traders.

Also, where part of a residential property is used for a non-residential use (such as a shop below a flat or as agricultural land) the property qualifies for much lower commercial rates of SDLT. For example, on a property being purchased for £1,000,000, the SDLT payable on a mixed use investment would be £39,500 instead of £73,750 on a pure residential purchase. Therefore, there may be opportunities to invest in residential property but also minimise your SDLT liability.

Whilst residential investors using offshore structures also have to pay the Annual Tax on Enveloped Dwellings (ATED) on properties valued at over £500,000, there are exemptions for properties which are being developed for resale.

How about the commercial market?

Given the uncertainty and increased costs in the residential market, we are seeing many investors turn to commercial property in 2017. There is strong demand beyond London for solid investments which are underpinned by good tenants and attractive yields. The illustration above demonstrates that SDLT rates on commercial property tend to be much lower than on residential investments and, of course, there is no ATED or IHT to pay on commercial property.

In terms of prospects for 2017, CBRE predicts a challenging year for retailers but another robust performance from the industrial sector. There is some uncertainty around the office sector, given the possibility of weaker employment growth. For office investments, location and quality are expected to be the key drivers for growth. CBRE predicts that student accommodation, particularly in towns without adequate supply, will be strong.

Therefore, there is no "one size fits all" outlook for the commercial property market. As well as studying a tenant's financials, investors should also consider the wider prospects for the tenant's sector. Do they import or export goods to and from the EU? Will a weakened pound have a positive or negative impact on the bottom line? Has the tenant diversified to reduce risk?

Conclusion

We would expect to see volatility in the wider economy and in the property market in 2017. Therefore, double-digit growth can no longer be assumed, even in the London housing market. However, by getting the fundamentals of investment right, focusing on location and quality, we believe that 2017 could provide some excellent opportunities for property investors with one eye on the long game.

FOR MORE INFORMATION PLEASE CONTACT:

MICHAEL MORRIS

Group Partner* // Guernsey

t:+44 (0) 1481 734263 // e:michael.morris@collascrill.com

DONALD MILLAR

Senior Associate* // Guernsey

t:+44 (0) 1481 734828 // e:donald.millar@collascrill.com