GOLDEN VENN
YOUR PROPERTY PROFESSIONAL

WINTER 2015

IN THIS ISSUE

Market Report

London House Prices – According to the Land Registry's House Price Index (HPI) for December 2014, which captures actual changes in the value of residential properties, the average price of property in England and Wales increased by 7.0% in the 12 months to December 2014. The region which experienced the most significant movement by far in its average property value

Autumn Statement 2014 Page 7

UK Property Taxes: Key Updates

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Key Points

Prime central London prices rose 5.1% in December 2014 – lowest annual rise in five years.

Prime central London rental rates rose 3.3% in December 2014 – highest annual rise in 36 months.

Prime central London rental yields rose to 2.92% in November 2014 – close to an 18 month high.

Autumn Statement 2014 - major reforms of SDLT, ATED, and CGT for non-UK residents.

Prime central London property remains strong investment choice – overall annual returns of over 9% in December 2014.

over the same period is London, with an increase of 16.3% (see figure 1). On a monthly basis, London property prices saw a 1.8% increase between November and December 2014, making it the region with the highest monthly increase.

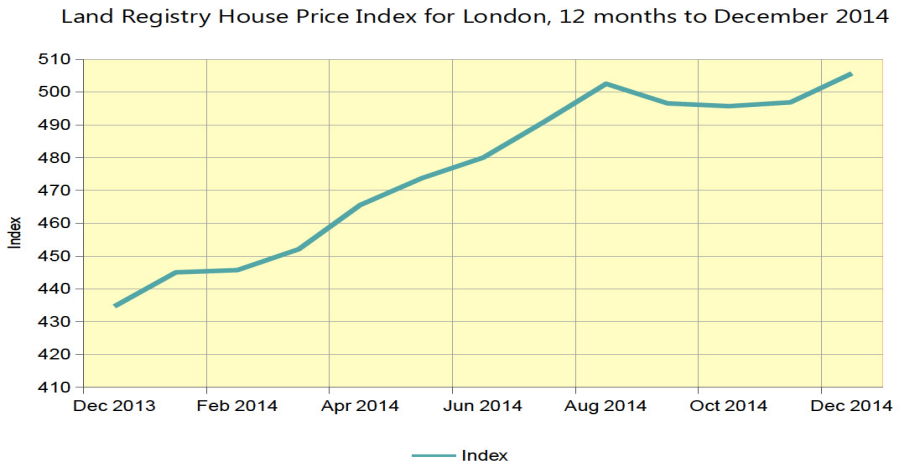

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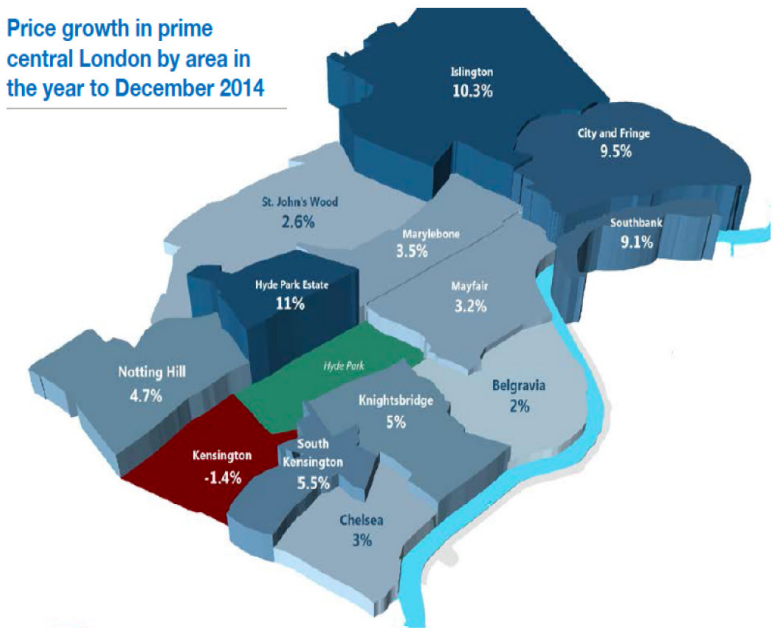
Figure 1

London Boroughs – While the two London boroughs with the highest average house prices remain Kensington and Chelsea, and City of Westminster, the 12 month increases to December 2014 in these boroughs were amongst the lowest at 11.5% and 14.2% respectively. These two boroughs did not fair so well on a monthly basis either, declining 0.6% each between November and December 2014. Southwark and Lambeth (Nine Elms) still remain amongst the London boroughs with the highest annual increases in average prices, for the same period. The annual increases to December 2014 in the these boroughs were 23.8% and 23.3% respectively. This supports our view of a growing tendency amongst buyers to place less importance on purchasing properties in the more conventional areas and more importance on the specifications of the property and the amenities of the building. This has led to an increase in purchases of new-builds and a shift towards areas that are less prime, but where redevelopment has been taking place over the last few years. Similarly, there are other areas that have been earmarked by developers where there are a number of upcoming new-build schemes that could possibly outperform prime central London (PCL) in the coming years.

Prime Central London Prices – An increase in the annual growth rate in PCL prices of only 5.1% in the 12 months to December 2014, compared to 7.7% in the 12 months to December 2013, puts price growth at its lowest level for five years. However, while we are now clearly seeing a slowdown in growth, according to Knight Frank, prices have still risen an impressive 52% in this same five year period. As prices in PCL areas like Mayfair have climbed steeply over the last years, buyers have now started to invest in the surrounding areas. The result being these surrounding areas are beginning to see their prices climb quite sharply. In 2013, Marylebone saw double-digit growth, which subsequently eased to 3.5% in 2014, and Hyde Park Estate took over with an annual growth of 12.9%, the highest in prime central

London in 2014. City and Fringe, and Islington still remain amongst the top three areas experiencing the highest growths in values (see figure 2). PCL prices declined -0.3% over the fourth quarter of 2014, compared to an increase of 1.0% during the third quarter. The rate of monthly price increases finally stopped in October 2014, and then declined slightly the following month. In December 2014, the decline in monthly price growth eased to only -0.1%, from a decline of -0.2% the previous month.

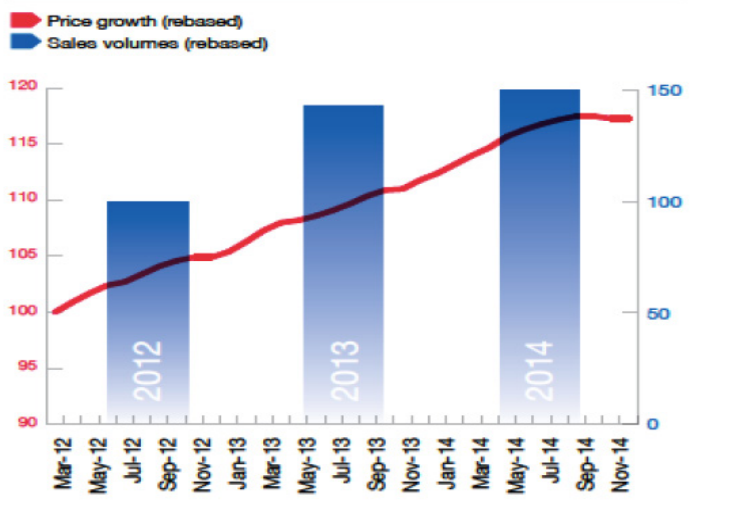


Source: Knight Frank Residential Research

Knight Frank's Prime Central London Sales Index, December 2014

Figure 2

Property Price Brackets – According to the Land Registry data, the number of £1 million+ properties sold in London in October 2014, increased by 4% on last year's figures, while £2 million+ property sales increased by 5%. Knight Frank's data shows, although it is still too early to have a clear picture, the market seems for the most part to be reacting sensibly to the increase in stamp duty introduced in December 2014, for properties valued at over £937,500, just as they did to the rise in stamp duty for £2 million+ properties from 5% to 7% in March 2012. Regardless of the fearmongering following that rise, prices for properties between £2 million and £5 million have actually grown 17% since then (see figure 3). However, the most significant increases have been seen in the super-prime £10 million+ bracket. In terms of volume growth, the number of £10 million+ properties sold in the first 10 months of 2014



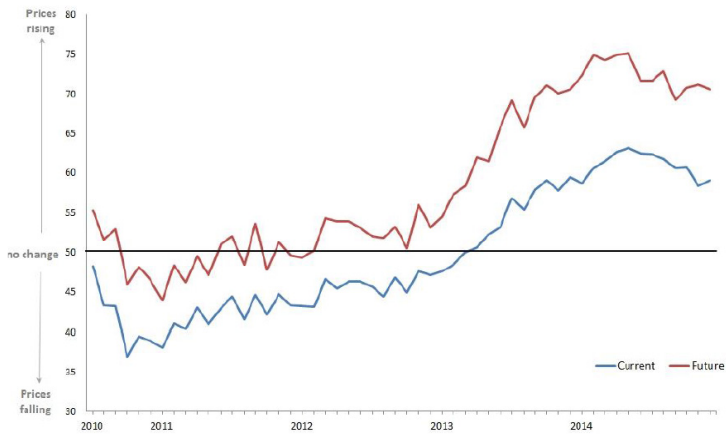
Source: Knight Frank Residential Research

Knight Frank's Prime Central London Sales Index, December 2014

Figure 3

were over 30% higher than they had been in the same period the previous year and over 90% higher than in 2012, when the stamp duty increases were introduced. In terms of value growth, prices of these super-prime properties have risen nearly 50% in almost six years, but have since levelled off to single-digit rises. In the 12 months to October 2014, growth stood at a more moderate 3.3%.

Current Price Sentiment – Knight Frank's House Price Sentiment Index (HPSI), which measures UK households' perceptions of current and future property values, saw the current HPSI value rise slightly in December 2014, after declining gradually for most of the latter half of the year, following its record high in May 2014 (see figure 4). However, for the 21st consecutive month the sentiment remains property values have continued to rise. Households across all 11 regions surveyed expressed a perception their property values had risen in December, with the index rising above the lowest values for the year seen in January and November 2014. As always, perceptions of current price rises were amongst the strongest in London.



Source: Knight Frank / Markit

Knight Frank's House Price Sentiment Index (HPSI), December 2014

Figure 4

Future Price Sentiment – The future HPSI for the UK fell to its second lowest value in 16 months, after peaking in May 2014 (see figure 4). Future expectations for London also fell in December 2014, following some ups and downs after their peak in April. For the majority of the last six months the South East has outranked London in terms of the strength of these future expectations. However, expectations for price rises in London still remain well above the index base rate and have consistently ranked in the top three. Overall expectations are property prices will continue to rise further in 2015, but at the diminishing rate of growth the market experienced over the second half of 2014. On a positive note, in December 2014, the percentage of UK households intending to purchase a property during 2015 was up from November's figures.

International Buyers – A significant percentage of PCL property buyers remain foreign. Although the upcoming UK general election will mean some buyers will be inclined to exercise caution, investment in London will continue to remain significantly driven by international investors looking to escape economic and political instability in their own countries. In the first half of 2014 we began to see a greater influx of Europeans from countries whose economies had been struggling to recover and who saw London as a safe place to weather the economic storm. According to Knight Frank, Italians made up 6% of the foreign buyers in London, the French were the second largest group at 4.1%, and the Russians were

in third place at 3.8%. However, following a time of uncertainty, the Russians appear to be resurfacing as key players in the PCL market. Between April and October 2014, 21% of super-prime properties sold were purchased by Russians, compared to only 13% between October 2013 and April 2014. The Chinese are also emerging as players in the super-prime market, accounting for 3% of sales, mainly houses, in 2014. Previously, the Chinese ultra high net worth individuals (UHNWIs) were happy to test the waters with properties below the £1m mark, often flats, but a weakening economy back home and the growth and expansion of Chinese companies globally appears to be stimulating demand (see figure 5).

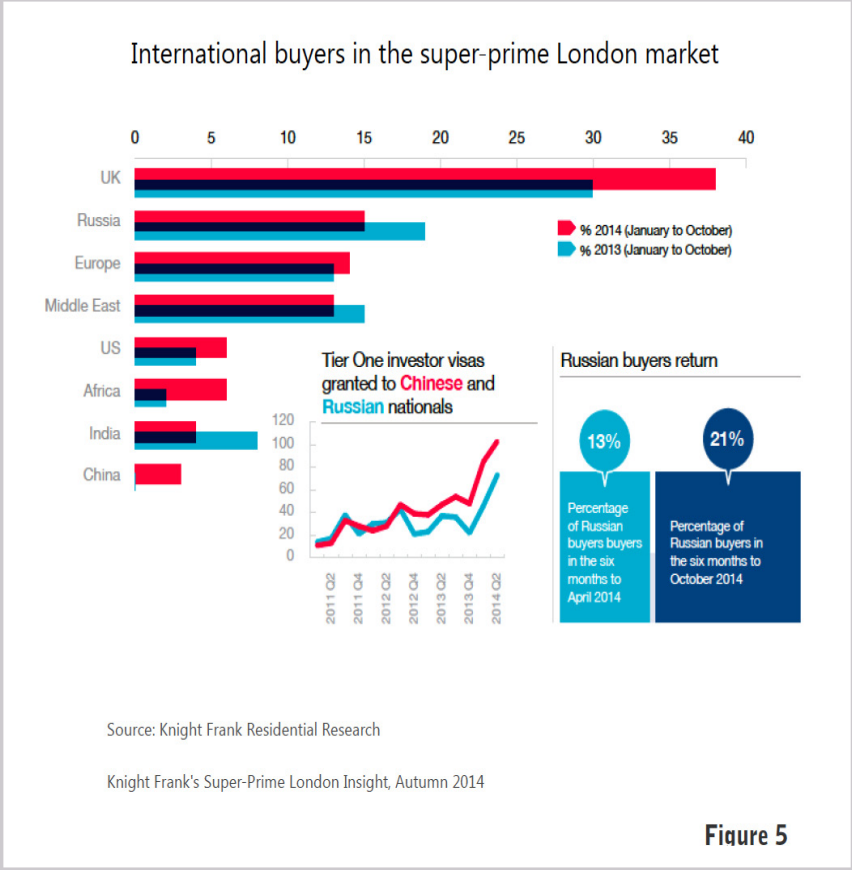


Figure 5

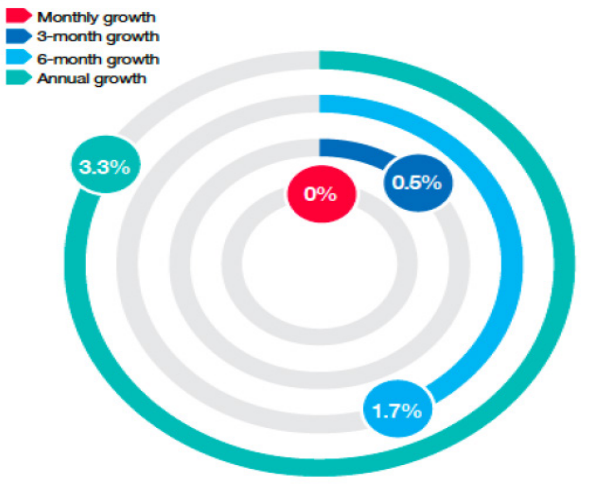
- *Land Registry House Price Index, December 2014 - © Crown copyright 2014 Land Registry. © Crown copyright material is reproduced with the permission of Land Registry under delegated authority from the Controller of HMSO;*
- *Knight Frank's Prime Central London Sales Index, August and December 2014;*
- *Knight Frank's London Residential Review, Winter 2015;*
- *Knight Frank's House Price Sentiment Index (HPSI), December 2014;*
- *Knight Frank's Super-Prime London Insight, Autumn 2014.*

The Rental Market

According to LSL Property Services' Buy-to-Let Index, the annual growth in rental rates in England and Wales rose to 3% in December 2014, significantly higher than its previous peak of 2.4% in August, and a far cry from its lowest annual rise of just 0.6% seen last April. In fact, average rental rates are still close to the record levels achieved in October, with 80% of regions seeing higher rents than the previous year, which is unusual for December. In London, the picture was even more positive with a record annual increase in rents of 4.1% and a monthly increase of 0.9%, which is the third highest monthly rise this year and a significant turnaround from the 0.9% fall in rates we had seen in January 2014.

In prime central London (PCL), according to Knight Frank's Rental Index, after rising for eight consecutive months, average monthly rental rates remained at 0% for a second month, following a 0.5% increase in October 2014. Although the monthly rate of growth has levelled off, it is now the sixth consecutive month in which annual growth in rental rates has been positive. In fact, at 3.3% for the 12

months to December 2014, it is the highest it has been for the past 36 months (see figure 6). The prediction that growth rates would be back in the black by July were clearly correct and the longest period of decline since the inception of the Knight Frank index is well and truly over. Quarterly PCL figures show an increase of 0.5% since September 2014, which is the fourth consecutive quarterly rise. Marylebone, St. John's Wood, and Kensington were the areas with the highest annual growth in rental values (see figure 7).

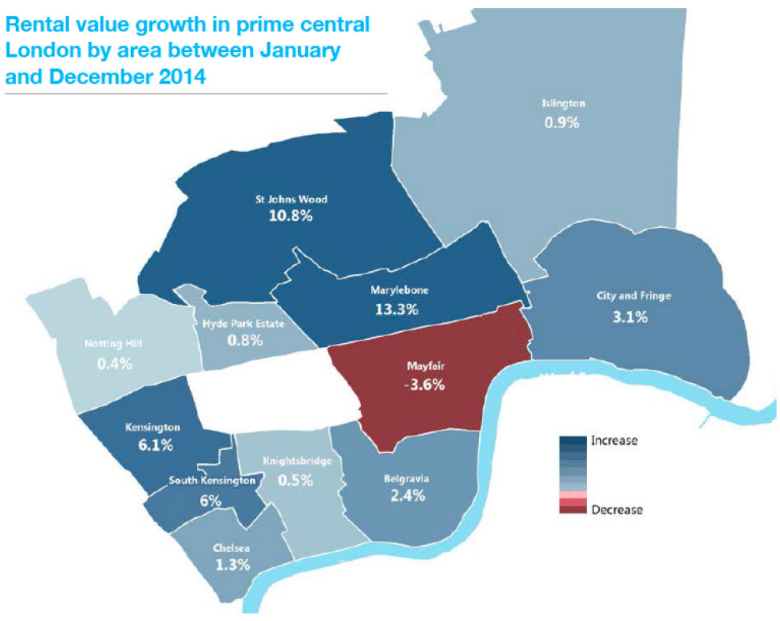


Source: Knight Frank Residential Research

Knight Frank's Prime Central London Rental Index, December 2014

Figure 6

The Knight Frank data also shows there has been a marked difference in the growth of rental values in different price brackets. Between January and November 2014, PCL properties valued at under £1,500 per week grew at 2.9%, while those valued at over £1,500 per week grew 3.8% over the same period. The picture for super-prime properties valued at £5,000 plus per week was also very positive compared to the previous year, which would indicate relocation budgets for top senior executives are increasing.



Source: Knight Frank Residential Research

Knight Frank's Prime Central London Rental Index, December 2014

Figure 7

The downward shift in the rental market began in mid-2012, when many jobs were lost in the financial sector. According to Knight Frank's data, rental rates began to recover gradually in the first quarter of 2014, hitting positive figures by July and rising consistently throughout the last six months of the year. As the UK economy looked to be improving - in the second quarter the size of the economy had actually grown 2.7% above its peak before the downturn

– and other major economies faltered, rental values were further buoyed by the lack of confidence surrounding the upcoming general election and the possibility of additional property taxes, namely the so called 'Mansion Tax', which has temporarily put some buyers off committing to a purchase until outcomes are clear. In November, yields on PCL properties were up again, this time to 2.92% from 2.9% the previous month, bringing yields close to 3%, a rate which has not been achieved for over a year and a half.

According to LSL Property Services, a similar picture is being seen across England and Wales. Gross yields on rentals increased to 5.1% in October 2014, up from 5.0% in September, and remained stable during the final two months of the year, though they ended the year slightly lower than the 5.3% seen in December 2013. Average total annual returns stood at 11.1% by the end of 2014, a fair bit higher than the 9.2% seen in December 2013, but a slight decline on the 12% seen in November 2014. According to LSL, with total annual returns well over 10%, average rent rates up, and yields steady all bodes well for those looking to invest in the rental market during 2015. By December 2014, London was averaging a monthly gross yield of 4.3%, up from the 4.2% seen in both September and October, and back to the level seen in August 2014.

- *LSL Property Services Plc's Buy-to-Let Index, October and December 2014;*
- *Knight Frank's Prime Central London Rental Index, October, November, and December 2014;*
- *Knight Frank's London Residential Review, Winter 2015.*

Fiscal & Regulatory Outlook

Key Points - Autumn Statement Tax Update 2014

A move from a 'slab' to a more fair 'slice' system.

Changes take effect for transactions completing on or after 4 December 2014 (with transitional rules for those who exchanged contracts before that date).

The reform affects residential property transactions only. Commercial property transactions are unaffected.

SDLT will be higher for anyone buying a house above £937,500 under the new system.

Proposed increases for ATED from April 2015.

New CGT charge from April 2015 for non-residents on residential properties only.

Source: Mishcon de Reya

Mishcon de Reya's Autumn Statement Tax Update 2014

Figure 8

The 2014 Autumn Statement has clearly targeted the non-doms and the top-end house buyers, which was expected given the imminent election in May 2015 (see figure 8). What was least expected were the changes in the Stamp Duty Land Tax (SDLT) rates. The Chancellor's Autumn Statement announced a major reform of SDLT for residential property

transactions. With effect from 4 December 2014, the structure, rates, and thresholds are being changed. The new rates, which apply were purchases are completed on or after 4 December, are set out below (see figure 9). Transitional rules apply to those who have exchanged contracts before that date.

The old 'slab' system for SDLT has long been criticised for its unfairness and distortion of the market. For example, a person paying £250,000 for a home paid 1% SDLT on the entire purchase price (£2,500), whereas a person paying £251,000 paid 3% SDLT (£7,530). Hence the new system is considered a more progressive system, as rather than paying a single rate of SDLT on the full purchase price of the property, a buyer now pays different rates within different bands. The changes will eliminate the 'cliff edge' increases in SDLT liability, which occurred under the old rules, and so will reduce pricing distortions that occurred around the previous thresholds. The Government has highlighted the fact that 98% of homeowners will pay less SDLT as a result of these changes. The 'break-even' price is £937,000 – so at prices below this, buyers will pay less SDLT under the new rules, but at prices above they will pay more, and at the top-end considerably more.

Stamp Duty Land Tax (SDLT) rates

0% on any amount up to £125,000.
2% on any amount over £125,000 up to £250,000.
5% on any amount over £250,000 up to £925,000.
10% on any amount over £925,000 up to £1,500,000.
12% on any amount over £1,500,000.

Source: Mishcon de Reya

Mishcon de Reya's Autumn Statement Tax Update 2014

Figure 9

It is important to highlight from 20 March 2014, SDLT has been charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain non-natural persons (mainly companies and partnerships), where they are not property rental businesses, developers, or traders. So effectively, if a company is buying a property to be occupied as a home by the shareholder, or someone connected with the shareholder, then the 15% rate remains. This percentage applies on the entire price of the property. If the company is buying the property as a genuine landlord or developer, then relief from the 15% should be available. This means the new rates / method of calculating SDLT on residential property would apply.

HMRC has a new calculator for the SDLT which can be found at www.hmrc.gov.uk/tools/sdlt/land-and-property.htm.

The Chancellor's Autumn Statement has also increased the Annual Tax on Enveloped Dwellings (ATED) rates. ATED is the annual charge payable by certain companies owning residential properties, where the property is not used for genuine business purposes. It is therefore no surprise the Government intends to increase the ATED for residential properties worth more than £2 million for the chargeable period 1 April 2015 to 31 March 2016 (see figure 10). The Government also announced, effective from 1 April 2015, it will introduce changes to the filing obligations and information requirements for properties eligible for ATED relief. The Budget 2014 also announced a reduction in the threshold from £2 million to £500,000 to be introduced over two years. From 1 April 2015, a new band will come into effect for properties with a value greater than £1 million, but not exceeding £2 million, with an annual charge of £7,000. From 1 April 2016, a further band will come into effect for properties with a value greater than £500,000, but not exceeding £1 million, with an annual charge of £3,500.

Annual Tax on Enveloped Dwellings (ATED) rates

£23,350 on properties valued at £2,000,000 to £5,000,000.
£54,450 on properties valued at £5,000,000 to £10,000,000.
£109,050 on properties valued at £10,000,000 to £20,000,000.
£218,200 on properties valued at over £20,000,000.

Source: Mishcon de Reya

Mishcon de Reya's Autumn Statement Tax Update 2014

Figure 10

It is the responsibility of the owner to file for ATED and the value can be either self-assessed or assessed by a professional valuer – which is more advisable. The valuation will be reported on the ATED return and must be on an open-market willing buyer, willing seller basis. This will not change for five years, even though the property may increase in value, when a revaluation must be done. So effectively, the property will remain in the same band for five years although the rate of tax in each band is likely to increase in that period. For properties held on April 2013, the ATED band is determined by a valuation of the property as at April 2012, while for properties acquired after April 2012, the ATED band is decided by the price paid.

The Government's long-awaited final proposals introducing Capital Gains Tax (CGT) for non-UK residents disposing of UK residential property have now been published. The charge (20% for companies, 18% or 28% for individuals, and 28% for trusts) will apply to sales and gifts of UK residential property, although it will only apply to gains arising from 6 April 2015 onwards. To calculate the post-April 2015 gain, either the property can be revalued at that date, or the entire gain from acquisition to disposal can be time-apportioned. Significantly, the Government has stated it "...does not intend to broaden the scope of the charge and apply CGT to disposals of interests in non-residential property". There will be an exemption for residential properties held by institutions and widely held companies and funds to encourage institutional investment. The CGT main residence exemption is also being restricted: broadly, a non-resident must spend at least 90 midnights in their UK home per tax year for it to be treated as their main residence in that year.

Confusingly, the 28% ATED-related CGT charge, which currently applies to certain companies owning residential property, where the property is not used for genuine business purposes, and which dispose of properties after April 2013 (the tax is only charged at the gain arising post-April 2013), will remain and will take priority where both charges apply. The Government has decided against a withholding tax system and is effectively relying on self-assessment. It is unfortunate the ATED-related CGT charge remains, as this will introduce a degree of complexity in the operation of the new charge. For example, whilst ATED-related CGT takes priority over the new CGT charge, it is possible some properties may fall within the two regimes at different times, requiring apportionments to be made. Without a withholding tax, questions remain about how the tax will be enforced where a non-resident sells their only UK property and receives the sale proceeds outside the UK. It has been suggested CGT will also apply to gains from disposals of off-plan residential properties, although obvious difficulties apply to its enforcement.

Finally, there were a couple of overt digs at the Labour leadership, as well as a clear attack on Labour's proposed 'Mansion Tax', especially with the surprise changes to the SDLT.

• *Mishcon de Reya, Autumn Statement Tax Update 2014.*

The GV Perspective

During the first quarter of 2014, the 2015 general election in the UK seemed a long way off and there was little, if any, effect on the property market. However, by the second and third quarters the level of uncertainty over the possible results of the election began to rise conspicuously, as more talk began to circulate about the notion of a 'Mansion Tax' being introduced should Labour win the election. As a result, the increase in the growth rate of average London house prices visibly diminished following a peak in August 2014, and the market lost some of its momentum. It is highly likely this uncertainty will continue to have an impact on the market until the conclusion of the election in May 2015.

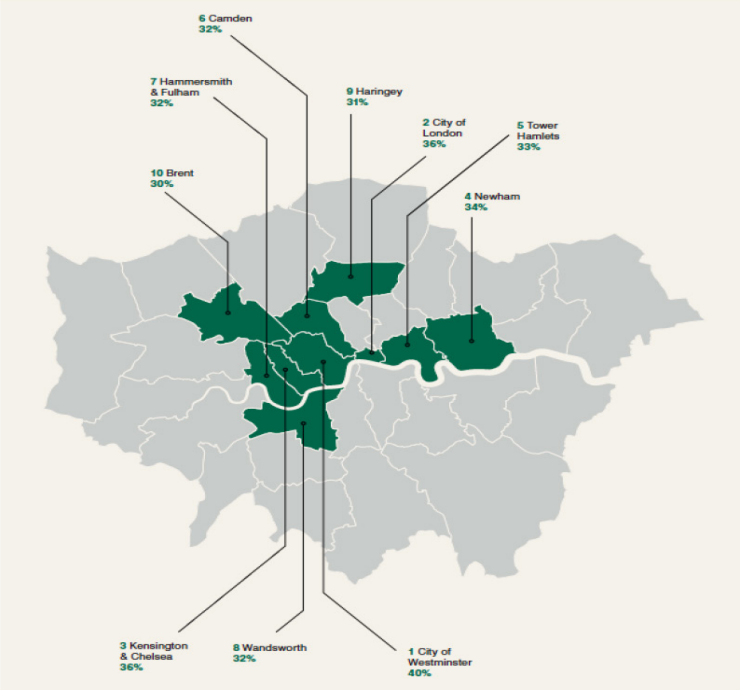
In the Autumn Statement for 2014, the Chancellor announced a rise in the Stamp Duty Land Tax (SDLT) charges for any properties valued at over £937,500, making the idea of a 'Mansion Tax' less plausible. The immediate effect of this may be that buyers become tougher negotiators, pushing sellers a little more on prices until they reach a price reflective of the increased taxes. We are already seeing some evidence of this taking place, but we believe just as the market adjusted fairly quickly to the rise in SDLT for £2 million+ properties in 2012, it will similarly adjust to this new rise. Following this latest increase in SDLT, the politicians in opposition will find it tough to find support for their proposed 'Mansion Tax' on the grounds prime central London (PCL) property is not taxed heavily enough. In fact, when one compares London taxation with cities of similar calibre around the world, such as Singapore, Hong Kong, Paris, and New York, London is actually amongst those with the highest taxes, although Singapore and Hong Kong do take the lead when it comes to stamp duty.

GV would advise investors looking to achieve higher capital appreciation to consider looking at areas outside the traditional ones. Buyers now appear to be striving to find investment opportunities further afield, away from previous hot spots such as Mayfair. The result being these surrounding areas are beginning to see their prices climb quite sharply. This happened in Marylebone in 2013, when the area saw double-digit growth, which subsequently eased to 3.5% in 2014. Similarly, Hyde Park Estate took the lead in PCL with an annual increase of 12.9% in 2014.

In addition to that we have seen a growing tendency amongst buyers to place less importance on purchasing properties in the more conventional areas and more importance on the specifications of the property and the amenities of the building. This has led to an increase in purchases of new-builds and a shift towards areas that are less prime, but where redevelopment has been taking place over the last few years. Similarly, there are other areas that have been earmarked by developers where there are a number of upcoming new-build schemes that could possibly outperform prime central London (PCL) in the coming years. In East London for example, growth has been boosted by the vicinity of the financial

districts, while in South West London, growth has been sparked largely by the resurgence in domestic buyers searching for better value for money, in particular when it comes to additional space for expanding families not so easily accommodated in PCL.

Top 10: Highest share of private rental households



Source: CBRE Group

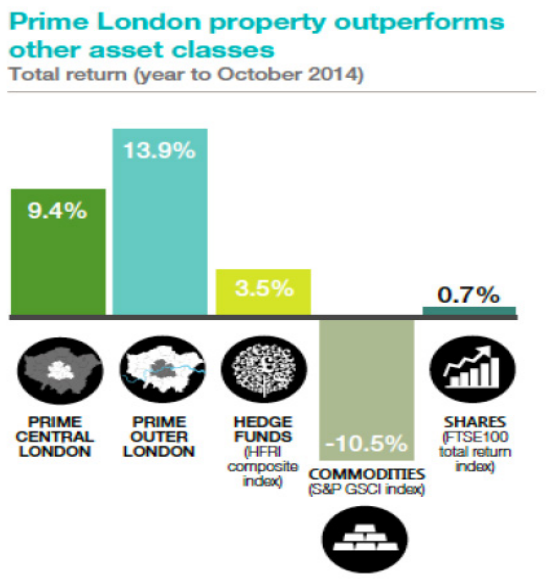
CBRE's Hot 100: The Winners of London's Residential Market 2014

Figure 11

According to CBRE Group, the London property market has seen the private rented sector grow considerably over the last 10 years, with it now accounting for a notable 25% of all London households. The top ten areas with the highest number of renters (see figure 11) are popular for various reasons, including accessibility to financial centres and schools. In terms of PCL rental property, according to Knight Frank, about 20% of the UK's properties in the £2 million plus bracket are in London, mainly within the prime boroughs of Kensington and Chelsea, and Westminster. Uncertainty remains over who would ultimately suffer the burden of the cost of a 'Mansion Tax', were it introduced following the upcoming election in May. While landlords may absorb some of the cost, they will need to either pass some of it on to renters or invest in cheaper properties in order to maintain their returns. Either way, the rental market would most likely be negatively affected, at least in the short-term.

The question of how imminent a rise in interest rates might be was the subject of debate and speculation throughout 2014. By the fourth quarter, there was little doubt interest rates would increase during 2015, but the expectation of an immediate rise had diminished slightly, given the further economic deterioration in Europe. The latest sentiment being expressed by experts is with the Consumer Price Index (CPI) at 0.5%, compared to the 2% inflation rate the Bank of England is aiming for, interest rates may not rise until as late as 2016. Additionally, the GBP has been weakening against the USD for the last six months, which favours dollar-denominated investors.

At GV we believe it is quite likely London prices will remain flat, with a low level of transactions this year, while Knight Frank forecasts growth of 3.5% for UK house prices in 2015. However, as it becomes more of a buyers' market, better prices could be negotiated with willing sellers and hence, we believe it is a good time for investors to buy, although stock may be low. Our long-term view is the London property market will continue growing as foreign investors maintain their quest to diversify outside their own countries, with London retaining its status as a safe haven. Notwithstanding the uncertainty surrounding the forthcoming general election, we believe PCL property remains a strong investment choice and a very attractive asset class given its overall annual returns (see figure 12). We strongly believe while the London property market might slow down, or even level off in 2015, it will grow in the long-term.



Source: Knight Frank Residential Research

Knight Frank's London Residential Review, Winter 2015

Figure 12

- *Knight Frank's Prime Central London Sales Index, December 2014;*
- *CBRE Group, Hot 100: The Winners of London's Residential Market, 2014;*
- *Knight Frank's London Residential Review, Winter 2015;*
- *Knight Frank's UK Residential Market Update, January 2015.*

Quarterly Tip

Short leases should not deter you... they might represent opportunities, as often there is less competition and one might be able to negotiate a better price.

GOLDEN VENN
YOUR PROPERTY PROFESSIONAL

Eirini Nousia
42 Brook Street
Mayfair
London W1K 5DB
+44 (0) 20 7117 6324
+44 (0) 77 8662 4376
eirini@golden-venn.com
www.golden-venn.com

Golden Venn is a boutique firm specialising in advising international buyers on the acquisition of investment properties in prime central London and other major cities around the world.