GOLDEN VENN
YOUR PROPERTY PROFESSIONAL

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IN THIS ISSUE

Market Report

London House Prices The average property price across England and Wales rose 4.2% in the 12 months to September 2015 to reach £186,553, according to the Land Registry. London saw the highest annual change in values at 9.6%, with the average property now priced at just under £500,000. London also saw the highest monthly change at 1.8%.

Summer Statement 2015 Page 7

UK Property Taxes: Key Updates

Pages 7–8

Key Points

Prime central London prices rose by 1% in October 2015 – the lowest annual increase since October 2009.

Prime central London annual rental rates eased to 1.5% in October – the lowest level since August 2014.

Prime central London average rental yields were flat at 2.95% in October.

Bank of England policy to maintain quantitative easing and current low interest rates until 2017 encourages the market.

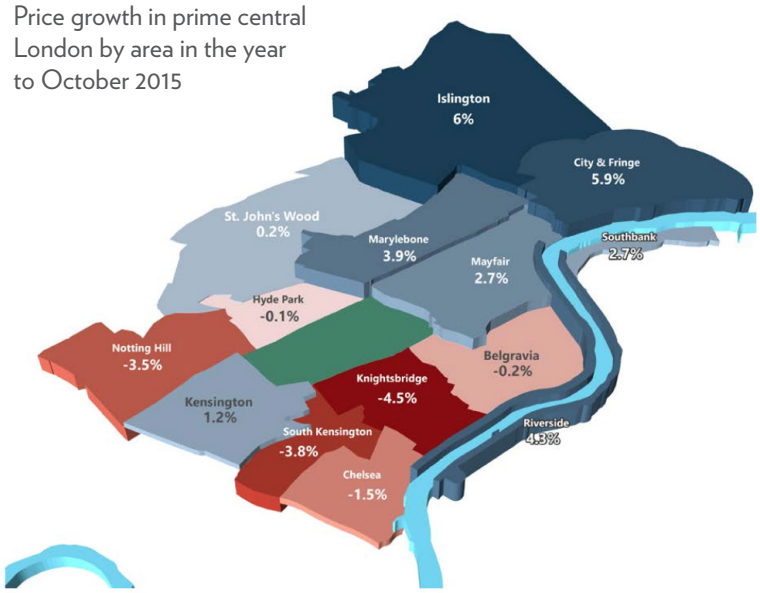
While short-term issues are impacting the market, buying opportunities are being created for those taking a longer-term view.

London Boroughs

Only two London boroughs have average house prices over £1 million: Kensington & Chelsea and Westminster, but these two boroughs have seen some of the lowest annual rates of growth – 2.3% and 2.6% respectively. Some of the outer London boroughs have seen the most dramatic price rises. Average forecasts from agents indicate Greater London is expected to outperform prime central London over the next five years, with anticipated growth of 28.4% compared to 23.2% in PCL. This corresponds to increasing interest shown by buyers for high specification properties, with some buyers placing less emphasis on location.

Prime Central London Prices

Annual house price growth in PCL slowed to just 1%, the lowest level since October 2009. Prices actually fell in October by 0.3%. The biggest annual declines were in Knightsbridge (–4.5%) and South Kensington (–3.8%) (see Figure 1). Some of the less traditional areas that have recently acquired the prime tag have seen more encouraging results. Islington leads the way with 6% growth, while City & Fringe achieved 5.9% growth. Of the more established west end locations, Marylebone demonstrated the most encouraging performance, with values increasing by 3.9%.



Knight Frank Residential Research
Knight Frank's Prime Central London Residential Sales Index October 2015

Figure 1

The impact of stamp duty reforms is being gradually revealed as the market settles. The last three months represented the first reliable test period of a market unaffected by issues such as elections and the traditional summer lull. Vendors are not always prepared to moderate their expectations to accommodate the increased costs arising from new stamp duty bands. Meanwhile, buyers are understandably concerned about the time it will take for house price growth to compensate for these additional purchase costs.

Interest from buyers is waning. Knight Frank reports the number of new prospective buyers being 30% down in September 2015 compared to September 2014. This has led to a downward revision in their 2016 price growth forecast from 4.5% to 2%. While this is disappointing news for some, the longer-term outlook for the capital remains positive as new buying opportunities are likely to be created in a less frenetic market.

Property Price Brackets

According to Land Registry data, the number of £1 million+ properties sold in London in July 2015 fell by 16% compared to July 2014. For properties over £2 million the drop was even more substantial: 26%. Across the capital, sales volumes were down 10% compared to a decline across England and Wales of 4%. Knight Frank recorded a heightened demand for quality in September, as buyers became more exacting in their requirements. Properties in good condition on a prime floor, square or street proved to be the most popular.

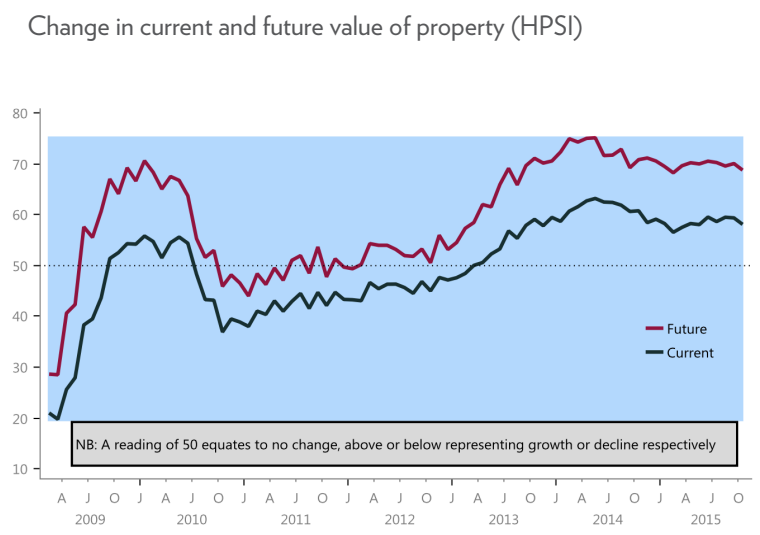
No other world city is home to more ultra-wealthy residents than London, as the latest Knight Frank Super Prime Development Focus reveals. Defined as those with more than $30 million to invest, London is expected to continue to appeal, with the population of UHNWIs expected to increase by 19% between 2014–2024.

While the range of locations being considered prime is expanding – both Regents Park and Marylebone have been emerging as prime locations in recent years – the demand for new buildings with amenities and more modern design within the "Golden Postcodes" has prompted developers in these areas to remain active.

2014 was an encouraging year for the super prime market, with the number of sales nearly doubling compared to 2012. The May 2015 election discouraged many from committing to purchases, with the threat of a mansion tax giving cause for concern. Despite the election result allying these fears, changes to stamp duty introduced in December 2014 increased acquisition costs for prime properties, and the summer budget sought to generate government revenue from IHT for properties held in company structures by removing the discrepancy for those with non-domiciled status. These factors help to explain the constrained growth seen in 2015 along with other recent tax changes such as the Annual Tax on Enveloped Dwellings (ATED) of March 2012 which were soon factored into the decision making process for buyers.

Current Price Sentiment

Knight Frank's House Price Sentiment Index (HPSI), which measures UK household perceptions of current and future property values, saw expectations moderate but remain positive (see Figure 2). Households across all regions perceived that the value of their homes rose in October, while London residents were most confident that their properties had risen in value, a situation that has held true for 10 of the last 12 months. The index for London was also at its second highest level for a year.



Knight Frank/Markit Research
Knight Frank/Markit House Price Sentiment Index October 2015

Figure 2

Future Price Sentiment

The future HPSI for the UK dipped to its lowest level since February of this year. In contrast, London perceptions were not only higher than anywhere else in the UK but also more optimistic than at any point since November 2014. However, this level of confidence is not translating into moves. London bucks the national trend again in terms of households seeking to buy in the next 12 months. Nationally the figure has fallen to 4.6% of households, down from 5.9% in August and the lowest recorded by the survey. In the capital, we see encouraging signs for future interest in London property, with 6.9% of respondents expressing a keenness to find a new home within a year.

Interest from China

The recent state visit from China has helped bolster the relationship between the UK and the world's second biggest economy. President Xi Jinping expressed his opinion that the UK plays an important role in the European Union and he hopes the upcoming referendum will result in the decision to stay.

The prime London market is intrinsically linked to political decisions such as this. HSBC has announced it will review the location of its global HQ, quoting issues such as the possibility of the UK leaving the EU as a reason for possible relocation. The bank's decision is likely to be made early in 2016. While there may be some organisations faced with decisions such as these, London is not expected to lose its global appeal.

The author of the Y/Zen Global Financial Centres report states that even if the EU referendum results in a Brexit, this will not be followed by a mass exodus of businesses and investors. London's fundamental qualities as a great place to do business – such as convenient time zones and an enriching lifestyle – will remain unassailable.

China's central bank selected London as the first overseas destination for the sale of debt, with the debut sale on the first day of the president's visit being oversubscribed. Demand for the 5 billion Renminbi pushed the final yield to 3.1% from a marketed rate of 3.3%.

- *Land Registry House Price Index, September 2015 © Crown copyright 2015 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, October 2015*
- *Knight Frank's House Price Sentiment Index (HPSI), September and October 2015*
- *Knight Frank's London: Super-Prime Development Focus – 2015*
- *Bank of England Monetary Policy Summary – 5 November*

The Rental Market

Rental values are diverging from current low inflation levels. They have reached an average of £816 per month across England and Wales, the highest average ever recorded.

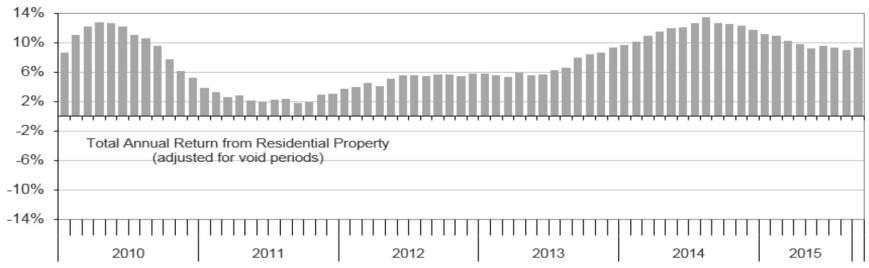
LSL Property Services buy-to-let index shows that, despite marginal deflation in the wider economy, rents rose by 6.3% in the last year and by 1.6% from August to September. Since January 2010, discounting the impact of inflation, rents have risen by 10.3% in real terms.

London is one of five regions to see record levels of average rent, increasing by 11.6% over the 12 months to September to an average of £1,301 per month. The last month has recorded an increase of 1.8%, the second highest regional increase, exceeded only by the south east. This has contributed towards a 4.4% yield, rising from 4.3% in September last year.

Gross rental yields across England and Wales for September now average 5.2%, which is a small increase on August 2015 and September last year when the figure was 5.1%. Combining this income with capital value gains results in an average total return of 9.4%. It represents an increase over the 8.9% total return recorded in August. Even when the market was performing poorly, average returns were positive. Now, returns are considered more sustainable than the figures approaching 14% seen in the middle of last year (see Figure 3).

Properties in PCL are yielding an average of 2.95%. The PCL rental index from Knight Frank shows annual rental growth of just 1.5%, down from the peak of 4.2% in May. Rental values in October declined by 0.5%, the steepest fall in two years. The number of new tenancies has also dropped: it was 12% lower in September 2015 than September 2014.

Total annual retrun from residential property



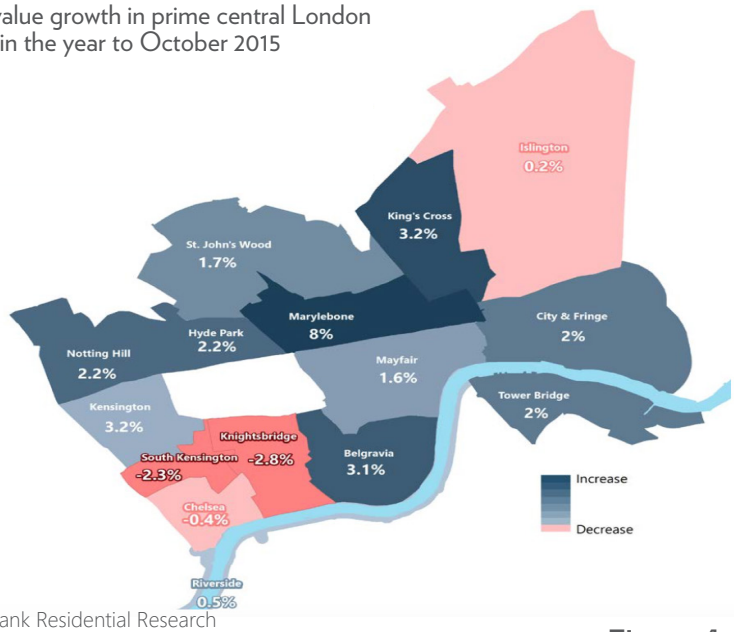
LSL
LSL Buy-To-Let Index September 2015

Figure 3

The highest increase in rental values in the year to October 2015 were recorded in Marylebone (8%) and Kensington (3.2%) with Belgravia following at (3.1%). The steepest declines in rental values were registered in Knightsbridge (–2.8%) and South Kensington (–2.3%) where an easing in demand possibly from financial service sector tenants has adversely affected the market (Figure 4).

Despite a temporary hiatus in London's short-term appeal, its global status was confirmed when it reclaimed the top spot in the Z/Yen Global Financial Centres Index. The British capital received a particularly favourable assessment following the general election in May 2015.

Rental value growth in prime central London
by area in the year to October 2015



Knight Frank Residential Research
Knight Frank's Prime Central London Rental Index, October 2015

Figure 4

- *LSL Property Services Buy-to-Let Index, September and October 2015*
- *Knight Frank's Prime Central London Rental Index, September and October 2015*

Fiscal & Regulatory Outlook

The 2014 Autumn Statement has clearly targeted the non-doms and the top-end house buyers with changes in the Stamp Duty Land Tax (SDLT) rates and the introduction of Capital Gains Tax (CGT) for non-UK residents disposing of UK residential property. In addition to these changes, the Summer Budget on 8 July 2015 provided further details on the proposals on new Inheritance Tax (IHT) rules on UK residential property held indirectly by non-UK domiciled individuals (non-doms) or by excluded property trusts.

IHT Changes for UK Residential Property Owned by Non-doms

From April 2017 all UK residential property held directly or indirectly by foreign domiciled individuals or excluded property trusts will be within the scope of UK inheritance tax (IHT).

The extension of IHT in these cases will broadly be in line with the Annual Tax on Enveloped Dwellings (ATED) but, unlike the ATED regime, there will be no £500,000 minimum threshold and ATED reliefs for let property will not apply. However, it is intended that the same reliefs and charges will apply as if the residential property was held directly by the owner of the company (e.g. spouse exemption) and there will be no IHT charge for diversely held vehicles that hold UK residential property. The government has accepted that there will be complications when implementing these changes and we are waiting to see further details.

The announcement is a further restriction on the tax advantages open to non-doms. If followed through it will significantly reduce the benefits of owning UK residential property via offshore companies (or other opaque entities), whether personally or through a trust.

Many non-resident and non-domiciled individuals and trustees will have already considered de-enveloping existing structures when ATED and ATED-related CGT were introduced – and extended – but decided to maintain the structure due to the IHT advantages and confidentiality offered.

Those individuals and trustees will now need to reconsider their position and the potential costs of de-enveloping following the extension of CGT to non-UK residents.

The Summer Budget also introduced changes that will restrict relief for finance costs on residential properties to the basic rate of Income Tax.

Income Tax Changes for Residential Letting

The government has moved to restrict the amount of interest which can be deducted by individual landlords of residential property when calculating their income tax liability. Under current rules, if the landlord is a higher or additional rate income taxpayer, then any interest on a loan taken out to acquire the let property will be deductible in full when calculating the individual's income tax liability. So if an individual pays income tax at the top rate of 45%, this effectively saves the individual a sum equal to 45% of the interest paid. The new rules will restrict the amount of tax relief to the basic rate (currently 20%), even if the landlord is a higher or additional rate taxpayer. The restriction will be in full force from the 2020/21 tax year, but will be phased in with effect from the 2017/18 tax year.

It is also proposed that the so-called "Wear and Tear Allowance" for furnished residential lets will be replaced by a new relief which will allow a percentage of the actual expenditure on furnishings to be deducted when computing taxable profits. The benefit of the current regime is relative simplicity: the Wear and Tear Allowance is broadly calculated as 10% of rents less certain expenses incurred by the landlord such as Council Tax. With effect from April 2016 this will be replaced by the new relief, which will be based on actual expenditure and will certainly be more complex. The government has promised to issue a technical paper on this in the summer.

The restriction on the amount of interest which can be deducted for tax purposes is only relevant for individuals owning buy to let properties. It does not apply to commercial property. It is also not relevant for companies, including offshore landlords who own their property through non-UK resident companies: these will always be liable to income tax on rental profits at the basic rate anyway.

• *Mishcon de Reya, Summer Statement Tax Update 2015*

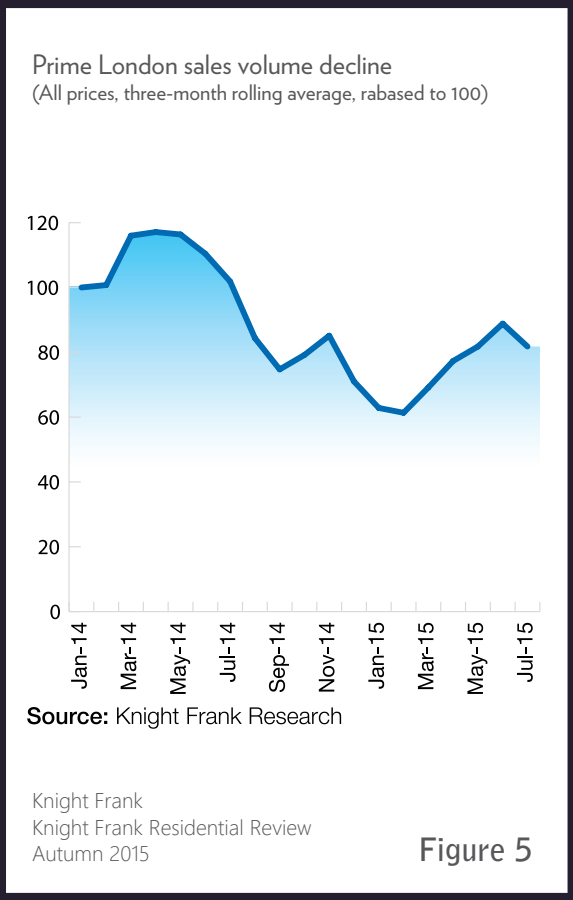
The GV Perspective

London remains one of the most appealing cities to the world's wealthiest and most discerning buyers, but the high levels of capital growth seen in recent years is slowing to more sustainable levels. New legislation has discouraged some buyers looking for short term returns, and while the market is still absorbing the high stamp duty obligations some vendors remain unrealistic. Falling transaction volumes at the higher end of the market (see Figure 5) are thought to reflect a lack of demand, rather than supply.

While short term predictions suggest the market will see little if any capital appreciation this year, the longer term picture of cheap credit, employment growth, an increasing population and a relatively stable political environment compared to so many global alternatives, suggest demand in the medium to long term will remain strong.

The definition of "prime" in London is expanding as developers try to satisfy the demand for high specification properties and buyers become more flexible in relation to location. Areas such as Southbank, Regents Park and Marylebone are becoming first choice destinations for some, rather than simply a more affordable alternative.

GV believe the declines seen in capital growth and transaction activity are a result of potential buyers having difficulty quantifying the effect of a number of major events influencing the prime markets in London, mainly the stamp duty reforms and changes to the rules on non-dom status. Rather than confront these issues, some buyers are taking a more passive approach, waiting to see what the future holds. This has created something of a buyers' market, with those willing to negotiate securing properties at more reasonable prices than we have seen in a very long time, in what is widely regarded as one of the world's most important destination cities.



- *Knight Frank's Prime Central London Sales Index, October 2015;*
- *Knight Frank's The London Review, Autumn 2015*

Quarterly Tip

Buy when people sell and sell when people buy...

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