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Commentary – Brexit & Beyond June 2016

COMMENTARY:

"Economic Suicide". Return to Status Quo by Autumn?

A US pundit noted on the result of the Referendum: "Never have I seen a country embrace economic suicide as willingly as the UK did on the 23rd June". How apt. In this report, we seek to examine what might develop over the next few months and what can be expected from the Property Market. We conclude we will revert to the status quo by the autumn, providing for a buying opportunity over the summer in parts of the market but there is an underlying problem we need to address – debt.

BREXIT – but we want access to Common Market.

The rhetoric over the last 24 hours from all political parties has been that the UK will remain in the Common Market. There are only two routes to achieving this: Not triggering article 50 (it would now appear that Parliament will have to vote to repeal the 1972 European Communities Act), or joining the EEA. Both entail the continued free movement of people, financial contributions to the EU and adoption of EU law. This is what the EU has to say about the EEA:

EU or EEA?

"The EEA goes beyond traditional free trade agreements (FTAs) by extending the full rights and obligations of the EU's internal market to the EFTA countries (with the exception of Switzerland). The EEA incorporates the four freedoms of the internal market (free movement of goods, people, services and capital) and related policies (competition, transport, energy and economic and monetary cooperation)"

EEA = No Influence.

I am not am international trade lawyer but this would appear to be quite similar to our existing relationship with the EU. One item however is missing from an EEA membership – the ability for UK to have any influence in Europe. Quite important, I would have thought, to have say on how the market we rely on operates.

EU will not allow us to trade on our own terms.

Notwithstanding what we may want, the UK will not be able to negotiate better terms than we already have. Any thoughts to the contrary would be a delusion – the very principal of the EU is sacred to the Commission and they will not further change the rules of their club to accommodate one member, particularly one that has voted to leave. The blurred relationship we are seeking where we can trade on our own terms has never existed and that has been made clear in the past. There will be no special relationship for the UK as otherwise France and the Netherlands will be quick to seek further accommodations.

Access to market requires immigration. Sovereignty not in question – BREXIT reasons voided. BUT Huge problem remains- Debt.

Whilst the need for the Referendum has now almost certainly been voided (the Leave camp will never be able to deliver on their promises and as to the question of sovereignty – we have proved that we have it, let's just hope we chose not to assert it), the question is now when can we expect a return to the status quo we had prior to the Referendum. Our view is that this will be during the autumn parliamentary session or if a general election is called, early 2017. But is it really rational to blame all of our current problems on Brexit? There is a huge additional problem may have contributed to the market volatility we have seen over the last few days. Our twin deficits and our national debt burden.

UK Debt is huge vs size of Economy so Brexit Catalyst to existing problems.

Politicians often talk about the Budget Deficit and very often confuse that with the Public Sector Net Debt. The former is approx £74bn and is the amount the Government spends over what it receives in Taxes. The Public Sector Net Debt is what the country owes and this stands at just over £1.5 Trillion. Our current account deficit is just shy of £100bn as we import more than we export and it is this last point that may lead to inflation as a weak currency makes imports expensive, pushing up prices. . These are huge figures for an economy of our size and many City professionals have been buying USD since last year in anticipation of an economic crisis and subsequent fall in Sterling.

Current Situation provides for 4 months of Opportunity. BUT pay down mortgage asap as if inflation bites, rates will rise providing for mortgage payment shock.

Therefore whilst Brexit may have been the trigger for the market sell-off, it was the state of the country's economy that is responsible for the extent of the sell-off. We wrote about this in our article "Brexit; Sure in an ideal world" where we concluded that the British Economy was not yet ready to take on the Burden of leaving the EU.
What implications does all this hold for the Prime and Prime Central property markets? First and foremost, those with high LTV mortgages need to start paying them down. Now. If for some reason Westminster can't accept that EU exit is a non-starter and seeks to negotiate over 2 years, then we will start seeing consumer prices creep up and inflation will ensue. Eventually interest rates will go up and this will provide for a payment shock for mortgage holders (most of whom are Tracker or 2 year fixed both resetting to Standard Variable Rate after an initial period). We have all too recently seen what a mortgage payment shock can do to a housing market.

If however, as we hope, Westminster decided to join the EEA or even better decides wisely not to assert it's sovereignty over the Lisbon Treaty, a degree of normality and confidence will return quite quickly. If this happens, all markets will react favourably in the autumn giving us about 4 months to look for opportunity in the property market during this time of volatility.

Expect some price volatility in Prime London but good opportunity to trade up.

No Forced selling but don't be shy to make an offer – you never know.

In Prime London, we do expect vendors to accept lower offers on their properties provided they are able to secure lower prices on the property they are seeking to move to. This is a chain market and more often than not, families are seeking to trade up to larger homes and a volatile market usually makes the financial chasm easier to breach. We have seen some transactions in Prime London since Thursday and we expect this to continue as the reasons that existed prior to the 23rd June and which drove the transaction (larger family, Divorce, Probate etc..) still exist. We <u>do not</u> expect a flood of panic sellers driving prices down, but we do expect a 7-10% reduction in offer levels vs original asking price. We <u>do not</u> see the market dropping the full extent of the range suggested by the Chancellor (-18%) but buyers should not be afraid of making offers as they may find that they are accepted.

Prime Central has been subdued for a while but now more attractive due to FX. But don't expect huge discounts.

The Prime Central London market was subdued prior to the Vote due to the Stamp Duty increase. The drop in value of Sterling may attract foreign buyers as London has become 10% cheaper against the USD and 7.5% against the Euro, effectively eroding much of the transaction tax we are subject to. That said, buyers should not expect huge discounts - the vendors of properties in Prime Central London tend to be debt free and at one point paid a great deal of money to buy their homes – they are unlikely to sell at a discount if they do not need to. Offering 10% below the asking price will almost certainly be rejected by the vendor – offering 7% below asking to settle at 5% below is now quite common.

NOW is the time to cut Stamp Duty.

On a final note, the Governor of the Bank of England has provided for £250bn in liquidity for the banking sector in these turbulent times. Our question is who is providing liquidity to the property market? Might it now be time to inject some liquidity into our market by reducing stamp duty for transactions over £925,000 to 7%. I don't think we'll need a referendum for that!

<u>**Sales**</u>

First and foremost, no transactions we were working on prior to the Referendum have fallen through and are all proceeding to exchange. Over the last 3 days, we have seen an increase in enquiry for our properties across the £1m to £8m bracket and the team are conducting viewings. Whether we receive any offers at acceptable levels to our vendors remains to be seen but so far so good. It is unlikely that this enquiry was triggered by Brexit – more likely that this was pent up demand which has been

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Waiting in the wings until after the Vote.   In terms of new instructions, we are bringing just over 10 in the next few weeks ranging from one bedroom flats just under the £1m mark to houses around the £7m mark. Do let us know if you would like to talk about the market or the implications of our current situation – we will do the best we can to provide a balanced view.
As we mentioned above, we do not see vendors in Prime Central accepting less than 5% discount to the current asking price but at the same time, one should never be afraid to make an offer.

Lettings:

Whilst it is far too early to come to any conclusions on the trajectory of the lettings market in Prime Central London post the Referendum, it is clear that the vote has not stopped people proceeding with their rental plans. We have recorded a 65% increase in new applicants registering since 24th June compared this time last year. The majority of the increase is in the middle (£2,000 per week) and lower (£700 per week) end of our market. When asked why they are choosing to move, applicants told us that it was planned but they were waiting for the Referendum result. This was a psychological barrier as when asked if they would have moved if we had voted to "remain" the answer was also yes. In terms of stock levels, we are still at 40% higher than June 2015 which will put some pressure on rents, particular at the higher end of the market (£2,750+ per week) which is not seeing a lot of traction.   Our only concern, truthfully, is that we are not really seeing the market grow right now (and will not until the UK becomes attractive for inward investment – hopefully per the timing in our commentary) but we are seeing our own book grow as we are taking market share from our competitors.

If any readers of this report would like to discuss the market, future plans or just have a rant about Brexit, please do feel free to call us – we would be delighted to listen and offer our candid opinion.

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