MERCURY
HOMESEARCH

“The scariest words in the English language are ‘I’m from the government, and I’m here to help!’”
Ronald Reagan

Facts & Figures

- London is now the No.1 tourist destination in the world with 18.7 million visitors last year and the West End is now set for the biggest tranche of new retail space in 50 years - **Jones Lang Lasalle**

- Properties worth in excess of £5m have fallen 0.1% in February while properties in the £1-2m bracket have risen 0.4% - **Knight Frank** (hardly catastrophic although I question how the figures can be so accurate)

- Industrial investment volumes in the UK hit £1.95bn in the final quarter of 2014, the highest quarterly level since the pre-crisis peak.

- In London, prices rose at an annual 9.5 percent in January, the slowest since September 2013… January data show a 7.4 percent drop in Kensington and Chelsea – **Bloomberg** *This is exactly what I predicted. Not an especially impressive prediction as it* *happens in the run up to any hotly contested election. Transaction levels have plummeted which also skews the figures.*

- Companies looking to expand in London are being forced to move out of the traditional business districts as the capital's office market boom hits heights last seen before the financial crash.

  As economic confidence gathers momentum and the jobs market strengthens, the amount of office space companies took up jumped 42pc from 5.8m sq ft to 8.2m sq ft over the course of last year, according to a study by Cushman & Wakefield. This is compared to a 33pc increase in 2013- **The Daily Telegraph**

- NEW Buyer registration numbers are up 78.65% compared to January – April 2014… For the month of March the Region within Hamptons which Tower Bridge sits in - North, South and East London has set a company record for sales agreed in one month – **Hamptons**

- Buy-to-let lending accounted for 15% of all residential property mortgages last year. **Bank of England**

- Rents are increasing across London and PCL

The Death of the First Time Buyer

The election is 9 days away. Anything could happen but at this stage it is all conjecture. I will update you next week on the effects of whatever the election result happens to be.

In the meantime, onto more important matters. Yes, Arsenal are in the Final of the FA Cup, but that is not what I am talking about.

No, you will be ecstatic to hear that the Old Etonians beat Lancing Old Boys to win the Derrick Moore Veterans Cup in a thrilling game at The Bank of England Ground - Extra time, penalties, it had it all.

“Not interested.” I hear you say? Funny, that’s exactly what Serena said when I strutted/hobbled through the front door brandishing my medal. “Not interested. Go and see your children” as I was despatched upstairs. She’s a shrewd operator, my wife.

Anyway as there seems to be universal disinterest in my sporting triumphs I will revert to London property and a topic I mentioned in my last report – the demise of the first time buyer (known from now on as FTB’s).

There are two major themes running through the predictions for a massive property crash in London. The first is that the price to earnings ratio is at all-time highs. Secondly, and inextricably linked to this, is the fact that FTB’s are all but priced out of the central London market and indeed most of the UK.

This is why the average age of an FTB has been increasing relatively swiftly to somewhere around 38 years old now. The problem is that they don’t earn enough, they don’t have sufficient capital for a deposit (much of their money is spent on rent) and in many cases they have not been able to find a decent job at all. This is after all a jobless recovery.

Now what I am about to say will be hugely unpopular but then the truth often is:

The fact that most people up to the age of 38 cannot afford to buy property is irrelevant for house prices. It simply doesn’t matter…

… and before you start railing about the injustice, how it does matter because it could cause social fractures and increased homelessness, I agree. It is all of those things and from a moral perspective it is not fair.

However, you need to repeat the following three times:

THIS IS TOTALLY IRRELEVANT FOR PRIME LONDON PROPERTY PRICES

I said repeat it three times not read it once. I don’t know why I bother. Really, this is for your own good.

So why is it irrelevant? Well just because FTB’s don’t have the means to jump on the housing ladder doesn’t mean that the money has disappeared into a vacuum or isn't being produced. The money to buy property is there it is coming from a different source.

The key word above is "produced". Earning money is dreadfully 20th Century. Why earn it when you can just print the stuff?

One of the major effects of QE has been to boost asset prices. It has failed in the original stated intention to boost jobs. This is the main reason why the young, i.e. FTB's are struggling. They rely on income rather than assets. They do not have the savings to buy the assets.

Meanwhile those with a lifetime of savings and assets have made out like bandits. This is why there is such a huge disparity in wealth between the older and younger generations and those with assets and those without.

Obviously I am using a broad brush here and there are some extraordinarily young billionaires, but you get the picture.

Trying to earn money as a youngster in a typical job to buy a property is futile as you will remain behind the curve. Indeed in prime central London you can have an excellent career as a lawyer, banker or stockbroker and still be completely inadequately funded in terms of buying a house.

Unless of course you have the best bank in the world.

The bank of mum and dad are now the middle men between the central banks and the younger generations (Mum, Dad, if you are reading this then I love you, but hand over the cash… to me and only me. Forget those two layabouts, Simon & Polly. You know I'm your favourite…).

The over 55's now have huge disposable wealth and are the wealthiest generation in the history of mankind. There is also now greater flexibility on how they can use the huge sum stored in the UK pension pot. A large percentage of this money will now enter the property market – this is likely to affect the lower end of the market more than prime central London so expect to see FTB's priced out even more.

Unfortunately there is also quite a divide in this older generation: if your parents do not have assets then you cannot benefit from this recirculation of QE money through asset prices, which is why QE has had such a divisive effect.

But that isn't the only source of money replacing first time buyers: international wealth is now more fluid than ever before. This is creating a completely different world. A world in which a few cities are attracting huge amounts of investment in terms of infrastructure (digital as well as physical).

In fact there was a very interesting article in The Straits Times about the rise of the Global City (thank you to Philip Anderson for bringing this to my attention):

"The Global City concept originates from the work of sociologist Saskia Sassen, which dates back to the 1980s. In an age of globalisation, division of labour is international in scope and production activities are distributed across the world. A global city is a significant point where the internationally oriented financial and producer services that make the global economy run choose to agglomerate.

The term "superstar cities" is a more recent concept and is the title of a study of United States cities by urban economists Joseph Gyourko, Christopher Mayer and Todd Sinai. Their paper notes the considerable differences in long- run house price appreciation rates across US metropolitan areas and towns after World War II.

These differences led to an ever-widening gap in housing prices between the most expensive metropolitan areas and the average ones. They define locations that experience persistently higher-than-average house price growth as "superstar cities"

Besides having higher than average house price growth, global superstar cities also have higher levels of economic inequality. Income inequality has been increasing in most of the developed countries in the past few decades."

Sound familiar? If you would like to read the full article, click here: http://www.straitstimes.com/news/opinion/more-opinion-stories/story/home-prices-and-inequality-singapore-versus-other-global-sup

The top five global cities are New York, London, Singapore, Paris and Hong Kong with Paris, surprisingly, being the top “superstar”. The markets have become more international and a few cities are attracting this international wealth.

Interestingly one of my clients, an expat who has lived in Hong Kong for years, recently commented that it is only when you leave the U.K. that you truly understand the sheer size of the capital flows around the world and how much is actually targeted at the UK and more specifically London.

It is also a simple fact that as humans we seem to have an almost unlimited desire to own property in all the best locations. This is not a new thing. Think of the influx of international money into southern Spain, Italy, France, the Caribbean, Thailand, Dubai, I could go on.

So we have a situation where there is:

1. A huge expansion of money through QE in several jurisdictions
2. There is a transfer of wealth from West to East
3. Money can transfer between jurisdictions at the touch of a button
4. The return on cash is abject if not negative
5. QE further dilutes the return on cash

Consequently, it is madness for those with huge sums of excess cash to stay in cash. Add in the tax advantages for buy-to-let landlords and the FTB’s don’t stand a chance. This is set to continue.

If the economy continues to recover, earnings will rise, which in turn will mean that rents will rise, which will attract more people to invest in property – including large institutions who will see residential property as a serious mainstream financial asset (as opposed to their previous focus on commercial).

In this world, you are a lame duck if you don’t have access to capital (yet another disadvantage is that the less capital you have the higher the rate at which you will have to borrow).

So this is pretty miserable news for those whose families don’t have assets. However, the death of the traditional FTB will not be detrimental to house prices for now.

The question is how long can this “new normal” last?

It all hinges on confidence. If we get through the next year without any calamities then people will believe that everything is in order. This will lead to greater confidence, borrowing and expansion. This in turn will lead to greater land speculation which will lead to the next boom and indeed bust. That is guaranteed.

Expect a humdinger of a crash around 2025 with a few wobbles in between, probably c. 2018/2019. I also believe that there will be issues in the new-build market in central London over the next two years

Of course, if Labour get in to power and decide to introduce a draconian Mansion Tax (what they have suggested up to £3m is far from onerous) then this will certainly affect the top end of the market.

However, it will also have unintended consequences. One of which will probably to be to drive international investors into the lower price ranges, thus causing yet more issues for the beleaguered First Time Buyer.

Nevertheless, I would rather be 23 again than 43. I am still hobbling around four days after the game. Are you sure you wouldn’t like me to give you a minute by minute account of the final?

Suit yourself.

I will update you on what the election result will mean for London property prices. In the meantime, email jeremy@mercuryhomesearch.com if you have any questions.

Best regards,

Jeremy

p.s. If you would like to request a complimentary copy of my book, *The Prime London Property Puzzle,* you can do so by clicking http://mercuryhomesearch.com/property-puzzle/