

FAIRWAY

C A P I T A L



Prime Central London
Residential

MARKET COMMENTARY

Q1-24

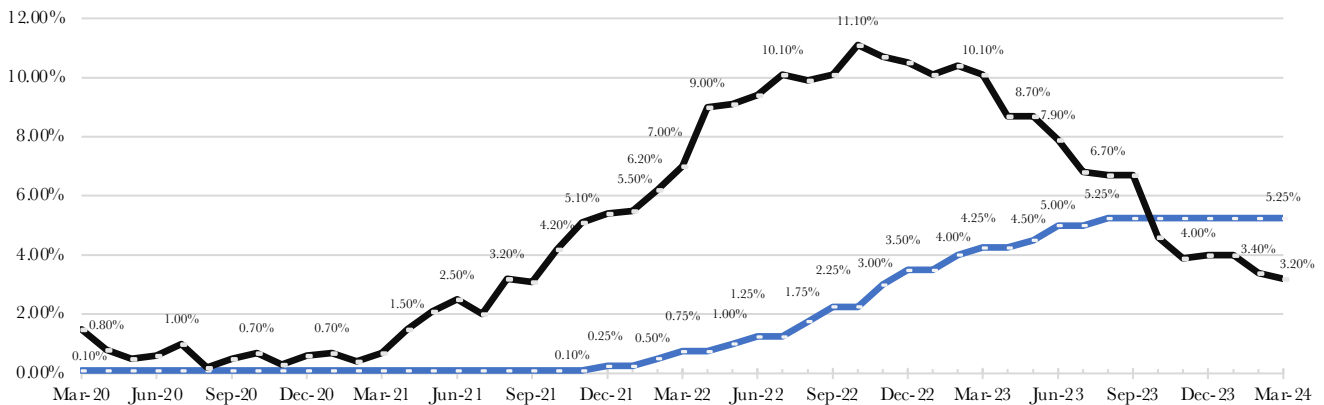
31.03.24

STRICTLY PRIVATE & CONFIDENTIAL

THE GLOBAL ECONOMY: The latest World Economic Outlook from the IMF reports that global economic activity has been surprisingly resilient across the disinflationary period of 2022–2023, despite the substantial interest rate hikes by central banks to restore price stability. In 2023, we saw a global expansion of 3.2%, which is now expected to continue at the same pace over 2024 and 2025. However, this growth remains low by historic standards, owing to both the short-term impacts of high borrowing costs and the longer-term spillover effects of the COVID pandemic and the Russia-Ukraine war (*IMF, World Economic Outlook, Apr-24*). The outlook for the global economy is now at a balance. Geopolitical tensions continue, including recent conflict in Gaza and Israel, disruption to shipping in the Red Sea, as well as the 70+ elections taking place across the year that will shape policy across the democratic world. Major economies such as the U.S., China, and the UK are facing deep fiscal deficits well above the 2% average for advanced economies (e.g. U.S. 8.8% in 2023) and are contributing to persistent core inflation, which may keep interest rates higher for longer and reduce asset prices (*FT, Apr-24*).

THE UK ECONOMY: Despite outperforming expectations across 2023, UK economic output remains suboptimal. The outlook across 2024 remains subdued, with growth of 0.5%, making it the second worst performer in the G7, behind Germany. Several risks to growth remain, including the lagged negative effects of high energy prices, the delayed impact of monetary tightening, weakening labour supply, and uncertainty around the upcoming general election. Recently, higher-than-expected wage growth could continue to fuel higher consumer prices, which, when coupled with a rising unemployment rate of 4.2%, will add to the inflation-grapple headache for policymakers at the BoE (*FT, Apr-24*). However, the medium- to long-term forecast is more optimistic, with an expansion of 1.5% in 2025 driven by tapering inflation and households recovering from the prolonged cost-of-living crisis (*IMF, World Economic Outlook, Apr-24*).

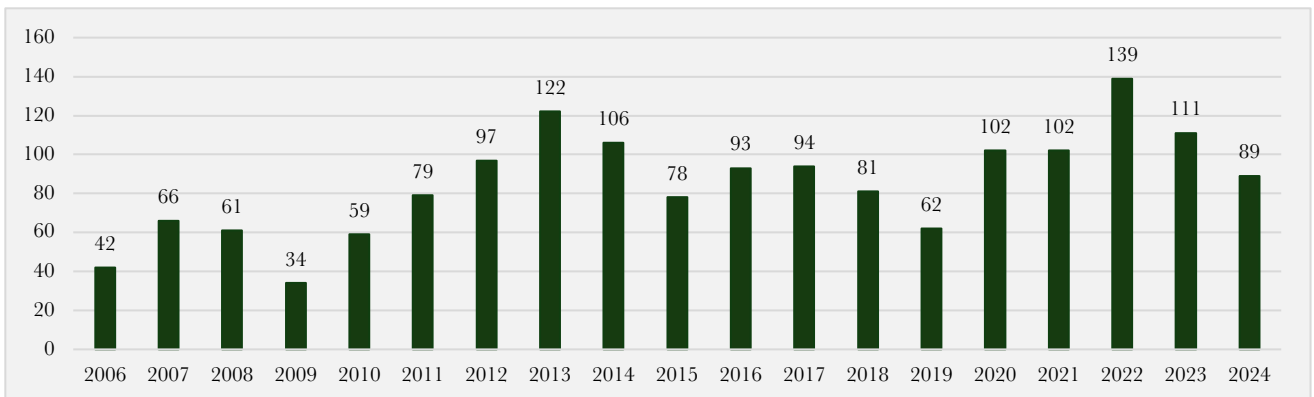
Figure. 1 Bank of England base Rate vs CPI Inflation (Mar-20 –Mar-24)



CURRENCY: While the dollar gained value against most global currencies last year, the pound and the euro outperformed, gaining +5.2% and +3.2%, respectively (*data from yahoofinance.com, Jan-24*). The U.S. dollar has had a strong start to 2024 (up 2.2%), and a rally is accelerating, driven by U.S. economic strength, which is keeping inflation sticky and threatening delays to rate cutting. Pound Sterling is also up 1.8% in the year to date, compared to the Euro, which has witnessed faster disinflation and is only up 0.4% in the YTD. The Swiss National Bank was the first major central bank to lower borrowing costs this cycle, which has been reflected directly in the value of the Swiss Franc, down -4.6% this year (*Currency figures based on JP Morgan trade-weighted nominal effective exchange rates, Rothschild & Co., Apr-24*). Any sustained weakening of the pound against the dollar could, as we saw in the autumn of 2022, translate to increased appetite from dollar-denominated buyers for prime London properties who will look to take advantage of any exchange rate discounts.

TRANSACTIONS: The first three months of the year are typically quieter for the top end of the market in London, but Q1 did see activity above £5m drop off further compared with recent years, recording 89 sales against the 111 in Q1 2023 and record 139 sales in 2022. Despite slowing, sales remain significantly stronger than the pre-pandemic average and are 44% higher than volumes seen in Q1 2019. Overall, the market continues to show its resilience, as evidenced by last year's 526 sales, which was just 13% less than 2022's record year of 606 sales and is more than in any year from 2013 to 2020 (pre-pandemic). 75 of the 89 sales in Q1 were between £5m-15m, which remains the most liquid segment of the prime market. Above £20m, there were just 8 sales in Q1, which is more likely a factor of the distinct lack of stock at this level than it is of buyer activity (*Savills data, Apr-24*). As we approach the most popular time of the year to buy and sell a property, Savills are expecting a pick-up in sentiment, with 31% of cash buyers now committed to moving in the next 6 months and 79% of respondents plans unaffected by the upcoming general election (*Savills, Prime UK Residential Spring/Summer, Apr-24*).

Figure. 2: Q1 sales > £5 million in London from 2006 - 2024



(Savills research data, Apr-24)

TAX CHANGES: The government's move to abolish the non-dom tax regime in April 2025 has provided some with a reason to pause on any immediate decisions, but the long-term impact of this on London's allure to wealthy overseas is likely to be trivial. There are 68,800 registered non-doms in the country, only c. 37,000 of which currently claim the remittance basis tax status, representing a mere 0.05% of the population. Research carried out by the London School of Economics suggested that while it may raise £3.2bn in tax a year, just 0.3% of people with non-dom status would leave the country. The abolishment of the regime will also come with the benefit of several transitional arrangements before they lose their foreign domicile status next April, such as the ability to set up trusts to place their overseas assets in, ringfencing them from inheritance tax indefinitely (*The Independent, Apr-24*). Shadow Chancellor Rachel Reeves also announced Labour would raise the stamp duty surcharge on overseas (currently 2%), but when compared on the global stage against the likes of Singapore (60%) and Hong Kong (30%), London still ranks competitively.

DEMAND: Several factors have brought about a slowing of the post-pandemic rebound in Q1, including the impending general election and wider political instability across the globe. Coupled with an improving economic outlook as inflation cools and rate cuts come into view, the market remains price-sensitive, which has led to buyers adopting a more cautious "wait and see" approach. There remains a unique dislocation in the market with little competition for unmodernised stock as buyers are put off by construction risk and high borrowing costs, while premium stock in prime locations still trades at a premium. The 'golden postcodes' of Mayfair, Belgravia, and Knightsbridge remain the most robust, accounting for 52% of sales above £5m (*Savills, Prime UK Residential Spring/Summer, Apr-24*).

SUPPLY: New planning restrictions across WCC and RBKC will continue to squeeze the supply of trophy homes above 200 sq m and push buyers to the second-hand market in search of such assets, where best-in-class product commands a premium. In Knightsbridge and Belgravia, the average second-hand sale price in the 12 months to November 2023 was £3,793,338, representing a 324% premium compared to the inner & outer London average. Likewise, in Mayfair, the average sale price was £3,462,112 with a 287% premium (*Savills, Prime UK Residential Spring/Summer, Apr-24*). These incredible premiums reaffirm the fundamental supply and demand imbalance that exists across these postcodes and provide evidence for the continued resilience of its values, regardless of the wider economic environment.

PRICES: Prices in PCL held up better than expected in 2023, with Savills recording a mere -0.8% fall (compared with the originally predicted -2.0%) and Knight Frank recording a -2.1% fall (compared with a -3.0% original forecast). The consensus among the main agents is that we are now past “peak pain” as the market bottoms out and price falls continue to ease. Early signs of recovery in the PCL market came in Q1 after it witnessed 0.1% growth, following a period of six successive quarterly falls prior (*Savills Prime Index, Q1-24*). According to Savills, prices in PCL remain 19% below their 2014 peak, and recovery is long overdue. It is expected that the PCL market may remain slightly more price-sensitive for longer as buyers digest the impacts on their tax positions following the abolition of non-dom status and wait for political clarity. Looking across 2024, PCL represents a good ‘buy’ opportunity for many before the market recovers over the next 5 years by 18%+, according to Knight Frank & Savills (see figure 3 below).

Figure. 3: Main agents 5-year PCL Residential Forecasts

Company	2023	2024	2025	2026	2027	2028	5-year Compounded
Savills	-0.80%	0.00%	3.50%	6.00%	4.00%	4.00%	18.66%
Knight Frank	-2.10%	1.00%	3.00%	5.00%	4.00%	4.00%	18.14%
Strutt & Parker	-1.00%	2.50%	2.50%	2.50%	2.50%		10.00%
JLL	-3.00%	0.00%	4.00%	4.50%	4.50%	5.50%	19.82%
Chestertons	-1.50%	1.80%	4.50%	3.00%			9.57%
Hamptons	-2.50%	1.50%	5.00%	7.50%			14.57%
AVERAGE	-1.82%	1.13%	3.75%	4.75%	3.75%	4.50%	19.16%

Savills 'Prime Central London' – Forecasts (Jan-24), Knight Frank UK Housing market forecasts, PCL (Jan-24), S&P 'PCL Price Forecast' - Best Case (Autumn-23), JLL Central London Residential Forecasts: 2024-28 (Nov-23), Chestertons Property Forecasts 2024 (Dec-23). *2026 Chestertons forecast from Dec-21 publication, Hamptons – Autumn Forecast 2023 - London (Nov-23).

PRIME AGENTS:

Francis Macdonald, Director of Research, Savills:

“The first three months of the year are typically quieter for the top-end of the London market, but activity is tracking at a lower level than during the post-pandemic rebound. Lower levels of stock, a weaker economic backdrop, and pre-election jitters, which typically have a greater impact on the more discretionary, very top end of the market, have all contributed to this,” comments Frances McDonald, director of research at Savills.

Alex Christian, Joint Head of the Private Office, Savills:

“We are still seeing a steady stream of interest – with the most notable overseas demand coming from India, The Middle East and America – and there have been some strong prices achieved, particularly for best-in-class properties – testament to the fact that quality of product and fair pricing remains critical in this market.”

3. CONSTRUCTION COSTS

Despite forecasts that workload, output, and new orders will all contract across 2024, as inflationary pressures continue to ease, there is optimism around declining input costs, which should pave the way for a more competitive environment for contractor pricing across 2024. For now, high borrowing costs and access to credit remain a pain point on project feasibility studies. As rate cuts come into view and viability improves, competition will return, spiking an increase in new order growth and output while putting downward pressure on prices.

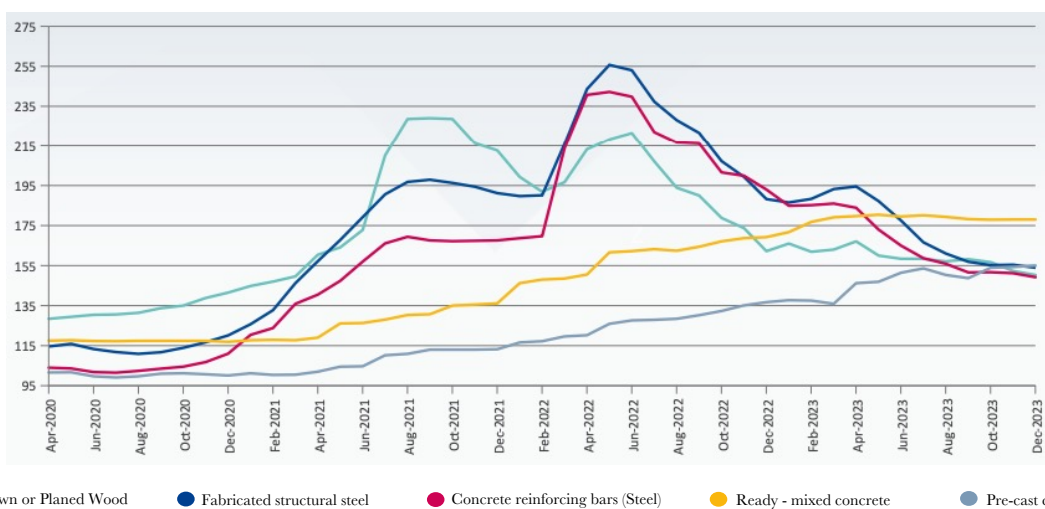
Across 2023, total construction activity (output) contracted -6.8% compared with 2022. A smaller contraction of -2.1% is forecasted for 2024, driven by slow economic growth hitting the industrial and private housing sectors, followed by a recovery of 2% in 2025. Some segments of the industry will fare better in 2024, such as commercial refurbishments, which will continue to grow and support workloads. However, much like last year, private residential new starts and repair and maintenance & improvement will remain subdued this year (-4% growth) as they remain the most exposed to higher cost pressures, higher borrowing costs, and an uncertain political landscape, which directly impact clients' investment plans (*Construction Products Association, Construction Industry Forecasts – Winter 2023/24*). Regulatory changes across the residential sector could also deter clients' willingness to progress schemes, e.g. regarding Gateways 2 and 3 of the Building Safety Act, which require more stringent protocols when working on higher-risk residential buildings of 18 metres or more (*Gardiner & Theobald, Q1 2024 Tender Price Forecasts, Apr-24*).

In the aftermath of the pandemic and the outbreak of war in Ukraine, construction material prices climbed 19.8% in 2021 and 10.9% in 2022. However, material price inflation appears to be stabilising after the BEIS All-Work index receded by -2.3% in the year to December 2023, driven by falling wholesale energy prices, improvements in supply chains, and stagnating demand (*G&T, Q1 2024 Tender Price Forecasts, Apr-24*). Steel, rebar, and imported timber have seen the largest decline in prices, although they were, by contrast, the most heavily inflated materials across 2021 and 2022 (see Figure 4). The effects of high energy costs have kept some materials, such as concrete and cement, insulation, and electrical components, on the rise, but it is expected that further falls in commodity prices will eventually filter through the supply chain, provided that the recent conflict in the Middle East and tensions in the Red Sea do not pose additional supply risks.

The labour market remains tight and was the biggest input cost driver in 2023, rising by 7.1% (*bcis.co.uk, Apr-24*). However, site rates are rising at a slower rate than originally anticipated due to reduced construction activity, particularly across private housing, and improved contractor capacity due to easing workloads and emerging pipeline gaps. The short-term peak may have passed, but the long-term outlook remains tempered by wider demographic and structural issues.

The Fund benefits from its key development partnership with Leconfield, who can be flexible in providing fixed-price or cost-plus contracts. Leconfield carries out the majority of work in-house, which keeps tight control over costs and timeframes.

Figure 4: BEIS Price Indices of Construction Materials (Dec-22 to Dec-23)



Source: Gardiner & Theobald, Q1-24 Market Intelligence, Apr-24).

DISCLAIMER AND CONFIDENTIALITY

This Commentary is issued by Fairway Capital Ltd (the “Fund Advisor”) for the sole purpose of providing recipients with an update on the PCL market in which FC Property Fund Ltd (“the fund”) operates. The Fund is a Jersey AIF and limited to expert investors, and this Commentary is only directed at professional clients and eligible counterparties. The information contained herein is not and does not purport to be comprehensive and should not be relied upon in relation to any commitment, contract or investment agreement.

Whilst this Commentary has been prepared using current market data from recognised sources, no representations or warranties, express or implied, are made in respect of the information given, and no responsibility or liability is accepted by the Fund Advisor or the Fund as to the fullness, accuracy or completeness of this Commentary, nor as to performance of the Fund. Statements herein regarding the potential future performance of the PCL market and/or the Fund should be regarded as projections and suppositions only.

Fairway Capital Ltd is an appointed representative of Laven Advisors LLP, which is authorised and regulated by the Financial Conduct Authority (“FCA”).

FAIRWAY

C A P I T A L

21-23 Ives Street Chelsea London SW3 2ND
UK: +44 (0) 20 7871 3612 UAE: +971 (0) 58 598 3953
www.fairwaycapital.com