

FAIRWAY

C A P I T A L



Prime Central London
Residential

MARKET COMMENTARY

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THE GLOBAL ECONOMY remains on a complex and fragile recovery path, with GDP growth of 3.2% in 2024 supported by easing inflation and strong performance from emerging markets. However, geopolitical tensions, energy market volatility, and economic disparities between advanced and emerging economies will shape the global outlook into 2025. The ongoing war in Ukraine continues to disrupt global supply chains, especially in energy and agriculture across Europe, which has had to seek alternative energy sources to reduce dependency on Russian Gas. Escalating tensions in the Middle East, especially the Israel-Hamas conflict in Gaza, have heightened uncertainty in global oil markets. China, the world's second-largest economy, has faced challenges to maintain its growth, including combatting a real estate crisis sparked by the collapse of its largest developers, weak consumer demand, and declining exports. Sluggish growth in China has ripple effects globally, particularly for countries that are dependent on Chinese imports and exports. With anticipated rate cuts and rising investments in green energy and infrastructure, the global economy could see a more balanced and sustained recovery next year, though the above risks remain.

THE UK ECONOMY: The average UK GDP growth forecasts for 2024 have been revised upwards from 0.4% to 0.9% for the year. Consumer confidence is at its highest since 2021, and key business indicators such as the Purchasing Managers Index (PMI) show a rise in new business activity (*Commonslibrary.parliament.uk, Jul-24*). However, while inflation control and wage growth provide hope for the short term, longer-term structural issues like sluggish productivity, high interest rates, and fiscal uncertainty remain the key hurdles for the UK economy. Rachel Reeves upcoming Autumn Budget on the 30th October will provide clarity about future tax policies, especially regarding capital gains and inheritance tax, which are currently weighing on some industries.

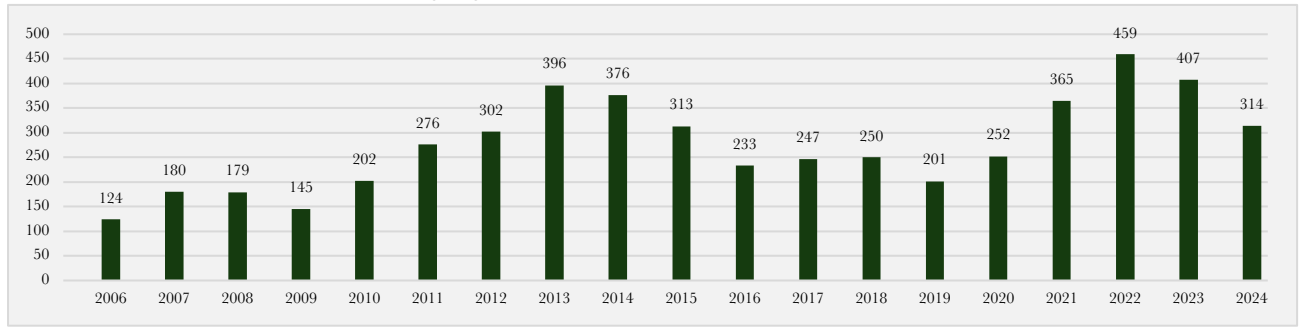
INFLATION: UK inflation has eased across Q3, dipping below the Bank of England's 2% target to 1.7% in September after peaking at a staggering 11.1% in October 2022. The sharp decline has been due to falling energy prices and supply chain improvements, bringing some relief to household budgets and boosting consumer confidence. However, core inflation, (excluding volatile elements like food and energy), remains higher at around 3.2%, and services inflation is still elevated, albeit falling at 4.9%. This has kept the BoE from slashing rates further than 5.00%. Like the UK, inflation in the U.S. has been moderating, standing at 2.4% currently, but strong consumer demand and labour shortages have kept core inflation elevated (*U.S. Bureau of Labour Statistics, Oct-24*). With inflation nearing the target in the U.S. further rate cuts are on the horizon. Following the autumn budget and the U.S. election, we'll no doubt see fiscal reforms to further alleviate core inflationary pressures.

INTEREST RATES: The BoE cut rates 25bps to 5.00% in August, marking its first cut since March 2020. Seven of the 10 big developed-market central banks tracked by Reuters have now started easing policy, with expectations of how quickly each will move swinging back and forth (*Reuters, Oct-24*). While the ECB have taken a more dovish stance with rate cuts so far this year, the Fed and BoE have remained more conservative, keeping rates high to manage stubborn core inflation risks. The Federal Reserve did slash the target rate by 50bps to 4.75% - 5.0% in September, their first cut in 4 years, with rate futures traders pricing rates to be in the 4.00%-4.25% range by end of this year. Back on home shores, markets are also pricing in a 98% chance rates will be cut 25bps to 4.75% at the next meeting and Economists at Goldman Sachs have gone as far as to predict rates could be at 3.75% by November 2025 (*The Times, Oct-24*).

CURRENCY: FX markets have continued to be shaped by global monetary policies across 2024. The British pound is one of the top-performing currencies, benefiting from the Bank of England's hawkish stance and political clarity, reaching two-year highs against the dollar and euro. The euro has weakened due to economic concerns and ECB rate cuts, while the yen has strengthened following Japan's recovery. The U.S. dollar remains robust but will continue to be influenced by the Fed's future decisions and global geopolitical tensions, including U.S.-China trade issues and the conflict in Ukraine. With the US election also drawing close, the dollar has rallied, spurred by stronger economic data and Trump's increasing perceived chances of winning, which would likely provide a major boost to the greenback, at least in the immediate aftermath of the election (*Capital Economics, Oct-24*).

TRANSACTIONS: There were 314 £5m+ sales across Q1-Q3 2024, which is 23% below the same point last year (407) and 32% down on the record levels seen in 2022. While sales volumes have slowed as buyers have remained hesitant and in-decisive in the run up to the election and the autumn budget, PCL has remained resilient. Driven by a core underlying demand for best-in-class product, transactions still remain higher (51%) than the 201 recorded in 2019, pre-pandemic. As ever, the £5-10m segment remains the most liquid, accounting for 69% of sales to Q3, whereas above £30m, there have been just 9 sales, which is more likely a factor of the distinct lack of stock at this level than anything else (*Savills Data, Oct-24*). As we enter the final 3 months of the year and the long awaited 'unknown' surrounding labour's tax regime are revealed, one can only expect a return to higher transactional activity, as discretionary buyers at the top end are provided with the clarity to provoke decision making.

Figure. 1: Q1-Q3 sales > £5 million in London from 2006 - 2024



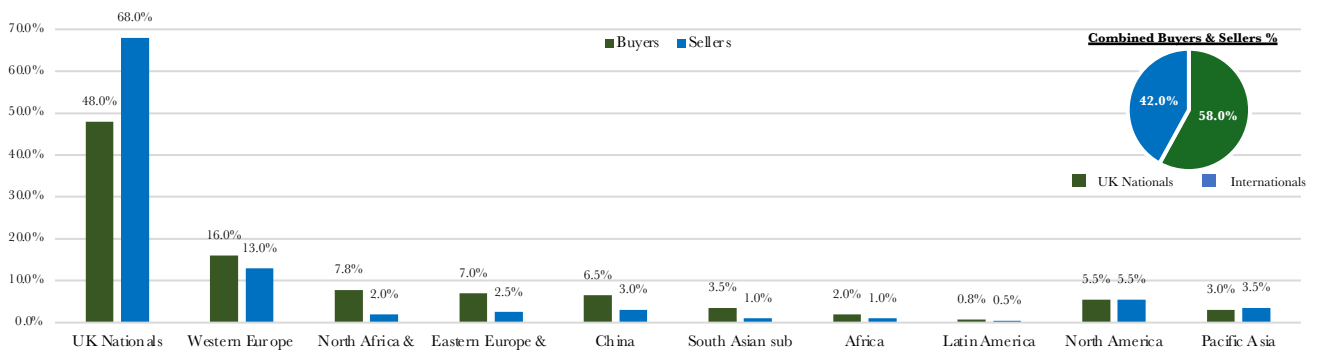
(Savills research data, Oct-24)

TAX CHANGES: With the Budget just over a week away, speculation continues to mount around how Labour will follow through with their manifesto, as Starmer and Reeves continue to remain tight lipped on their tax plans. Increases to capital gains tax or a raid on inheritance tax could be caught in the crossfire. They have already confirmed they will increase the SDLT for overseas buyers of UK property by 1%, but when compared on the global stage against the likes of Singapore (60%) and Hong Kong (30%), London still ranks competitively. The move to abolish the non-dom tax regime in April 2025 has provided some with a reason to pause on any immediate decisions. The Office for Budget Responsibility has already voiced their scepticism around the move’s ability to raise money, estimating that only 5,500 “non-doms” would be affected by the changes, which has seen Reeves hint at a revised approach (*PCL in Focus, Autumn 2024, Savills, Sep-24*). Any changes to the tax landscape should be viewed in the context of relatively low property values (in historical terms) and London’s ongoing status as a cultural and economic hub, with a limited supply of premium stock.

“WE WILL ALWAYS HAVE LONDON”: This was the name given to Gucci’s most recent campaign in an ode to the “timeless allure” of the Capital. Regardless of what we see on the 30th, the fundamentals of London as a global city do not change. The vibrant neighbourhoods of Knightsbridge and Mayfair are seen as global hubs for the world’s largest luxury brands, and home to some of the world’s finest restaurants, theatres and galleries. London’s thriving culture and historical significance is matched with world class education and healthcare, a transparent legal system, a stable political and economic landscape, and a time zone that can look just as easily left as it can right. Together, this makes buying and owning property in the UK a comparatively headache-free experience. For wealthy GCC buyers in particular, London offers an enduring appeal and is why 1/3 of high-net-worth investors from Saudi Arabia, Qatar, and the UAE purchased prime property in London across the 12 months to October 2023, more than any other major global market (*Tatler Address Book, Islay Robinson, Oct-24*).

DEMAND: Demand in the prime markets has undoubtedly dipped over the course of 2024, as the runway to the general election and subsequent governments inaugural budget has provided reasons for discretionary buyers and investors at the upper end to ‘wait and see’. Knight Frank data shows that the number of offers made on UK properties below £2 million fell by just 5% in the year to September, meanwhile, the equivalent fall above £5 million was 18% (*Knight Frank Research, Tom Bill, Oct-24*). The market above £5m is far more discretionary than that of the needs-based market below £2m. As such, the market remains dislocated as these discretionary buyers still compete over the very limited supply of best-in-class stock in A1 locations, which are still achieving premium prices, while anything compromised or requiring work are taking longer to sell or subject to price discounts. Domestic buyers have represented 48% of the market over the last 10 years, a key factor in PCLs resilience against macro headwinds. However, international buyers have also consistently outweighed international sellers, a clear sign of London’s global appeal (see figure 2).

Figure. 2: Buyer & Seller Profiles > £5 million in PCL over the last 10 years



Source: Savills research (Sep-24)

SUPPLY: There remains a significant supply shortfall in PCL, and the development pipeline has contracted 70% over the last decade, meaning the delivery of new units to the golden postcodes remains constrained. According to Knight Frank, the pipeline of homes with a blended value of £3,000 per square foot and above either with planning, under construction or recently completed, has shrunk from some 3,350 units ten years ago down to 1,114 currently (*Knight Frank Residential Development Update, Jun-24*). New planning restrictions across Westminster and RBKC, restricting the supply of new homes above 200 sq m, alongside high build costs and limited land availability have further constrained construction pipelines. Buyers will be forced to the second-hand market in search of such assets, where best-in-class product is scarce and commands a premium. In the year to Q3, 287 sales (91%) of sales above £5m were in the second-hand market (*Savills data, Oct-24*).

PRICES: Average prices in PCL experienced a 0.7% quarterly drop and a 1.1% annual decline in Q3 2024 as a more cautious buyer sentiment lingers due to uncertainties surrounding the October Budget and potential changes to tax regulations (*Savills data, Oct-24*). The market remains incredibly price sensitive price. While the top-end market remains somewhat insulated due to cash buyers, these high-net-worth individuals are increasingly selective, focusing on the best-in-class properties. Such homes, in impeccable condition, continue to command premiums, further highlighting the divergence between average and premium assets. Emerging from the 30th October, post budget clarity may drive improved sentiment, and the main agents remain confident in forecasting significant growth over the next 5 years as this clarity is restored (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%	4.00%	4.50%	5.00%	16.36%
Strutt & Parker	-1.00%	2.50%	2.50%	2.50%	2.50%	2.50%	12.50%
JLL	-3.00%	0.00%	3.50%	5.00%	5.50%	4.50%	19.81%
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%	0.80%	3.67%	4.67%	4.13%	4.00%	18.44%

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

PRIME AGENTS:

Liza-Jane Kelly, Head of London Residential, Savills:

“Whatever tax changes we see in the coming months, the fundamental cultural and physical characteristics that make central London so unique will endure. Pockets of London, including Belgravia and Knightsbridge, have had significant investment, bringing more high-end retailers and luxury apartments to the area”.

Marcus Dixon, Director of UK residential research, JLL:

“Despite moving from election uncertainty through to pre-Budget trepidation, the PCL housing market has shown resilience across both sales and rentals. Many are pricing in uncertainty until the Budget but once we have more clarity on Labour’s plans and buyers understand the implications we expect to see activity increase. London’s residential market has proven resilient in recent years. We don’t expect that to change anytime soon.”

CONSTRUCTION COSTS

The UK construction market has continued to experience a mix of growth and challenges across Q3, with positive economic indicators being tempered by capacity and cost concerns.

As the BoE started its rate cutting cycle in Q3, this has sparked hopes for increased construction activity and investment, although the long-term interest rate path remains uncertain.

The UK construction industry saw its fastest growth in new orders since 2022, with a 16.5% rise across all sectors. Private industrial and housing projects were the key drivers of this growth. Following a likely temporary election-related slowdown, the UK Construction Purchasing Managers' Index (PMI) rose to 55.3 in July 2024, indicating a significant acceleration in construction activity. In London, new orders rose by 14% in Q2 2024, reaching £4.8 billion, which is well above the 10-year average. Market confidence was buoyed by stabilizing costs and the prospect of lower borrowing rates (*Q3 2024 Market Update, Gardiner & Theobald, Sep-24*).

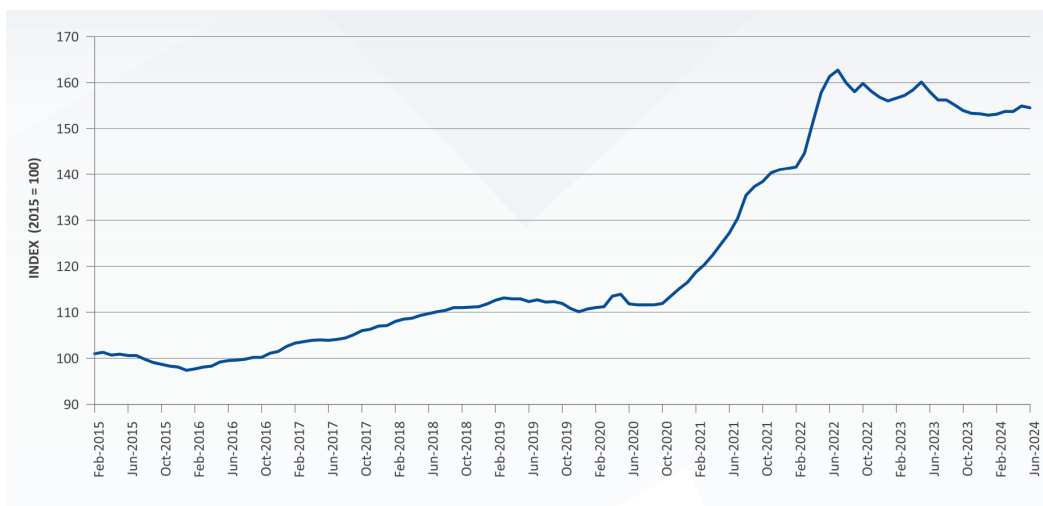
Although some material costs, such as steel, have stabilized, the risk of further increases remains due to distribution challenges and global demand fluctuations and materials prices remain elevated, 39.2% higher than pre-pandemic levels. After two years of declining steel prices, they have now stabilised. Rebar prices fell by 1.3% between May and August 2024, however structural steel prices did increase by 3.3% over the same period. Global commodity prices, while stabilising, remain above their 10-year averages with geopolitical tensions and supply chain disruptions remaining key risks affecting commodity price trends (*Q3 2024 Market Update, Gardiner & Theobald, Sep-24*). Figure 4 shows how material prices have moved over the last 10 years, remaining elevated by historical standards.

Labour costs have continued to rise, driven by a fundamental shortage of skilled workers. Despite moderating slightly in the short term due to softer demand, wage growth also trends upwards as the demand for labour exceeds supply, with vacancies remaining above the 10-year average, raising further concerns for future capacity as demand recovers.

Despite political stability and hopes for lower interest rates, contractor capacity has remained under pressure. Insolvencies and a reduction in overall contractor capacity has created workload gaps, limiting the industry's ability to meet rising demand. A total of 4,287 construction firms went out of business in the year to May 2024, representing a 1.9% increase from the previous year. Insolvencies have surged by 35.2% compared to pre-pandemic levels due to historical cost inflation and the slowdown in construction activity. Smaller firms offering specialized construction activities, such as MEP contractors, have been the hardest hit, though main contractors also faced financial pressures from fixed-price contracts and delayed payments (*Q3 2024 Market Update, Gardiner & Theobald, Sep-24*).

While the outlook for the UK construction market starts to look brighter, with a potential surge in activity driven by lower interest rates and policy reforms, significant challenges do remain.

Figure 4: 'All Work' Construction Material Prices Index, UK (Feb-15-Jun-24)



Source: Department for Business and Trade, Building materials and components statistics, Oct-24

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