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Is the super-prime party over?

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Super-prime London properties have enjoyed a price boom in recent years, with a surge in foreign investors vying to snap up the most luxurious homes, but is there a danger of investor fatigue and how tough is it for brokers to break into this competitive market?

For many tourists, a trip to London would not be complete without a visit to Harrods, if only to buy get one of its iconic green bags. For a small, wealthy minority of these visitors, multi-million-pound properties in London's best neighbourhoods are also on the shopping list.

The value of prime London properties has surged 20.9 per cent from 2009 while the value of homes worth more than £10m has leapt almost 58 per cent from the bottom of the market, according to property agents Savills.

Transactions have been equally robust, with a surge of foreign investors from the Far East, Middle East and the eurozone competing for luxury properties in a handful of postcodes across the capital and home counties. International buyers account for 34 per cent of all prime London sales and 65 per cent of purchases of new developments in 2012.

Now Savills warns annual price growth has slowed to 6 per cent, the lowest level since September 2009, leading some to question whether the London boom enjoyed by buyers, brokers and private bankers is over.

Can it last?

Such has been the demand been for property in the London hotspots of Mayfair, Kensington and Chelsea that developers have embarked on building 15,500 new units worth an estimated £38bn by 2012, according to asset consultancy EC Harris.

Naturally, plans to build prime property with the equivalent floor area of the London Olympic Park does not come without risk. EC Harris is careful not to downplay the threat of "investor fatigue" or waning interest from international buyers having an adverse impact on sales volumes and values of prime property in fringe areas.

"We are seeing more and more foreign national who want to live in certain areas and are willing to pay top dollar and are happy to take out mortgages," says Coreco Group director Andrew Montlake.

"In certain pockets of London, the lack of supply is driving the house prices because the people who want to live in these areas have the cash and they are not really bothered about the actual value. If they want that property, they will pay what it takes to get it."

Even though London's political stability is one of the key attractions to overseas buyers, further intervention from Westminster cannot be discounted.

The Knight Frank Prime Central London index estimates exchanges of properties worth £2m and £10m dropped by 29 per cent in the three months to the end of July in the wake of the new stamp duty.

Prices rose 0.5 per cent over the quarter but calls by Liberal Democrat leader Nick Clegg for a further asset-based tax on the wealthy will not have been missed in Mayfair.

The new stamp duty land tax rate has temporarily divided the prime market in terms of activity, according to Countrywide financial services director Nigel Stockton.

"These buyers have not gone away. It is not that they cannot afford the stamp duty but it has made them put their foot on the ball and think what it means to them," he says.

"We have two markets. Under £2m is solid but not spectacular but the over £2m, we have definitely seen changes. Our view is that London remains a safe haven and the market in the medium and long term will continue to be a strong one."

Foreign investors had been driving valuations in the prime and super-prime market but resident and non-domicile British buyers were also active, according to Investec Specialist Private Bank head of specialist lending Jack Jones.

Jones says the majority of Investec's clients lived and worked in London and were buying homes rather than investment properties.

"I think the fundamentals of the prime and super-prime market in London are pretty sound going forward," says Jones.

"We still have to see the affect of the final legislation around some of these issues but I think the point is that the majority of transactions we see are people are buying because they have a need not just from a financial perspective."

Tax avoidance

Proposed new tax rules to tackle stamp duty land tax avoidance will also be causing a headache for wealthy property owners and their advisers.

The 15 per cent tax on properties worth more than £2m bought through an overseas company and an as yet unspecified annual charge may however prove a boon for brokers.

Enness Private Clients director Hugh Wade-Jones explains many investors were rushing to unwind complex ownership structures, sparking a trickle of remortgages he expected to turn into a flood.

"If the annual levy does come in contrary to the idea it will have a big impact on our business, I think we will be remortgage central for six to 12 months," he says.

"It will be unwinding for people, who are worried about the annual levy on owning a property in a non-personal vehicle worth over £2m. We are doing a lot of work with trust companies and family offices whereby we are removing ownership from companies and back into personal names."

Largemortgageloans.com head of sales Mike Perrin believes the same measure could also boost new lending.

"It is now not efficient for them [high-net-worth individuals] to purchase property through an offshore limited company structure," he says.

"Therefore, if it is secondary home, they are liable for inheritance tax and capital gains tax but by creating debt on the property, they are instantly reducing their potential liabilities."

Stockton argues that the London super-prime property was more volatile than the rest of the UK property market but the fundamentals were sound.

"What happens with these taxes, the buyers pause for reflection and this will take the froth off the top of the market," he says.

"If they are going to spend £17m on a property on Bishops Avenue, they will not be put off by stamp duty or a wealth tax."

While brokers and lenders are confident of the fundamentals of the prime and super-prime market in London, macro-economic factors may slow the flow of new money. London's role as the world financial capital is closely tied to the demand for these properties but a series of scandals has put the city's title under threat.

Equally, a rise in the value of sterling would reduce the appeal of London to foreign investors while depreciation of the US Dollar against the pound would make New York more attractive to international buyers.

MMR

A further cause for concern for prime property brokers has been the FSA's proposals for high-net-worth lending in its Mortgage Market Review. The regulator was criticised by brokers and the Council of Mortgage Lenders for its proposal to set the benchmark for these individuals at £1m of an annual income or £3m of net assets.

The FSA's plan to restrict access to interest-only mortgages would have been a significant blow for younger high-net-worth clients, who used infrequent bonuses, dividends or proceeds from business sales to repay home loans. The regulator was now likely to revise, or drop this definition altogether, according to John Charcol senior technical manager Ray Boulger.

"Defining high-net-worth by the size of gross assets make more sense than by net assets but there are strong indications from the FSA that the definition will be changed or in fact it might not remain in the MMR," says Boulger.

Funding for Lending
Government action normally spells bad news for high-net-worth individuals but in a rare boost, the Funding for Lending initiative could increase the availability and reduce the cost of large mortgage loans, says Wade-Jones.

“We are doing a deal at the moment which is £3m on £5m for a guy buying his own office block. He has qualified for the Funding for Lending scheme so has ended up with no fees and a percentage off the rate. Now I am not sure he is the kind of person the Government had in mind for the scheme but then these are the people creating business and wealth.”

Who are the lenders?
The world of high-net-worth lending may seem unfamiliar to many brokers with private banks and foreign banks, who may be better known for their investment management arms, dominating the market.

Private banks can tailor LTV rations, rates and mortgage terms to suit almost client, however unusual the circumstances, provided they have the right assets or income. This flexibility can also come with excellent interest rates but there is often a catch. Lenders will make it a condition of the loan for clients to transfer management of investment portfolios or place significant amounts of money on deposit.

“The private banking market is all about asset management. So there are some lenders who will be prepared to take the mortgage without any other assets although that is more difficult than a year ago,” explains Boulger.

“It is a sprat to catch a mackerel, they may offer loans at skinny margins to catch other business.”

Clients were often reluctant to move assets but the potential savings on mortgage interest could sway minds, says Wade-Jones.

“That is where we come in as a broker and find where someone fits,” he says. “People are often closed to the idea initially but can warm up quickly, particularly if they are borrowing larger sums of money, and you can say shave 50 basis points off.”

This portfolio pricing can mean some private banks can offer extremely competitive rates.

“We struggle to understand some the pricing in that market,” says Jones. “We price our loans in relation to the risk and client strength, we sometimes find that very economically challenging, and we see offers like that ebb and flow while we would rather be consistent.”

The low cost of funds was attractive to clients but the security and investment potential of London prime remained the primary motivation for buying, says Perrin.

“If you compare the cost of funds in the UK compared with the Far East, we are relatively expensive,” he says. “You will get a private bank lending at 150 basis points over Libor but these people are buying the property for other reasons. These guys are buying London because it is perceived as a safe bet and a good place to invest.”

Mainstream lenders
Mainstream lenders like Halifax became active in the large loan market around 2007 and 2008 but pulled out, leaving the market to private banks, says Legal & General Mortgage Club managing director Ben Thompson.

‘In the last six to nine months, a couple of private banks have had enough of certain types of business so have become more demanding in terms of what they are looking for,” he says.

“Secondly, a little more interest from the mainstream lenders, who began very quietly began to express more interest, which we have not seen come through yet in a meaningful way. It will be slow progress though.

“I expect to see if someone decided to make a play into the middle or upper end of the market. There is an reasonable level of interest in the £500,000 to £2m because that seems to be the area deemed lower risk in this higher risk market,” says Thompson.

“The banks are under pressure to lend. If you are going to lend, would you rather lend to someone in Sydenham or Hong Kong? If you are worried about risk, lending to an offshore person or entity is much riskier as opposed to an UK resident, where you can do a Experian report,” says Perrin.

Perrin was sceptical whether mainstream lenders would or could operate at the higher end of the prime market.

“You will never get the likes of Santander lending to this clientele,” he says. “One, because they can’t get their head around it and, two, because it [a multi-million loan] represents too large a risk.”

Joining the club

The prime market is clearly an attractive market for brokers but the barriers to entry are high. The prime and super prime property market was a small one centred on London, says Montlake.

"It is a good area for brokers and a lot try to go into it but dealing with someone of this nature is not like dealing with a straightforward first-time buyer because there are lots of other things to consider," says Montlake. "There is a lot more to think about than just putting them with the cheapest lender."

Boulger argues the skill of the super-prime broker was in knowing the private banks and having the right relationship. While Wade-Jones agrees this was important, brokers also needed specialist knowledge and the savvy to structure unusual mortgage agreements for unconventional clients.

"We have spent the time learning [the more complex trust structures] so we can approach the family offices and trust companies on a equal level rather than not really understanding and keeping fingers crosses"' he says.

"A lot of it does come down to understanding of tax planning, a trust and legal implications. If people have thousands of pounds and years structuring how they are paid, ploughing in there with a hand grenade by trying to stick them with the Halifax is going to be terminal."

Brokers will also need to adjust to the fact that a number of private banks do not pay proc fees.

"That is an interesting dilemma for brokers – how seriously do you consider any private bank who does not pay a proc fee?" says Boulger.

"If you are not getting a proc fee on a £50,000 mortgage, you may be happy to put down that down to your proposition but if you are not getting a proc fee on a £2m-£3m mortgage, you perhaps think more carefully about how you research the market."

Montlake argues all brokers in the prime property market should charge clients fees.

"Brokers need to professionalise themselves and charging a fee for their services is one way to do it," he says. "Then you are able to bring into play lenders who do not pay proc fees and give a better level of service to the customer."

Outlook

Government action around stamp duty has caused tremors in the super-prime market but the foundations seem sound for now. London-based brokers are well placed to reap the benefits of overseas and local demand for prime properties, which show every indication valuations will continue to rise in the medium-term but at a less explosive rate.

Hugh Wade-Jones, director, Enness Private Client

We had a large rush before the budget, with some very large purchase sizes. Our average loan size in the first quarter of this year was in the region of £2.25m. We have found since then the £2m market has dropped off quite a bit but there has been a huge increase in the £1m to £2m corridor.

We have seen a lot of the foreign guys have cracked on regardless. It has not had too much impact on them but with the British contingent, there has been a drop-off.

In terms of the stamp duty annual levy, there has been some scaremongering which has ruffled a few feathers but nothing concrete has been laid down. There has been a discussion and what comes to fruition will dictate what kind of year we will have. It think it will be very strong regardless.

On the private side, there are no rate sheets, hard or fast requirements. It is very much down to how the bank sees the individual and how much they want to do business with them. There is not a lot of money in lending because the margins are very small but if there is potential, private banks will forgo the immediate assets under management just for the promise of the relationship later.

By and large, you find the private banks split themselves into three categories. Those who are quite happy to do the lending. Then there are those in the middle who will want this amount of money but will let the client get a foot in the door if there is promise. Finally, there is the extreme who will say we have requirement of 25 per cent of whatever you borrow has to be under our management on day one.

It is not just about sticking money in an account the client can't touch. If a bank can take over the running of a trust, which will generate fees. They are not fussed about the client chucking £500,000 on account, which will only earn them very little anyway.

The way we try and structure deals when clients do have to put money under management is to try and borrow against it. The bank will say you have to put down £500,000 but you can borrow up to 90 per cent of that cash's value and that borrowing can be done at a quarter of half a percent so it is absolutely dirt cheap. The bank does not mind lending because it is good business for them with no risk.

Or if the client has cash offshore rather than it bringing onshore the bank will offer 75 per cent on the property then lend the remaining amount against the cash held outside the UK so the client does not have to pay any remittance. If you are talking about bringing £500,000 into the UK if the client are taxed at 40 per cent or 50 per cent that is a potential saving of £250,000.

In my experience the private banks are very clear as to what they are expect on day one. If a deal is put together on the basis of such and such coming across in 24 months and it is not there then I think bank is well within its right to renew the facility.

I have never heard, or experienced a situation where nothing has been implied for the client and the loan has been pulled because no money has been moved across. It does tend to be a case of over promising and under delivering on the client's behalf.

Jack Jones, head of specialist lending, Investec Specialist Private Bank

We are talking about bespoke solutions for high net worth individuals. People hear mortgages and think it is 25-year facilities, capital and interest repayment, and when you have retired you have paid your mortgage off but it is very dynamic in the market we are involved in where clients have significant and continuous liquidity events.

The prime property market has been very strong. Look back from the depths of the market and prime prices are almost 20 per cent higher and a number of factors have driven that the foreign investment in London has been significant and is likely to continue.

Around 12 months ago asking prices were being agreed and valuations were coming in light but I think vendors have adjusted and people know where the market is now. I think the market has now absorbed some of the stamp duty changes and taxation issues. I think that still has time to play out but it has been pretty robust. Going forward London is still an attractive market for the international wealthy and people who are working here.

As a private bank we are comfortable dealing with this kind of client, whether with lending or backing them in a business venture, or a MBO. We have not set out to build a mortgage book but are trying to build a relationship with clients, who would want to use the other Investec services we offer.

We are a low volume business and we are able to employ good credit skills and spend the time to truly understand what is happening in these guys lives and balance sheets.

When you start to treat these facilities as commodities; saying you will do 70 per cent of a loan up to £2m I think it is difficult to understand what the clients' needs are. We start with a set of principles where we believe the client will want to interact with us. We ask them what they are looking for so we craft the loan around their needs, balance sheet and cash flow.

A lot of mortgage offers for high-net-worth individuals tend to be contingent on the other services those banks are offering. Our stance is that we would love have a long-term relationship with those clients we class as entrepreneurial whether they have their business or are decision makers at major financial, or professional services firms.

We price our loans in relation to the risk and client strength. We sometimes find that very economically challenging and we see offers like that ebb and flow while we would rather be consistent. It is tough out there and we to see struggle how some of those loans are economically viable.

We have seen steady demand for people who can understand our value proposition. These clients understand risk intuitively and are often keen to repaid terms aggressively.

Ray Boulger, senior technical manager, John Charcol

One of the more difficult things with high end properties are the valuations. With a typical estate property it is pretty easy to get it within 5 per cent because there are likely to be similar sales but a lot of the top properties are very individual so there is much more scope for valuations to be very different from what the client expects.

If it is a remortgage that would not be surprising as most people struggle to put a realistic price on their home if they have not had it valued recently. With a purchase the fact you have a buyers normally sets the price but valuers might say there is only one buyer and the price was much more than it is worth.

If you are looking to borrow right on the margin in terms of LTVs you need to be very conscious of the risk the new valuation may result in you breaching the LTV margin. It maybe that borrowing at 75 per cent LTV might mean you have to pay a higher rate but if you get a down valuation you might be better going to another lender.

My impression was that the stamp duty going up to 7 per cent, or even 15 per cent with avoidance charge, would have a pretty negative impact on the sector. That was clearly the case in the short term but I have seen conflicting reports some have suggested after two or three month lull activity was back at pre-Budget levels.

The long-term impact is that because of the way stamp duty is set no one will buy a property for £2.05m. What the chancellor has done is create a void from £2m up to £2.1m or £2.25m where there will not be any transactions and that is a ridiculous situation.

It has an impact initially but the big question is how long does it last? As time goes on the impact starts to wear off because if you are buying a £3 or £4m property then the stamp duty is an annoyance but if you are in that sort of market you will have the money for the stamp duty. If you really want a £5m property you are not going to buy it because stamp duty is 7 per cent rather than 5 per cent.

The private banks will generally look at anything above £500,000 but equally some of the mainstream lenders will look at cases up to £2m. So if you have got a case between £500,000 and £2m you have a choice but above £2m there are far fewer options in the mainstream market.

A key part of brokering this sort of business is identifying whether the client is prepared to put some assets with the lender to manage and if so that widens the choice of lenders you can use. If not you have less choice but then any mortgage over £2m is down to individual negotiation.

The competition between private banks is not as strong as it was a year or so ago and there is more competition for good quality business from the mainstream lenders.

Webcast

Mortgage Market Review