WMG Real Estate

Objective:

WMG, acting as principal together with its investors invest in London Real Estate, for capital appreciation as well as yield. It aims to return more than 15% IRR.

If you would like to discuss, or receive further information on potential opportunities, please email: property@wmgfunds.com

Contact Details

WMG Advisors LLP
Bond Street House
3rd Floor
14 Clifford Street
London W1S 4JU
United Kingdom

Email: info@wmgfunds.com

Tel: +44(0)2074918844

UK RESIDENTIAL MARKET OPENING UP

Dear Investor,

"Build, Build, Build"

How is Boris Johnston doing? If you want to give him the benefit of the doubt, you would say its too early to judge. He was effectively, voted in to see Brexit to its conclusion. COVID-19 had changed that. He now has a pandemic crisis on his hands, and an economic crisis not seen since the second world war, with a large unemployment looming ahead and more, much more. Yet he still has an eye on the elections ahead. His popularity is down, and the switch from labour supporters to him, may not be there in the next few years. He and his team have identified the construction sector as "the single most effective policy tool to achieve this." Government policy has shifted to such an extent that we expect the sector to sustain its growth over the next few years. This belief is led by what we have seen in the way the government is reforming planning, investing in infrastructure, and as recently as last week changes in the tax system.

Using the construction sector as a way of moving towards a "one-nation Conservatism" society is nothing new. David Cameron and Theresa May were both clear in their manifestos, of the importance of this sector, but failed to implement. Yet there are signs. Sector has been growing for a while. For example, social housing has been growing over the last few years, where capital investment has averaged +13.5 per cent per annum, (that's 5.5 per cent more than the Labour government when in power) the current Conservative Manifesto put construction at the forefront of stimulating the economy. That was well before COVID-19.

Rishi Sunak's "summer update" shows clearly that the government is moving its timetable up to navigate through this crisis. His speech and subsequent policy announcement were aimed at boosting the economy. Key takeaways are as follows;

- developers to demolish and rebuild vacant and redundant residential and commercial buildings to redevelop as residential
- a wider range of commercial buildings to be converted into residential without planning application
- defunct buildings on high streets to be repurposed allowing new homes and reducing pressure on the greenbelt
- property owner to build additional space above their properties through a fast track approval process
- a stamp duty holiday

Sources: Savills, ONS, The Guardian, FT, Knight Frank, Halifax, RICS, EPRA

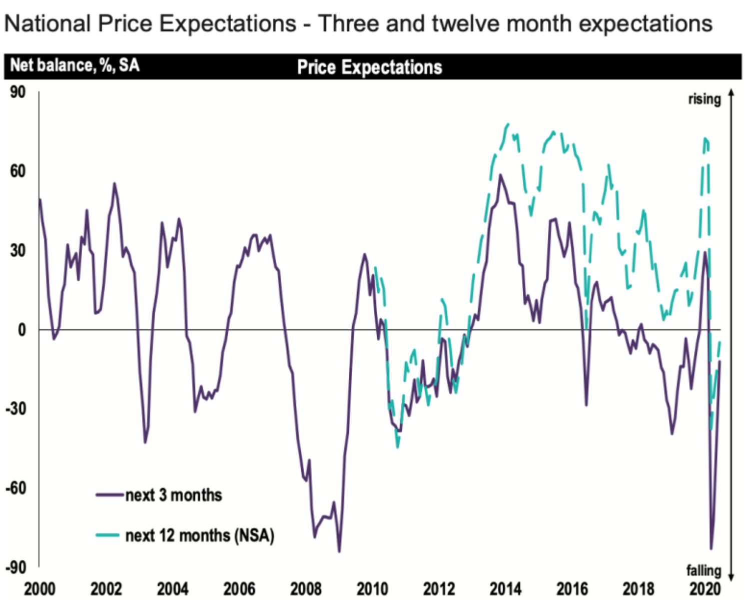
What the Chancellor announced is far more significant than at first sight. He is actually attacking and redesigning the whole planning regime. We are told more details to come in September, but we can already see that the scope of permitted development will be expanding, with planning permission easier to get. Brownfield sites will become desirable commodities for the residential market.

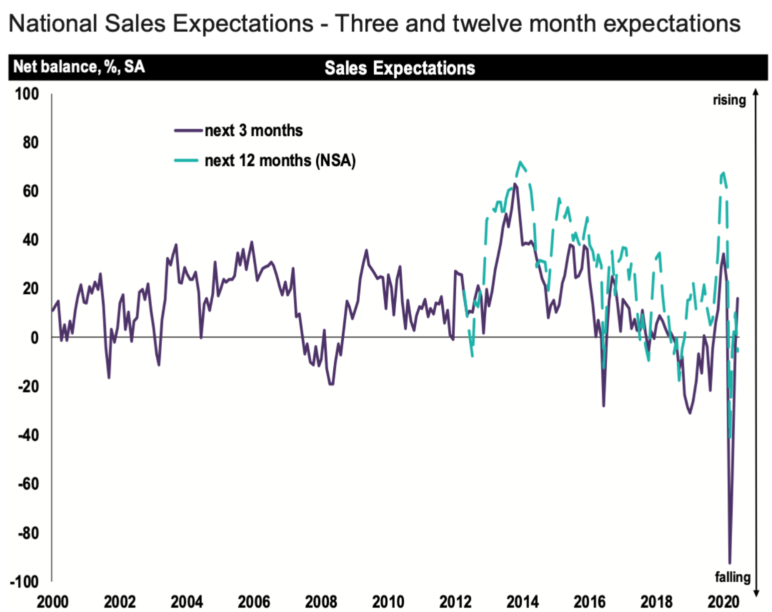
We saw the conservative governments ambitions under Theresa May, who declared she wanted to see 300,000 new homes a year. Unfortunately, she never got anywhere near it. Boris is, however, determined, announcing a 12 billion investment over eight years, with the objective to build 180,000 affordable homes.

The Chancellor confirmed a cut to SDLT with immediate effect starting from 8th of July until March 31, 2021, increasing the threshold at which buyers start to pay the levy from its current level of £125,000 up to £500,000 regardless of the buyer/property type. This should boost transactions and provide a stimulus to the residential market. The stamp duty holiday corresponds to a £15,000 saving for a purchase of a home with a value of £500,000.

Early indicators suggest downwards pressure on prices has slowed down since the market re-opened, although it is still too early to comment whether the pent-up demand and increasing inquiries will translate into meaningful activity. Knight Frank forecasts price falls of 7% in UK markets and 5% in prime London in 2020. Most of the decline has already taken place. Savills, on the other hand, says UK average house price fell around 7.5%, keeping the mainstream residential 5-year price growth forecast for UK and London at 15.1% and 4% respectively.

RICS June 2020 UK Residential Market Survey indicates recovery in activity. Yet it cautions on longer-term expectations as buyer demand saw a strong rebound in enquiries over June compared to April and May.





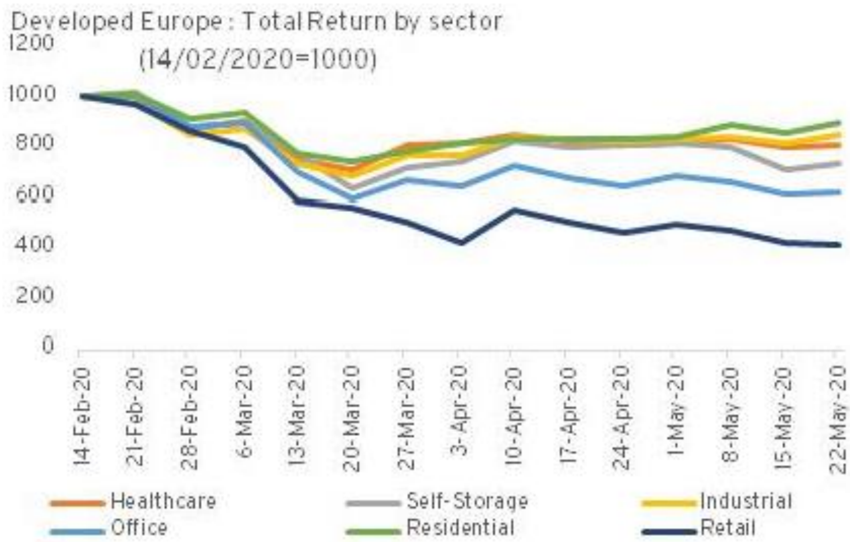
Source: RICS

Investment in Infrastructure and public sector will undoubtedly lift the residential market. Funds earmarked for Rail, water, electricity, hospitals, road improvement and schools will have significant effect on residential building projects. HS2 has finally been approved.

All this leads to a simple conclusion. Construction sector is set to be the main weapon of the current government to fight recession and win votes. We expect to see good growth in the sector over the next few years and beyond. Residential subsector will be a major beneficiary.

Remote working is here to stay. Large number of companies are not yet back to their offices. Social distancing rules are in place and several are introducing new working conditions in the physical space and setting flexible working arrangements. Residential market will remain the main focus going forward helping the adjustments needed to be made to respond to the new order. Knight Frank Survey shows that a home office or study (53%) and privacy (43%) are among the top three most popular amenities for a new property as 53% of respondents said they planned to work from home more often.

Although real estate markets are going through a significant global downturn, residential sector has proven to be one of the most resilient, together with logistics and healthcare, during the COVID-19 crisis.



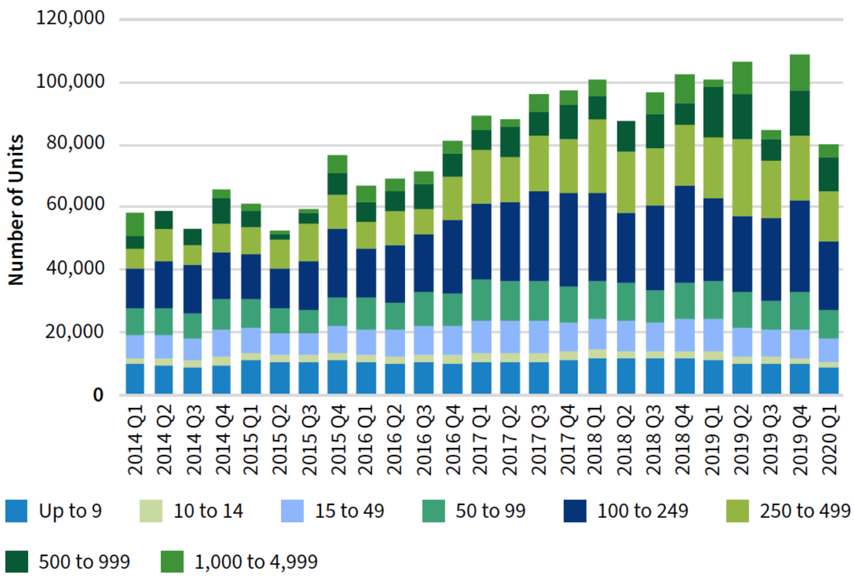
Source: EPRA

After an unforeseen start to the year, construction industry is slowly getting back to work under new conditions with a challenging economic outlook. Following the easing of the lockdown, residential market started to recover as development and sales are back on track since 85% of suspended development sites reopened. Sales and marketing are back following online only viewings in the past few months. Developers are keen to complete work at existing sites, but are cautious to take new work on, until there is more clarity towards the future. The Chancellor's speech should have helped.

In line with rising unemployment, lenders are cautious. Mortgage approvals have fallen to levels less than half of what we have seen during 2008 crisis. According to Halifax House Price Index, prices have fallen for four consecutive months and the quarterly change recorded is -0.9%. However new mortgage enquiries surged; up by 100% compared to May with prospective buyers revisiting purchases put on hold, thus increasing transaction volumes compared to previous months. The Bank of England base rate is expected to remain at 0.1% until 2022 Q2; which is expected to be an important catalyst to support sales and demand.

On the supply side Savills estimate 171,000 new homes will be built in England this year (2020-2021); which corresponds to 66% of number of homes built last year due to reduction in construction capacity during lockdown and limited motivation to start new sites. This is expected to ease the downward pressure on prices due to the increasing undersupply especially in low to middle income segments.

Chart 2: Private residential projects



Source: Glenigan

Introduction of new technologies, changes in lifestyles and increasing concerns around sustainability along with improvements in mobility and transport infrastructure, providing easy access to the city centre from more affordable locations, will keep playing a key role in creating new opportunities for residential developments. Despite the ongoing uncertainty around real estate markets especially with regards to the timing and pricing, we believe the construction sector is going to be the key driver for the current government. Large scale infrastructure investments will help the sector as logistics improve and demand for residential London continues to grow.

So, how is Boris doing? Really difficult to call, at least as of yet. Without the COVID-19 pandemic, he would have led the country out of Europe, set the economy on a growth pattern through expenditure, with construction sector as the foundation of his political beliefs of a united conservative society. Instead he is facing a pandemic, which he has not handled well. His popularity is down and national debt at levels last seen after the second world war. Unemployment set to double and more as we come to end of furlough, with redundancies across the board. Yet, construction remains the main focus in navigating the nation out of the pending crisis. A quick look at the conservative manifesto shows a commitment to build 40 new hospitals, £100bn additional infrastructure spend, £30bn on road improvement, £1b on fast charging for electric cars, and a commitment to invest in the railway network on Northern England and the Midlands. 300,000 new homes remain the target for the government with help to low income buyers with fixed long-term mortgages, discounts and an affordable Homes program. All eyes on the September announcement with regards to the changes in the planning process. This could be a key to a surging real estate market.

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