RESIDENTIAL RESEARCH

PRIME CENTRAL LONDON RENTAL INDEX

BANK JOB CUTS DAMPEN DEMAND IN THE PRIME CENTRAL LONDON LETTINGS MARKET

Job cuts and declining optimism at banks has slowed rental value growth over the last six months, says Tom Bill

December 2015

Annual rental value growth eased to 0.7% in December, the lowest level since July 2014

A quarterly decline of -1.1% in December was in line with seasonal slowdowns of previous years

Prime gross yields have declined from **2.96% in May to 2.93% in December**

Optimism among financial services companies **fell in the third quarter of this year**

Macro View: Taxing property transactions

TOM BILL

Head of London Residential Research

"Profitability has fallen due to new regulations that force banks to hold more capital, which has contributed to job cuts at European banks that have been in excess of 100,000 in recent months"

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Annual rental value growth in prime central London eased to 0.7% in December, on the back of falling demand in the financial services sector.

Rental values fell -0.4% from November, taking the annual rate of growth to its lowest level since July 2014.

There is also an element of seasonality and a quarterly drop of -1.1% in the last three months of the year was the weakest since December 2014 and repeats a pattern of previous years.

Rental value growth peaked in May this year at 4.2% and the subsequent decline has resulted in prime gross rental yields dipping from 2.96% to 2.93% over the same period.

Demand has fallen over the last six months as a number of banks have implemented restructuring plans.

European banks in particular have been slower to cut jobs than their US counterparts following the financial crisis. Profitability has fallen due to new regulations that force banks to hold more capital, which has contributed to job cuts at European banks that have been in excess of 100,000 in recent months.

As well as the macroeconomic backdrop, including uncertainty over China and falling commodity prices, the situation is compounded by the fact many large European banks have new chief executives, who typically take a more radical approach to cost savings in the early stages of their tenure.

The result is that optimism at financial services companies fell markedly in the third quarter of this year across a range of sectors, as figure 2 shows

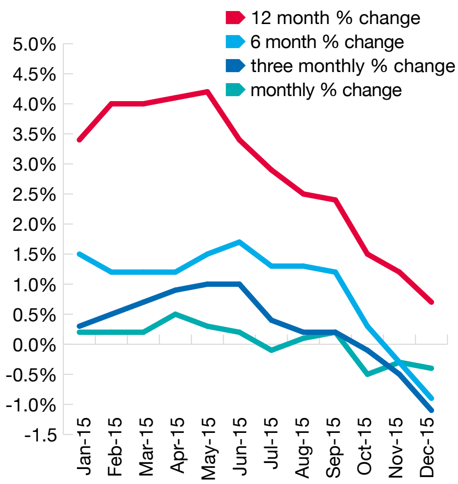
However, there have been signs of stronger demand from boutique financial services companies like private equity businesses and hedge funds as clarity emerges surrounding the level of 2016 bonus packages.

Meanwhile, demand at the super prime level of £5,000-plus per week remains strong as uncertainty continues to surround taxation and price growth in the higher price brackets of the sales market.

Equally, demand remains strong in lower price brackets among workers of all professions, bolstered by the strength of the UK's economic recovery.

FIGURE 1

Rental value growth in prime central London

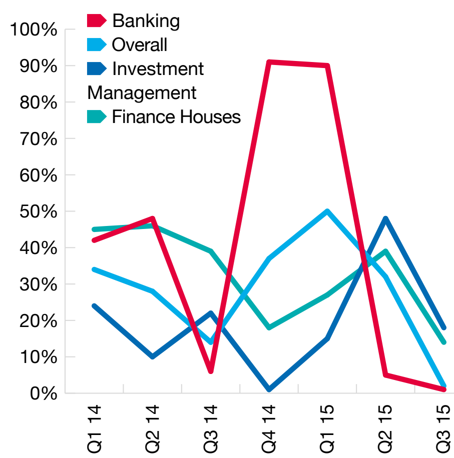


Source: Knight Frank Residential Research

FIGURE 2

Optimism in financial services falls

(PWC/CBI survey, % balance of more vs less optimistic)



Source: Knight Frank Residential Research

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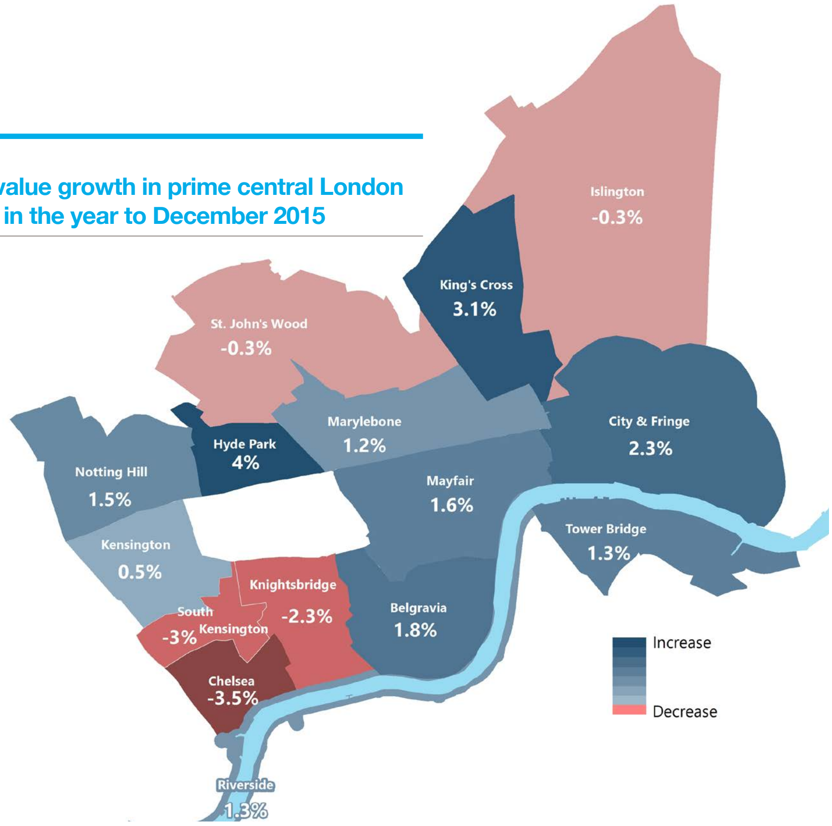
FIGURE 3

Rental value growth in prime central London by area in the year to December 2015



DATA DIGEST

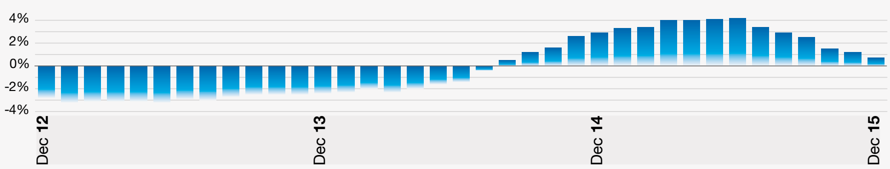
The Knight Frank Prime Central London Index, established in 1995 is the most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks rental values of prime central London residential property. 'Prime central London' is defined in the index as covering: Belgravia, Chelsea, The City& Fringe, Hyde Park, Islington, Kensington, King's Cross, Knightsbridge, Marylebone, Mayfair, Notting Hill, South Kensington, St John's Wood and Tower Bridge. 'Prime London' comprises all areas in prime central London, and in addition Canary Wharf, Fulham, Hampstead, Richmond, Riverside*, Wandsworth, Wapping and Wimbledon.

* Riverside in prime central London covers the Thames riverfront from Battersea Bridge in the west to Tower Bridge in the east, including London's South Bank. The City Fringe encompasses the half-mile fringe surrounding most of the City including Clerkenwell and Farringdon in the west and Shoreditch and Whitechapel in the east.

THE MACRO VIEW DECEMBER 2015

Prime Central London Index | **175.2**

Annual rental value growth in prime central London over the last three years



TAXING PROPERTY TRANSACTIONS

The issue of stamp duty has dominated the prime central London market in 2015.

In January, buyers and sellers began to digest higher rates for property worth more than £1.1 million. It slowed transaction levels but by November there were tentative signs of strengthening demand.

The Autumn Statement in November added three percentage points to rates for buy-to-let investors and second home purchases.

The proposal is subject to review but the effect has been to disorientate a market finding its feet.

Fewer transactions have reduced the tax take in prime central London, an outcome consistent with the Laffer curve, an economic model which indicates that tax increases beyond a particular rate can be counter-productive.

Excessive property transaction taxes can produce "inefficient and destabilised markets", said Richard Grover, a senior lecturer at Oxford Brookes and an advisor to governments and global financial institutions on property taxation.

"In countries with high transfer taxes, it simply discourages transactions. In some cases it changes behaviour to the point markets become less transparent," he told Knight Frank.

"That is not the case in the UK but the purpose of the tax was to raise revenue not result in buyers who are unwilling to transact," he said of the changes announced in December 2014.

Reform of council tax is a more effective way of guaranteeing revenue and has a markedly less distortive effect on property markets, he said.

"Increasing stamp duty produces far more sporadic results but is politically an easier thing to do than the highly desirable but more unpopular option of restructuring council tax."

"Stamp duty changes in the UK have resulted from the displaced need to tackle council tax reform, which is highly visible and highly opposed across the whole spectrum of the market."

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