PRIME CENTRAL LONDON RENTAL INDEX

Knight Frank

RENTAL VALUE GROWTH TURNS NEGATIVE ON GLOBAL MARKET VOLATILITY

Annual rental value growth in prime central London declined to -0.2% in February as global economic events took their toll, says Tom Bill

February 2016

Annual rental value growth fell to -0.2%, the first decline since June 2014

There was a fifth consecutive monthly **decline of -0.1% in February**

Annual growth for properties under £1,500 per week was 1% versus -0.6% for properties worth £1,500-plus per week

The average gross prime yield was **flat at 2.92%**

Macro View: Brexit and the London property market

The performance of the prime central London lettings market has historically been linked to the health of the financial services sector.

It is therefore unsurprising that against the background of volatility on global financial markets that rental value growth in prime central London has been declining since May 2015.

The start of 2016 has been overshadowed by fears surrounding the impotence of central banks and the prospect of negative interest rates triggered a fall in the share price of European banks and spread uncertainty in markets already digesting low oil prices and a Chinese economic slowdown.

As a result of this uncertainty, rental values fell -0.1% in February, which was the fifth consecutive decline and meant annual rental value growth fell to -0.2%. It was the first time annual rental value growth has been negative since June 2014. Average gross prime yields were flat at 2.92%

This trend has been exacerbated by high supply levels, particular at above £1,500 per week, as a result of more vendors deciding to let their properties due to uncertainty over taxation and price growth in the sales market.

As a result, tenants feel little urgency to agree deals and the result is that a growing number of landlords need to reduce their rental income expectations.

More volatile economic conditions and a weaker financial services industry mean corporate budgets are reduced, which lowers demand for higher-value rental property in particular.

This effect can be seen in figure 2, which shows how annual rental value growth of 1% for properties worth less than £1,500 per week exceeds the -1.6% decline for properties worth more than £1,500 per week. The same effect means that price growth for flats has out-performed houses in the last year.

Given the supply and demand imbalance, there is also a marked difference between newly-refurbished and un-modernised properties. For example, in Marylebone, rental property in the best condition will achieve an average of £1.15 per square foot per week, which compares to 80p per square foot per week for properties that have not been updated.

TOM BILL
Head of London Residential Research

"Tenants feel little urgency to agree deals and the result is that a growing number of landlords need to reduce their rental income expectations"

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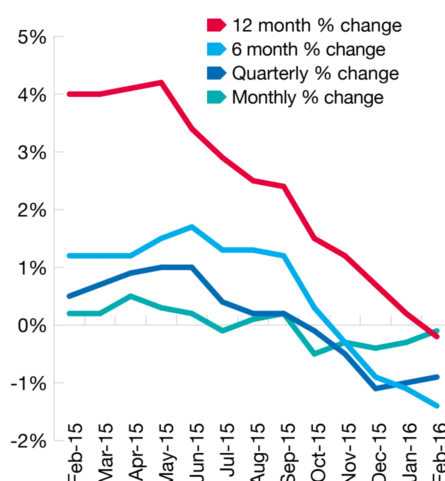
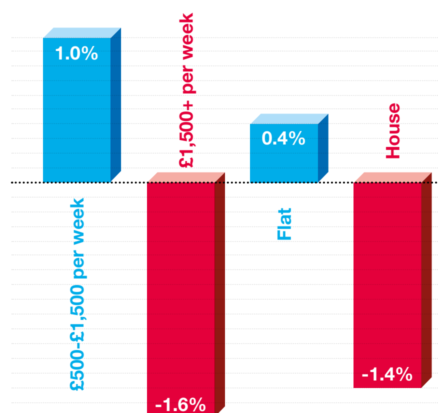
FIGURE 1
Rental value growth in prime central London



Source: Knight Frank Residential Research

FIGURE 2
Differing fortunes in the lettings market
Annual growth by price bracket and property type (February 2016)



Source: Knight Frank Residential Research

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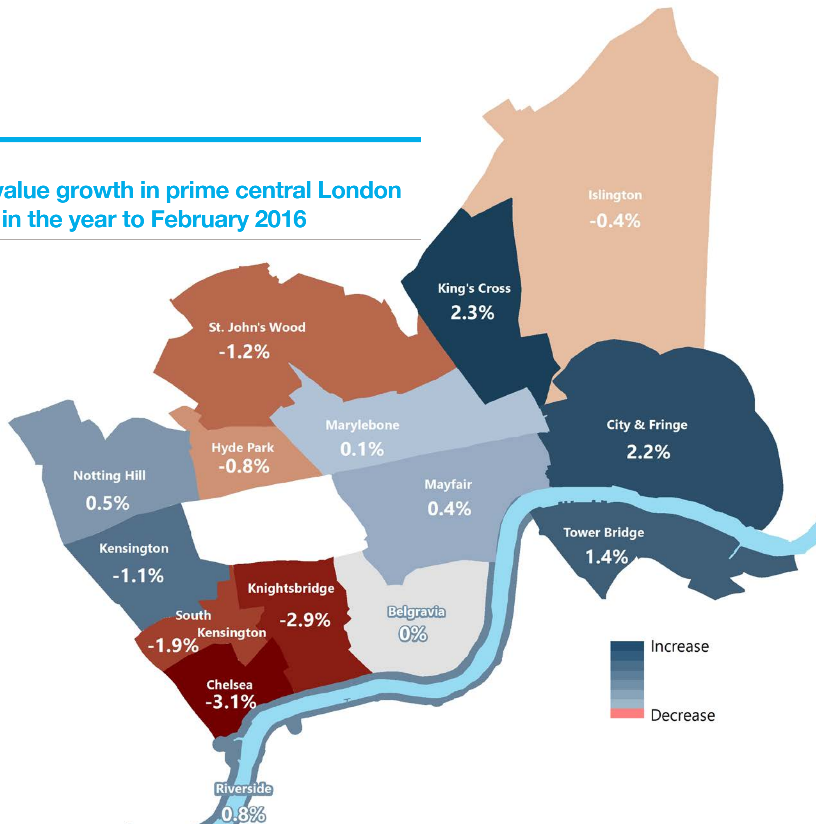
FIGURE 3
Rental value growth in prime central London by area in the year to February 2016



DATA DIGEST

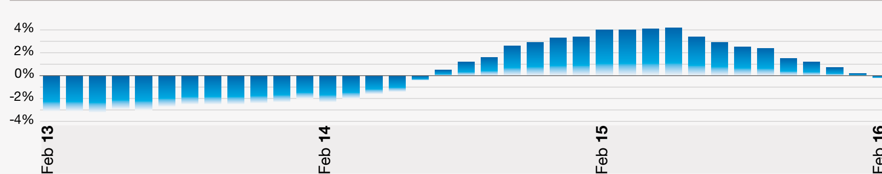
The Knight Frank Prime Central London Index, established in 1995 is the most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks rental values of prime central London residential property. 'Prime central London' 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 FEBRUARY 2016

Prime Central London Index | **174.4**

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



BREXIT AND THE LONDON PROPERTY MARKET

Uncertainty surrounding the outcome of the EU referendum is the latest in a series of factors to affect the prime central London property market.

The UK faces four months of campaigning, headlines and polls that financial markets will use in an attempt to anticipate the outcome and move asset prices including Sterling.

However, the extent of the uncertainty in the run-up to the vote means the country is likely to experience a 'Brexit effect', irrespective of whether the country votes to leave the EU.

The uncertainty means investment decisions, including property, are more likely to be delayed until after the vote. Some predict a negative impact on the economy and Sterling weakened in the days after the date was set.

So, what if the country votes to leave? Hedge fund Toscafund analysed the issues surrounding what a 'Brexit' would mean but is dismissive of those who claim to fully understand the implications.

"I have as much confidence in claiming I know how many grains of sand there are in the Gobi desert as I do in asserting what the net cost to the UK might be were it to decamp the EU," said Toscafund chief economist Savvas Savouri, a view based on the unknown degree of isolation that a 'Brexit' would involve.

However, several short-term outcomes would be more likely than others until clarity emerged. In addition to a weaker Sterling, economic uncertainty may keep interest rates lower for longer, both factors that in more ordinary circumstances would be positive for the prime London property market.

London's dominance as a financial centre and its strengthening relationship with China would prove critical, Savouri argues, who believes the UK would be better off outside the EU.

"For China there is no plausible alternative and neither Frankfurt or New York will beat London for this hugely important and lucrative role."

He believes, however, that the likely result will be to remain in the EU. "My hunch is based on old fashioned human nature to opt for continuity over uncertainty."

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