PRIME CENTRAL LONDON RENTAL INDEX

FALLING OIL PRICE AND RISING STOCK DAMPEN RENTAL GROWTH IN PRIME CENTRAL LONDON

Global economic events and a supply increase have weighed on rental value growth in the prime central London lettings market, says Tom Bill

January 2016

Rental values declined -0.3% in January, meaning **annual growth eased to 0.2%**

Tenancies agreed, new prospective tenants and viewings **rose 5.6%, 4.8% and 2.8%, respectively, in 2015**

Global economic events sent UK profit warnings to a seven-year high in 2015, which has weighed on tenant demand

Average prime gross yields were **flat at 2.92%**

Macro View: The falling oil price and London property

Two factors dominated the fortunes of the prime central London lettings market at the start of 2016.

First, a succession of tax changes in the sales market has raised transaction costs and heightened buyer uncertainty over the outlook for price growth, which has boosted demand for rental property.

As a result, the number of tenancies agreed, new prospective tenants and viewings rose 5.6%, 4.8% and 2.8%, respectively, in 2015 compared to 2014.

However, this uncertainty in the sales market has also boosted supply as more vendors decide to let their property until the implications of the tax changes become clearer, which has weighed on rental value growth.

The second factor influencing the lettings market is the volatile global economic backdrop, including the slowdown in China, the falling oil price and interest rate risk.

As companies curb costs and continue to reduce headcount, the result has been a decline in demand, in particular from the financial services sector.

To demonstrate the impact of global events on the UK's own relatively strong economy, accountant EY reported in January that profit warnings from UK companies hit a seven-year high in 2015.

So, while demand has grown, it has been outweighed by global economic events and a supply increase. The result is that annual rental value growth has declined steadily from a three-year high of 4.2% in May 2015.

The trend for more vendors becoming landlords has been particularly marked in recent weeks as decisions are taken at the start of the year.

Rental values declined -0.3% in January, which meant annual growth fell to 0.2%, the lowest rate since June 2014. Gross rental yields were flat at 2.92%, having grown marginally from 2.8% over the last 18 months.

However, demand remains strong at the super-prime level of £5,000-plus per week, largely as a result of higher rates of stamp duty. The number of super-prime rental deals rose 10% in 2015 versus 2014.

The stamp duty on the purchase of a £15 million property is about £1.7 million, which is the equivalent of more than three years in rent.

TOM BILL
Head of London Residential Research

"While demand has grown, it has been outweighed by global economic events and a supply increase."

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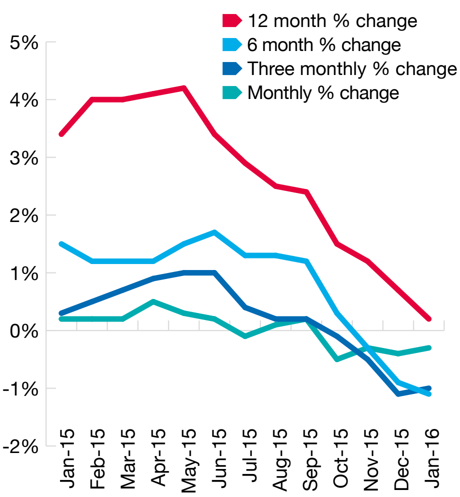
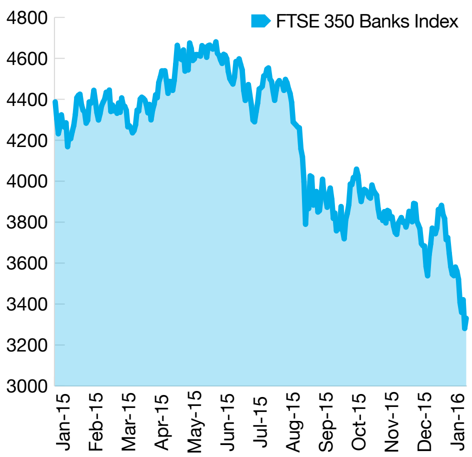
FIGURE 1
Rental value growth in prime central London



Source: Knight Frank Residential Research

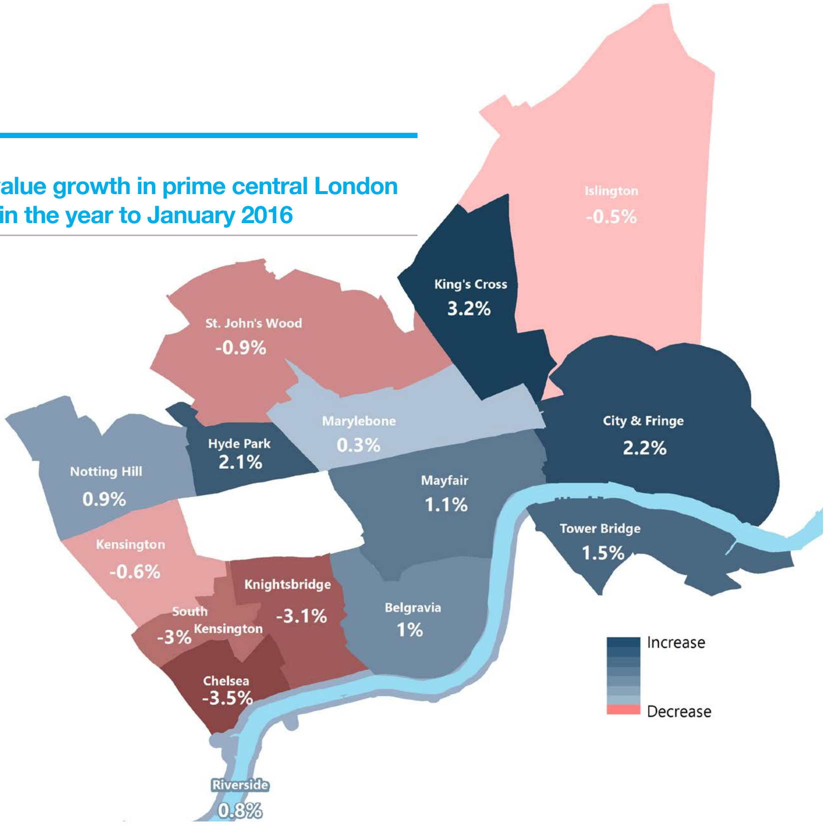
FIGURE 2
Banks under pressure
Bank share price since January 2015



Source: Knight Frank Residential Research

FIGURE 3

Rental value growth in prime central London by area in the year to January 2016



DATA DIGEST

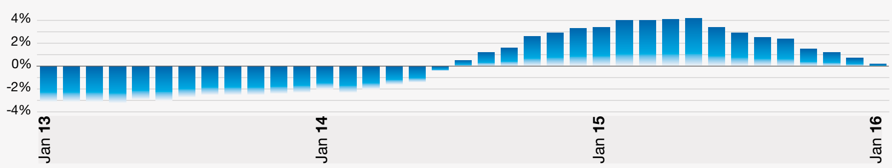
The Knight Frank Prime Central London Index, established in 1995 is the most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks rental values of prime central London residential property. 'Prime central London'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

Prime Central London Index | **174.6**

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



THE OIL PRICE DECLINE AND PROPERTY MARKETS

At the World Economic Forum in Davos, the chairman of Saudi Arabia's state oil company said the current price of about $30 per barrel was "irrational " and would recover in 2016.

However, the world's largest oil exporter said it would not cut production unilaterally, highlighting the complex dynamics that exist between oil producing countries that some believe will keep prices lower for longer.

Saudi and other oil exporters have created a supply glut to fend off competition from the shale gas industry and Alp Eke, chief economist at National Bank of Abu Dhabi, believes the oil price won't hit $70 per barrel again until 2020.

"I can't see the good old days of $100 per barrel for even longer than that," he told Knight Frank. "Iraq is rebuilding so won't cut production and now Iran is free to export after the sanctions were lifted. The ability of the Saudis to influence the oil price is decreasing. Even if they cut Iran won't match it."

There are two significant implications for property markets.

First, a lower oil price will keep inflation in check, which will delay the moment the Bank of England raises interest rates, supporting demand for mortgages.

Second, while some institutional capital is returning to or remaining in the Middle East to support the local economies, private individuals are more likely to buy property and other asset classes outside the region due to longer-term concerns about what the falling oil price may mean.

"The oil price is the number one cause of anxiety in the GCC region," said Eke. "Assets will be depleted and governments will introduce austerity measures and consider taxation," he said.

This trend for outflows of private capital has parallels with what has taken place in China, with the Institute of International Finance reporting in January that outflows from China and emerging markets were larger than anticipated due to concerns over the country's economic slowdown and outlook for the stock market.

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