RESIDENTIAL RESEARCH

PRIME CENTRAL LONDON RENTAL INDEX

This report analyses the performance of single-unit rental properties in the second-hand prime central London market between £500 and £5,000-plus per week. For an analysis of the build-to-rent market and the institutional private rented sector in London and the rest of the UK, please see our Private Rented Sector Update report here.

TENANTS RETAIN CONTROL IN THE PRIME CENTRAL LONDON LETTINGS MARKET

High stock levels mean rental values continued to decline in October but there are signs the balance is beginning to self-correct, says Tom Bill

October 2016

The number of tenancies agreed rose 25% year-on-year in the three months to September

Annual rental value growth fell to -4.9% in October

Number of new lettings properties on the market rose 27% year-on-year between January and September

Prime gross rental **yield was 3.1%**

Macro View: The foreign exchange market since Brexit

The number of tenancies agreed in prime central London in the three months to September increased by 25% year-on-year.

However, while more transactions have taken place, rental values have fallen every month for the last year and annual growth declined to -4.9% in October. This is as a result of markedly higher stock levels.

The number of new lettings properties coming onto the market rose 29% over the same three-month period and there was a 27% year-on-year increase between January and September.

Demand has not been rising at the same pace, as figure 2 shows, which underlines the extent to which prime central London is a tenants' market.

Higher stock levels are the result of uncertainty over the short-term prospects for price growth in the sales market, which has led more vendors to let their properties.

However, the flow of stock from the sales to the lettings market is not entirely one-way. As rental values decline and ahead of cuts to tax relief next year, a small number of landlords have begun to explore a sale. It is an early indication of how the lettings market may self-correct, supporting rental values as stock levels reduce.

Higher stock has had another effect. With more properties on the lettings market that were originally destined for sale, landlords have to increasingly ensure their properties are refurbished to a high standard to prevent void periods.

Demand in the super-prime market (£5,000-plus per week) remained strong in October due to higher levels of stamp duty in the sales market. Similarly, demand below about £1,500 per week also remained robust

The performance of middle segment, which is typically driven by senior executives, remains patchier. As figure 4 shows, it is where the steepest rental value declines have been registered. In areas including Chelsea it has had the effect of boosting activity, while demand remains slow in other areas.

The trend has also increased demand in markets like Mayfair, where rental values have started to look relatively better value.

TOM BILL
Head of London Residential Research

"As rental values decline and ahead of cuts to tax relief next year, a small number of landlords have begun to explore a sale. It is an early indication of how the lettings market may self-correct, supporting rental values as stock levels reduce"

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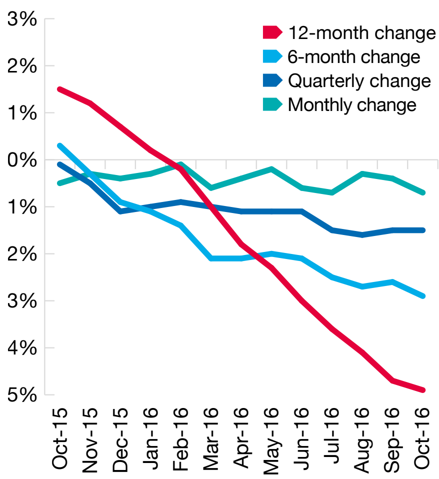
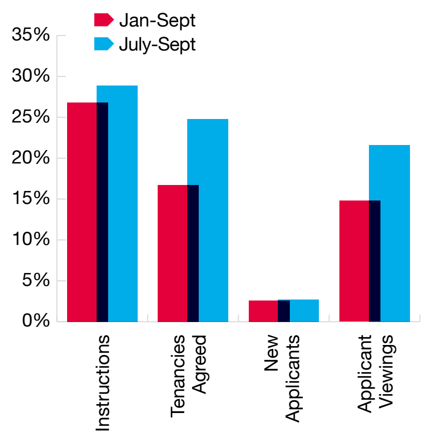
FIGURE 1
Rental value growth in prime central London



Source: Knight Frank Research

FIGURE 2
Supply and demand grow in the lettings market
Year-on-year changes, 2016 versus 2015



Source: Knight Frank Research

For the latest news, views and analysis on the world of prime property, visit Global Briefing or @kfglobalbrief

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

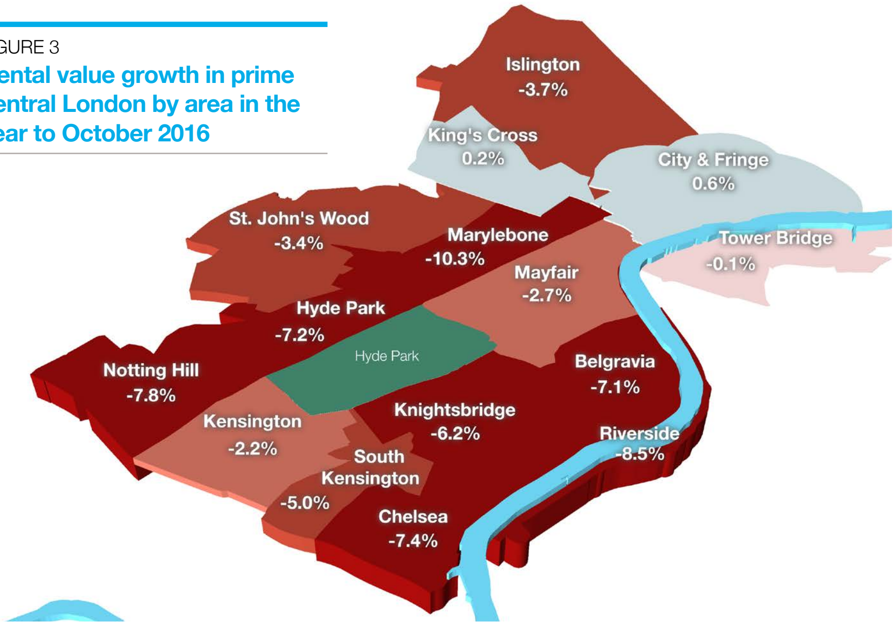


FIGURE 4
Rental value growth in prime central London by price bracket and property type

Prime Central London Index **167.7**

	£250 -£500 pw	£500 -£750 pw	£750 -£1,00 pw	£1,000 -£1,500 pw	£1,500 - £2,000 pw	£2,000+ pw	Flat	House
1 month	-0.4%	-0.5%	-0.4%	-1.3%	-1.1%	-0.7%	-0.6%	-1.0%
3 months	-0.4%	-1.5%	-1.0%	-2.1%	-1.7%	-1.7%	-1.2%	-2.1%
6 months	-0.7%	-2.0%	-3.4%	-4.3%	-3.2%	-3.5%	-2.4%	-4.2%
1 year	-1.1%	-2.4%	-5.3%	-8.0%	-5.4%	-6.3%	-4.2%	-6.8%
YTD	-1.0%	-2.4%	-4.3%	-6.9%	-5.0%	-5.4%	-3.7%	-5.9%

THE FOREIGN EXCHANGE MARKET SINCE BREXIT

Sterling has weakened by more than 15% versus the US dollar since the EU referendum, boosting the interest of buyers denominated in overseas currencies.

The decline has had a more modest impact on the number of transactions for two reasons.

First, part of the demand is opportunistic in nature, based on an erroneous belief that the decision to leave the EU has triggered sudden price declines across prime central London. This has caused some buyers to seek double-digit price reductions on top of a favourable double-digit currency swing, to which vendors are resistant.

As we have discussed here before, higher rates of stamp duty are the biggest influence on pricing and demand and the referendum result should be seen in that context.

The second reason that the decline in Sterling has not had a more marked impact is that some buyers are anticipating further currency weakness.

The current high levels of volatility in the Sterling/Dollar exchange rate, which now moves following interventions by key politicians, underline the risks of this strategy.

Savvas Savouri, chief economist at asset manager Toscafund believes buyers should think longer-term. "For anyone planning to be cute on currency with a property purchase, I would suggest there is no way on earth the pound will be as low as it is today in two years' time," he said.

Furthermore, Savouri believes London will remain a significant financial services centre after Brexit. "Nobody is suggesting there won't be satellite offices opening in the EU but I would argue that entirely new firms will more than fill whatever space is vacated, for the most part these will arrive from far outside the EU.

"They will have ambitions to operate from London not as some Trojan Horse to enter continental Europe, but as a secondary-hub to complement their operations in their domestic markets, from Singapore and Sydney to Sao Paolo and Shanghai. They will, in short, not give a hoot about passporting rights."

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.

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