RESIDENTIAL RESEARCH

PRIME CENTRAL LONDON RENTAL INDEX

FINANCIAL MARKET NERVES DAMPEN TENANT DEMAND IN PRIME CENTRAL LONDON

Jitters over the Chinese economy and higher stock levels have led to a decline in rental value growth, says Tom Bill

AUGUST 2015

Annual rental value growth **fell to 2.5% in August**

Quarterly growth was 0.2%, the **lowest three-month change since April 2014**

Prime gross yields **edged up to 2.96%**

New applicants fell by 15% compared to 2014

Rental stock levels rose as vendors wait for stronger price performance

Macro View: Chinese currency and stock market nerves

Annual rental value growth in prime central London fell to 2.5% in August as demand remained subdued over the summer holiday period and stock levels stayed high.

A significant proportion of tenant demand in prime central London derives from companies, in particular financial services, and volatile global stock markets continued to affect sentiment in August.

Rental values rose 0.1% from July, however quarterly growth was 0.2%, the lowest three-month change since April 2014. Prime gross rental yields edged back up to 2.96% from 2.95% in July.

There is a correlation between rental values in prime central London and the performance of the FTSE 100, as figure 2 shows.

The recent stock market dip has been due to concerns over the state of the Chinese economy, with weak manufacturing data and the recent devaluation of the Yuan increasing nerves.

Despite the recent volatility, the devaluation should be seen in its historical context and China has several levers it can pull in an attempt to calm stock market falls that aren't necessarily a reflection of its underlying economic health, as we analyse in the Macro View section on page 2.

The result is more subdued corporate activity and fewer relocation agents currently active in prime central London.

Typically, new tenancies in recent weeks have been UK-based families that are moving from one neighbourhood of London to another.

In the three months to July this year, the number of new applicants fell by 15% compared to the same period in 2014, while viewing levels were down 12.6% and the number of tenancies agreed declined by 12.1%.

Meanwhile, the rentals market is still affected by distortions in the sales market following the general election.

Some vendors have delayed selling and are exploring the rental option as they wait for stronger house price growth to return after a stamp duty increase in December for properties worth more than £1.1 million dampened growth.

The result is more rental stock on the market, which has led to prospective tenants making offers on multiple properties, meaning deals are harder to finalise.

TOM BILL

Head of London Residential Research

"Some vendors have delayed selling and are exploring the rental option as they wait for stronger house price growth to return"

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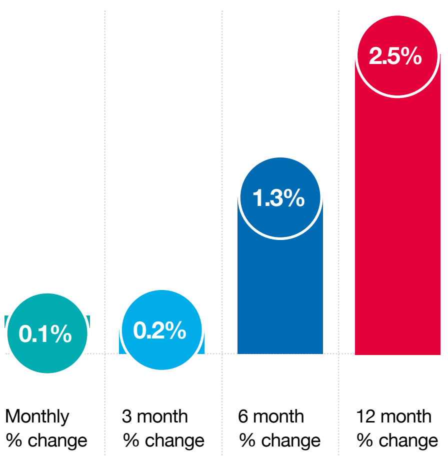
FIGURE 1

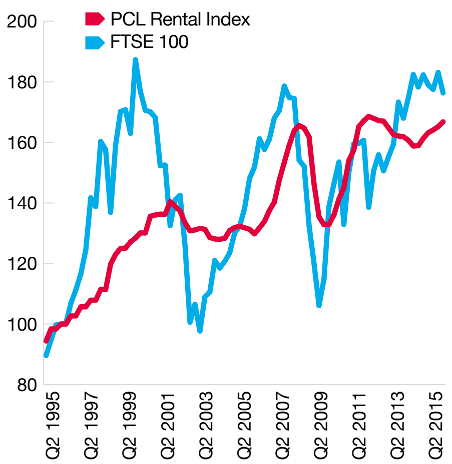
Rental value growth in prime central London



Source: Knight Frank Residential Research

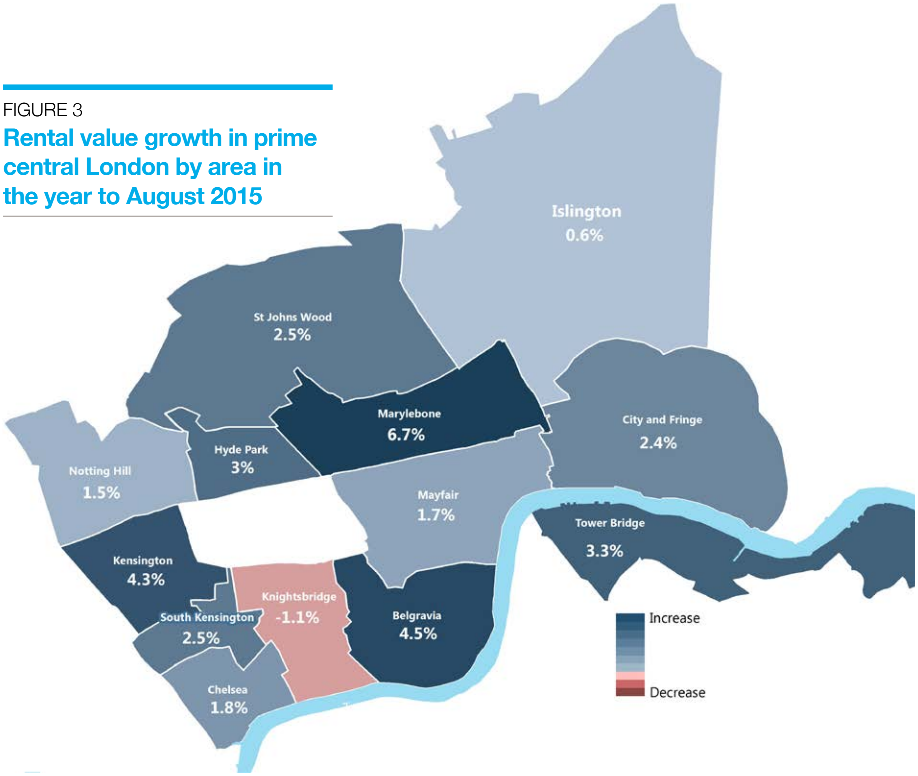
FIGURE 2

Rental value growth tracks FTSE100



Source: Knight Frank Residential Research

FIGURE 3
Rental value growth in prime central London by area in the year to August 2015



DATA DIGEST

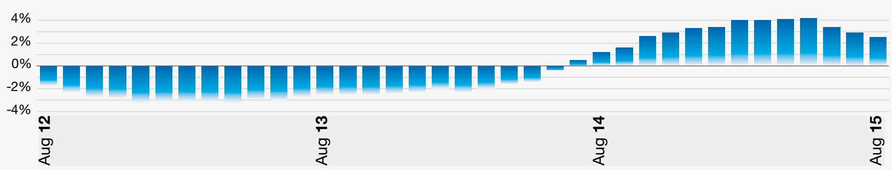
The Knight Frank Prime Central London Index, established in 1976, is the longest running and most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks capital values of prime central London residential property. 'Prime central London' is defined in the index as covering: Belgravia, Chelsea, Hyde Park, Islington, Kensington, Knightsbridge, Marylebone, Mayfair, Notting Hill, South Kensington, St John's Wood, Riverside* the City and the City Fringe. 'Prime London' comprises all areas in prime central London, as well as Barnes, Canary Wharf, Chiswick, Clapham, Fulham, Hampstead, Richmond, 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 AUGUST 2015

Prime Central London Index | **176.8**

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



China once again dominated the performance of the global economy over the last month.

This time it was the surprise devaluation of the Yuan rather than the performance of the country's stock market that caused the jitters.

It sent the price of various assets lower, including the share price of luxury goods companies, commodities and the dollar, as expectations of a rate rise by the Federal Reserve next month tempered.

The resulting sense of unease at financial institutions has contributed towards slowing rental value growth in prime central London.

Financial markets do not like surprises but an analysis of why China loosened its peg to the dollar suggests panic over the state of its economy was unlikely to have been motive.

The International Monetary Fund recently said the Yuan was overly-managed and it was reserving judgement on its inclusion in a basket of international reserve currencies, a move with long-term benefits for the Chinese economy.

"This slight will not have gone down well in Beijing," said Savvas Savouri, chief economist at asset manager Toscafund. "The timing of the IMF announcement with the move in the Yuan is no coincidence."

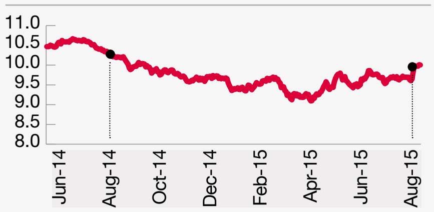
"This is a currency whose fundamentals are extremely sound and whose recent moves have been modest by comparison with its general upwards performance," he added.

Questions over the spending power of Chinese buyers in international property markets like London should be seen in the light of the currency's longer-term performance.

Though the Yuan weakened against Sterling in August, it remains stronger than it was 12 months ago, as the chart shows.

In relation to weak manufacturing data in August, Savouri said: "China's economic growth has slowed but the question is will Beijing respond and will it work? I am convinced it will and can. Interest rates are there to be cut and the falling price of oil and other resources will free up spending."

Yuan/Pound



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