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.

December 2017

An average gross yield of 3.2% in prime central London compared to a 10-year UK government bond yield of 1.2%

Average rents in prime central London fell 2.2% year-on-year in December

The number of new lettings properties coming onto the market recorded a like-for-like fall of 1.2% between January and November versus 2016

There was a 19% rise in viewings between January and November 2017 versus 2016

The number of tenancies agreed rose 14% in the first eleven months of 2017

Macroview: The political backdrop

TOM BILL
Head of London Residential Research

"In a world of low returns, the prime central London lettings market became a comparatively more attractive asset class in 2017."

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TOTAL RETURNS IN PRIME CENTRAL LONDON SET TO RISE

A combination of rising rents and capital values means total returns will improve, says Tom Bill

Average rents in prime central London fell 2.2% year-on-year in December, which was the most modest decline recorded in 21 months. Average rental values for existing homes have been falling year-on-year for more than two years due to rising supply but the pattern is now reversing.

A large spike in new lettings properties in the middle of last year, which followed the introduction of the additional rate of stamp duty in April 2016, was one of the factors behind the increase. The other key reason has been a growing number of so-called 'accidental landlords', a group of would-be vendors who are waiting for more pricing certainty before they return to the sales market.

As figure 2 shows, the rate of new lettings properties coming onto the market has slowed. Indeed, November was the first month in 2017 that recorded a year-to-date decline in the number of new lettings properties placed on the market, with a fall of 1.2%.

Demand remained stronger than last year, which will also underpin rental value growth. There was a 19% rise in viewings between January and November 2017 compared to 2016. The number of tenancies agreed rose 14% over the same period while there were 17% more new prospective tenants registering.

From an investor perspective, in a world of low returns, the prime central London lettings market became a comparatively more attractive asset class in 2017.

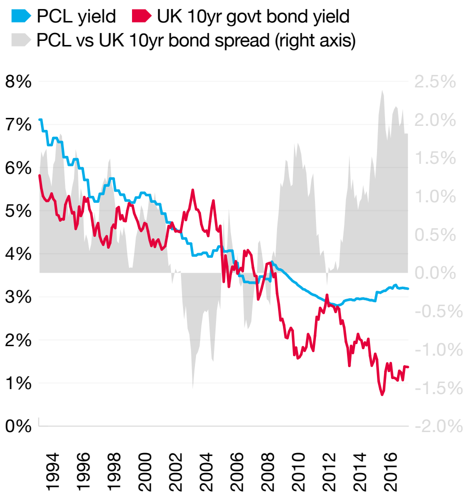
Although extra taxes have given landlords pause for thought in recent years, this has come against the backdrop of rental values that are bottoming out.

The current average gross yield in prime central London is 3.2%.

This is higher than the risk-free rate of a 10-year UK government bond, which was yielding approximately 1.2% in mid-December. Indeed the spread between the two is high by historic standards, as figure 1 shows.

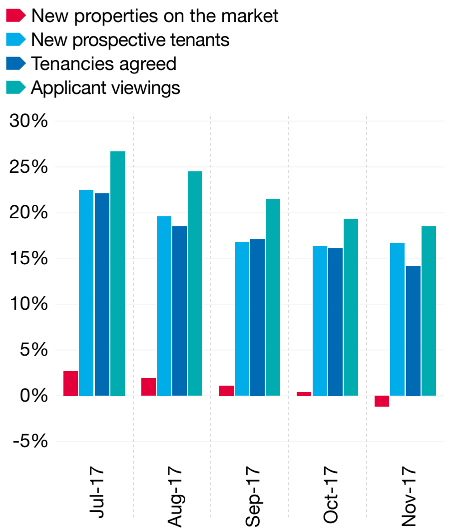
This trend looks set to continue which, combined with bottoming out sales values, will boost total returns. Despite the fact that UK inflation rose to 3.1% in December, there is no immediate likelihood of a rate rise. Indeed, subject to the usual caveats, the Bank of England expects the base rate to be 1% in 2020, which is still ultra-low by historical standards.

FIGURE 1
PCL returns look more attractive
Spread between average gross PCL yield and 10-year UK government bond yield



Source: Knight Frank Research

FIGURE 2
New demand outpaces new supply
Calendar year-to-date 2017 versus 2016



Source: Knight Frank Research

MACROVIEW | THE POLITICAL BACKDROP

News of a breakthrough in Brexit negotiations in early December meant that political uncertainty in the UK receded to some extent.

David Davis, the Secretary of State for Exiting the European Union, said the odds of the UK leaving the EU with no deal had "dropped dramatically".

Political uncertainty has not been the primary reason for the relative slowdown in sales volumes and price declines in prime central London

Tax changes have been the fundamental cause of pricing tension between buyers and sellers.

However, the political backdrop has altered the more intangible dynamic of sentiment. This, in turn, has prolonged the period over which asking prices have adjusted to higher transaction costs. Two general elections and a referendum since 2015 mean political uncertainty has played an important role.

While there would be a material impact on prime central London property markets in the event of a large-scale exodus of financial services workers from London, there are few indications this would happen.

Instead, as a greater sense of pragmatism appears to take hold in Brexit talks, it is the stability of the UK government rather than the contents of the deal that would arguably have a greater impact.

In the week following the breakthrough deal on 8 December, came a government Parliamentary defeat over the extent to which MPs will have a final say on the shape of the deal, reopening questions about how able the government will be to implement its version of Brexit.

However, it is worth noting that a version of Brexit that has the backing of a majority in Parliament may lead to a more consensual outcome that is less subject to challenge.

The indirect role played by politics perhaps explains the limited anecdotal evidence that the 8 December deal bolstered demand. Given the extended nature of Brexit talks, asking price reductions are likely to remain the key prerequisite for increasing market liquidity in 2018.

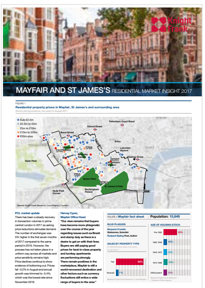
FIGURE 3

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

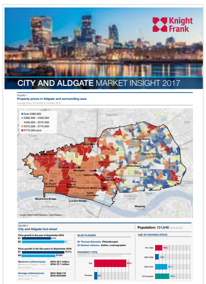
Prime Central London Index **162.6**

	£250 - £500 pw	£500 - £750 pw	£750 - £1,000 pw	£1,000 - £1,500 pw	£1,500 - £2,000 pw	£2,000+ pw	Flat	House
1 month	0.0%	0.1%	-0.2%	-0.4%	-0.2%	-0.2%	-0.1%	-0.2%
3 months	-0.8%	-0.5%	-0.3%	-1.6%	-1.2%	-0.3%	-0.6%	-0.9%
6 months	-0.8%	-0.3%	0.2%	-2.1%	-1.4%	-0.7%	-0.8%	-0.7%
1 year	-1.8%	-1.0%	-0.1%	-4.8%	-4.0%	-2.0%	-2.1%	-2.4%
YTD	-1.8%	-1.0%	-0.1%	-4.8%	-4.0%	-2.0%	-2.1%	-2.4%

Prime Central London Sales Index December 2017



Mayfair market insight 2016



City and Aldgate market insight 2017

London Review Autumn 2017

Victoria and Westminster Market insight 2017

Marylebone market insight 2016

Residential Market Update

Prime Country House Index

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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