RESIDENTIAL
RESEARCH

SUPER-PRIME COUNTRY HOUSE MARKET

Knight Frank

2012

A DIVERGING MARKET

While London prices are booming, the country house market has struggled to gain traction. Liam Bailey investigates the reasons behind this divergence.

Liam Bailey
Head of Residential Research

Prime country house prices normally start to rise around 12 months after London prices begin to take off. As we noted in our third-quarter update on the prime country house market, these are not 'normal' times.

The prime and super-prime (£5m+) country house markets have been tracking UK mainstream prices for the past two years rather than central London prices. There are three key reasons for this divergence between prime London and prime country.

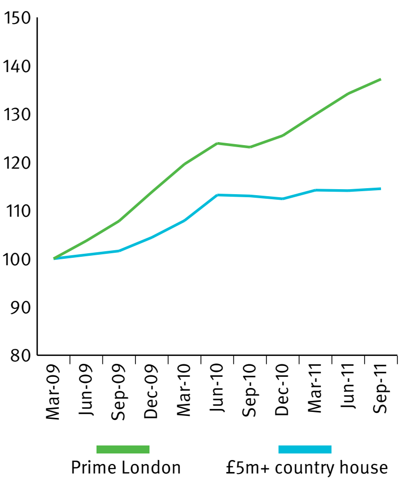
Firstly, international buyers are just not as important to the country market as they are in London. Just under 65% of £5m+ country house buyers are British, compared to barely 40% in London. This more domestic market has not been influenced by the weak pound which has super-charged the London market by drawing in buyers looking to spend their dollars and euros.

The second issue is the economy. The impact of the recession in the UK has been hugely amplified in the regions. London's economy has outperformed and businesses have focused resources on London investments – driving prime property sales in the capital.

The third consideration is vendor behaviour. The fact that the prime country house market has been relatively subdued prevented some of the best properties from coming to the market in 2010 and 2011, as discretionary vendors felt they would do well to wait for stronger conditions. These properties would have been well received by purchasers and their absence has depressed trading volumes, weakening price performance as a result.

Another aspect of vendor behaviour, which became very pronounced in 2011, has been the issue of overly ambitious pricing. A large number of properties that came to the

Figure 1
Prime market performance
Price change, indexed from March 2009



Source: Knight Frank Residential Research

Figure 2
Sales volumes
Difference in annual country house sales volumes compared to 2007

Source: Knight Frank Residential Research

> "The issue of overpricing has been as pronounced in the super-prime sector as the wider market."

market in 2010, just as the impact of low interest rates was dissipating, were priced too high and have remained on the market. As asking prices on these properties have been cut, belatedly, to more realistic levels, this process has helped to push overall prices lower over the past 12 months.

Across the whole country house market prices fell 1.2% in Q3 and are now down 1.7% since September 2010. The traditional picture of market ripples flowing out from London remains the case in some parts – prime property prices in the South East rose by 0.4% over the past year, managing to climb 11.4% from the mid-2009 trough.

For the super-prime market, excluding the best parts of Surrey, prices have been flat at best, and have probably fallen back very slightly in most cases, especially in the six months to September 2011.

The issue of overpricing has been as pronounced in the super-prime sector as the wider market, and has meant that sales volumes have been distorted as active buyers have been unable to persuade vendors to drop prices to realistic levels.

But it is dangerous to generalise across the whole of the UK – the experience in locations like Esher and Cobham is that the last 12 months have seen some of the most active conditions for the last three years, with the number of £10m+ sales at its highest for a five-year period.

The London opportunity

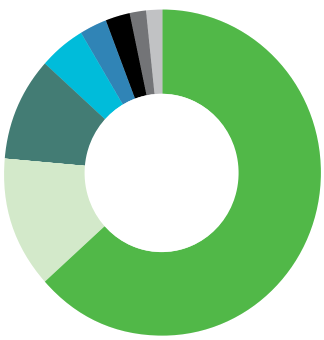
The impact of the above trends has been to see price levels in the prime and super-prime country house markets underperform London by some margin. The upside of this process is that purchasers moving out of London are seeing their money stretch much further.

For example, if you were planning on selling a £5m property in London in early 2009 and buying a similar-priced property in the country, delaying for two years until now

Figure 3

Buyer nationality

£5m+ UK country house purchaser, split by world region, 2010 and 2011



UK	63.4%
Europe	13.2%
Russia & CIS	10.1%
Middle East	4.8%
Africa	2.7%
Asia	2.5%
North America	1.8%
Australasia	1.5%

Source: Knight Frank Residential Research

Defining the super-prime country house market

It is generally accepted that the prime country house market is made up of properties priced £1m+ across the UK, a little more in the South East, and a little less in the Midlands and the North. We define the super-prime country market as that featuring properties priced £5m and above.

Within this headline definition there are three key super-prime tiers. In the £5m to £10m bracket, while properties and sales are concentrated in the South East, examples at this level are found across the UK. Excluding a rare number of prestige estate sales, the £10m to £20m bracket is dominated by areas neighbouring London. The top tier of sales, above £20m, are infrequent and are almost always located within a 45-minute drive of central London.

The typical buyer in the super-prime country house market is an average age of 48, with 44% of buyers being in their 40s, 36% in their 50s, and a perhaps surprising 13% in their 20s and 30s.

While cash buyers make up 40% of the market, compared to 32% in the sub-£5m country market, this figure is skewed as we know that many buyers will acquire a property in cash and then look to arrange a mortgage later so that they can release cash for other investments.

The typical property in this very untypical £5m+ market has seven bedrooms, five reception rooms, five bathrooms, and extends to 12,000 sq ft, with gardens, woodland and agricultural land extending to 21 acres.

SUPER-PRIME COUNTRY HOUSE MARKET

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would have seen your London property rise in value to around £6.75m and the country property rise to around £5.5m at best, leaving a cool £1.25m available for buying 200 acres of agricultural land to add to your new country pile, or for reinvesting in a weekday pad back in London.

The compelling case for buyers to shift from London, based on the above value relativities, has left most country agents surprised that they haven't seen more London buyers over the past two years. The lack of high-quality properties available in the country market to attract buyers is an issue we explore below.

Outlook

Current trends seem to point to the sluggish super-prime market continuing in 2012. Our headline forecast is for prices to fall slightly in nominal terms in the £5m+ sector, by 1%, which equates to a fall of around 5% in real terms, allowing for inflation.

Our downbeat assessment is based on an assumption that the wider UK market and economy will see more troubled times.

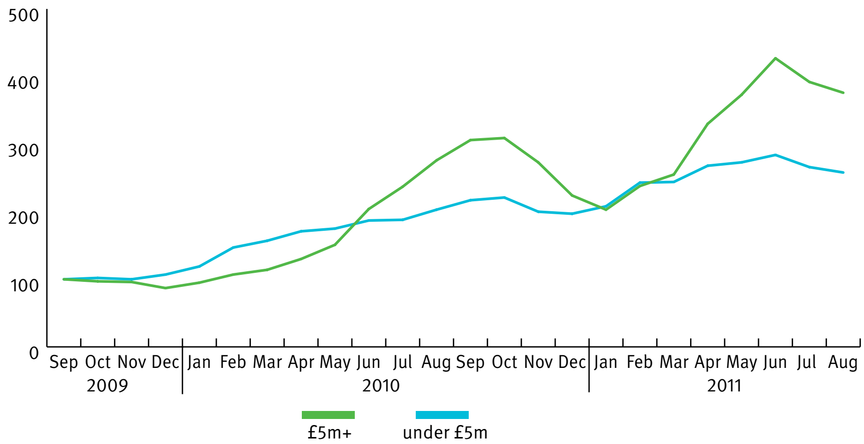
There is a strong likelihood that geo-political issues will continue to push overseas buyers into the UK, especially at the top end of the market. The forthcoming Russian election in March has already spurred increased activity from Russian buyers, and the ramifications of the Arab Spring are still not fully played out, with the strong flow of buyers from this region still looking to make investments outside their home region.

One of the reasons for our less than positive view on the country house market over the next 12 months is the likelihood that international buyers will remain in London and are unlikely to explore much further than Surrey and Berkshire.

If more international buyers decide to enter the country market we may see some modest price growth. The outlook for the pound is a central consideration in this regard. A strengthening of the pound will see some demand from overseas being choked off.

The final outcome for the euro will be very interesting in this regard. If there were a return to national currencies it is likely the pound would weaken sharply against the northern European currencies and appreciate equally sharply against the southern and peripheral currencies – the main unknown is the direction of the pound's relationship with the dollar, which will have the most significant impact on the relative competitiveness of UK property values in an international context.

Figure 4
Online demand growth
Index of UK country house property viewings on http://search.knightfrank.com, split by price band



Source: Knight Frank Residential Research

Domestic concerns will become more important over the next 12 months. Taxation, for example, is likely to become more controversial. The desire by the Conservatives to abolish the 50% income tax rate, and the call from the Liberal Democrats to introduce a new property tax, would both have a direct impact on the demand for luxury property and on price performance.

The ability of the City of London to start creating new jobs after the latest round of investment bank cuts will again directly impact on the prime and even super-prime markets in 2012.

The combination of these two issues – wealth taxes and financial sector performance – will also impact on confidence. The quicker a political settlement on London's long-term role is established, the more confident wealthy buyers will be to invest in luxury UK property.

For the moment we are still very far from the position elaborated by Peter Mandelson in the 1990s, of being "intensely relaxed about people getting filthy rich". Even when we consider the caveat that accompanied his statement: "as long as they pay their taxes", the idea that politicians today are even remotely relaxed about the first part has become increasingly debatable.

The quality issue

The main complaint from agents for the last two years has been the shortage of supply, by which they mean a shortage of the highest-quality properties. These top-end properties are not coming to market as their owners tend to be very wealthy, are under no pressure to sell and see no better asset class in which to invest at the current time.

Time and again, when high-quality properties have been offered to the market, they have sold well and often with competitive bids. It is the volume of overpriced and slightly compromised properties in the market that has acted to weaken overall market performance.

Another issue in the country market, and it is a growing one, is that buyers in the super-prime London market have become accustomed to very high specifications. In fact, the new-build and refurbishment sector in London is where the super-prime sector originated.

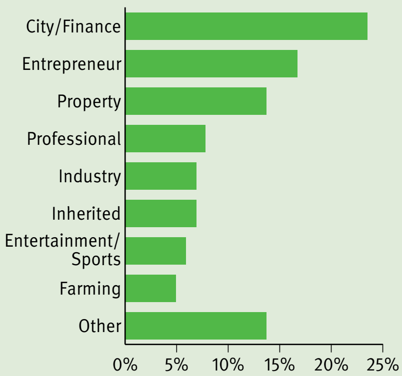
As buyers have become more exposed to the very high level of design, specification and facilities on offer at the top end of the London market, the country market has appeared by comparison to become ever more deficient in properties that match up to this.

Our view is that the country market is set for a new divide. A number of developers are working on projects which are bringing Belgravia standards of renovation or new-build into the country market. These are the properties that will outperform. They are being skillfully targeted at their international market and the difference in performance between these properties and others will become increasingly marked.

Figure 5

Where the wealth comes from

£5m+ UK country house purchaser, split by wealth source, 2010 and 2011



Source: Knight Frank Residential Research

"The volume of overpriced and slightly compromised properties weakened market performance. Our view is that the country market is set for a new divide."

Super-prime insight: Mike Spink

Spink Property is a multi-disciplinary property development company that acquires, designs, builds and project manages some of the UK's most expensive residential properties in prime locations in central London and estates between Wentworth and Oxford. Founder of the company Mike Spink discusses the "new super-prime country market", seemingly limitless budgets, and where the sector is heading.

Mike Spink
Founder, Spink Property

What changes have you witnessed in the country house market?

The demand for country property has begun to change as people's aspirations and expectations have evolved. As different business sectors and countries thrive, new sources of extreme wealth are created and new owners emerge from around the globe. It might be argued that changes of this nature have always taken place – a number of estates have, in the past, been virtually rebuilt to suit the latest fashion each time they changed hands. But what we are experiencing now appears to be a new super-prime country market.

What sub-sectors have you identified in the super-prime country market?

First there is the 'edge of London' market, where owners benefit from proximity to the M25. Good examples can be found in places like Virginia Water and Ascot. These properties are likely to be similar to those found on Bishops Avenue or in Kensington, but with more land and a secluded location. Then there is the group featuring Scottish hunting lodges, Irish equestrian estates, and traditional West Country landed estates. Only in exceptional cases would we consider these to be super-prime. The classical English country house is still in strong demand. This will typically be a fine Georgian mansion set in a farmed estate, and enhanced for field sports over generations. These tend to be purchased as second homes. Part of the charm might be the faded grandeur, understated architecture and the long history. The price could be £20m to £30m, or even more, but this is not part of the new super-prime country market.

What are the characteristics of the "new super-prime country market"?

Estates will have the style and finish of a £100m+ London house – newly created, immaculate, and offering the peace and security impossible to achieve in a city. For accessibility reasons they are most likely to be found west of London. Buyers will typically own other super-prime properties, perhaps in the South of France, in a ski resort and in a major city such as London, but they yearn for the privacy and amenities offered by a country estate. The budget might appear to be almost limitless, but there will always be an eye on value, even in the search for perfection.

How much demand is there for these properties?

Demand for the perfect modern estate is there, but they are rare commodities. Many former estates have either had their land sold off, or are blighted by road noise, public rights of way, or flight paths, and all will be dated at best. I would estimate that there are around 10 buyers at any one time with almost unlimited funds looking to buy in the countryside. They are looking for a primary residence rather than a country retreat. Some are looking to spend in the region of £50m, others up to £200m, but there is rarely anything available for them.

What does it take to create properties at this level?

Refurbishment of a listed country house, ancillary buildings and a landed estate is a time-consuming and difficult thing to do well. Even if you find a suitable property to work with, it will more often than not require a virtual rebuild to achieve the ideal accommodation arrangement, and planning permission is certainly not guaranteed. Many years could be lost in fruitless negotiations.

How long does it typically take?

Based on our experience near Henley-on-Thames, the planning and construction of an immaculate, modern country estate can easily take six or seven years and will cost many tens of millions of pounds, even when doing nearly all of the work in-house. Years could be added and costs could sky-rocket if elements such as design, planning, construction and interiors were outsourced. It would also present too many opportunities for disaster in terms of the quality of workmanship and the restricted ability to revise designs to keep pace with changes in demand, fashion and the quirks of old buildings.

What level of finish do buyers normally expect?

Some expect the property to have been created to an exacting standard, carefully and skilfully furnished down to the last Hermes cup and saucer. Many appreciate having maintenance agreements available, leaving the option for a turnkey move in, a true 'lock-up-and-go' on a grand scale.

Do you use your central London model for your country projects?

I don't see it as a model, we just do whatever is right for that project – we create a completely different specification for each property to ensure it is appropriate for its market. That said, we do tend to attract a type of buyer who is looking for a subtle, restrained architectural design, and who puts great emphasis on meticulous detailing and workmanship. We are creating homes for exacting buyers who are often the leading experts in their own field but have neither the time, nor usually the experience and expertise, to carry out the projects themselves.

Do you receive much interest from Russians? What do they look for?

Although there are clearly more Russians in the market now than before, it seems to us that their market dominance is exaggerated. In our experience, of well over 100 projects, we have only sold a few to Russians. Our buyers come from all over the world and increasingly there is more interest from the Middle East and China. I can only generalise, and Russians – like any other nationality – are individuals who place emphasis on different factors. But based on my meetings with Russian and CIS buyers, they typically put more emphasis on slick and well-engineered building services specifications, including cooling, and on immaculate interiors, as opposed to faded charm. They would also probably seek better country views and greater privacy, but accept smaller acreage than the traditional buyer. They and, say, Middle Eastern buyers, would probably prefer to be located just five minutes from a good A-road or motorway, rather than a 15-minute drive away.


Sold by Spink: an estate near Henley

Are there any other countries that offer more at this level than the UK?

In the knowledge that my clients will be looking at what's on offer elsewhere, I do monitor this, and although you can find some excellent examples outside the UK, there is no one location that stands out.

Where do you see the sector heading?

We are increasingly encouraged by the number of people who can't find what they are looking for. If it could be created, the perfect product would command a significant price. The new challenge is this: to create a piece of future heritage that incorporates the best modern technologies and offers excellent accommodation, entertaining and leisure facilities, all set in the perfect landscape, with no public footpaths, and offering total privacy. As a result of recent success we are undertaking two more country developments, including another luxury family estate in 250 acres with over 80,000 sq ft including the main house and guest houses, along with a gallery, spa and ancillary buildings.

> "Estates will have the style and finish of a £100m+ London house – newly created, immaculate, and offering the peace and security impossible to achieve in a city."

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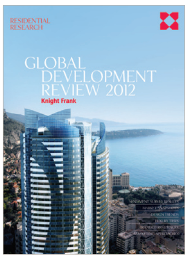

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