RESIDENTIAL RESEARCH

Knight Frank

LONDON RESIDENTIAL REVIEW

HOW THE MARKET HAS REACTED TO STAMP DUTY REFORM

AUTUMN 2015

PRIME SALES VOLUMES ANALYSIS

PRICE PERFORMANCE MAP OF LONDON

LONDON'S LATEST £1 MILLION MARKETS

KEY FINDINGS

Annual growth in prime central London declined to 1.7% in August as changes to stamp duty dampened demand

The number of £1 million-plus sales in London **declined by 21% in the year to April 2015**

New "£1 million London neighbourhoods" include **Hammersmith, Maida Vale, Queen's Park, Muswell Hill and Vauxhall**

Annual price growth in prime outer London fell to 3% in August though **activity was stronger in markets with higher levels of UK demand**

Annual rental value growth decreased to 2.5% in prime central London and 1.2% in prime outer London due to jitters over China and high stock levels

TOM BILL
Head of London Residential Research

"It was never going to be 'business as usual' in the prime London property market after the election."

FROM HEADY TO STEADY IN PRIME LONDON

Despite the general election result, it was never going to be 'business as usual' in the prime London property market, says Tom Bill

Buyers in prime London have had a lot to contemplate since May's general election.

In the days that followed the Conservative Party victory, the widely-held assumption was that normal service would resume together with double-digit annual growth.

That proposition never looked likely for several reasons.

First, the political backdrop has fundamentally changed. Despite the fact Labour lost the election and therefore the proposed 'mansion tax' fell from the agenda, the tax treatment of wealth has remained a live issue.

Seismic economic events like the sub-prime crisis produce political aftershocks and given the UK has had a prolonged period with the lowest interest rates in more than 300 years, it was never going to be 'business as usual' in the prime London property market.

One example of how the political landscape has changed is Labour's proposal to scrap the non-dom tax status of UK residents during the election campaign. The idea proved so politically popular that George Osborne revived it in his July budget.

Further evidence of increased political volatility can be found in the Labour leadership campaign, the Spanish and Greek elections and the US presidential primaries.

The second reason it was never going to be 'business as usual' is the degree to which prices and transaction costs have risen.

When George Osborne announced an increase in stamp duty for properties worth more than £1.1 million in December 2014, prices in prime central London had already risen by 52% in five years.

Though part of the rationale behind the tax changes has been political, it is also worth bearing in mind that Bank of England Governor Mark Carney described the residential property market last year as the biggest risk to the UK's long-term economic recovery.

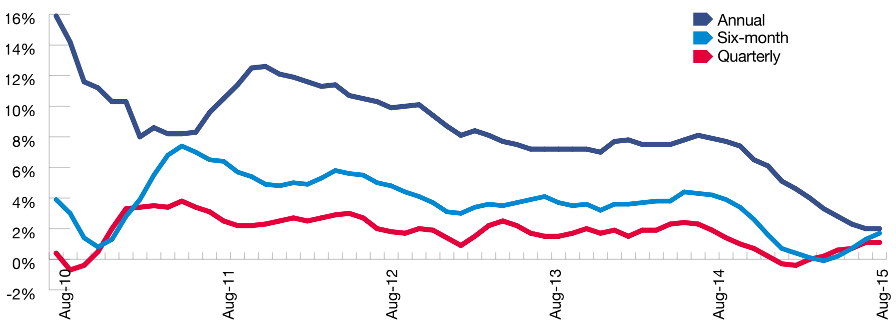
As a cooling measure, December's stamp duty rise for high-value property has succeeded. Activity levels have become more subdued, as we discuss on page 3, and annual price growth in August was 1.7%, down from 7.7% a year ago, as figure 1 shows.

All of which led to a temporary pause over the summer as buyers digested recent events.

The strength of the UK's economic recovery means demand is poised to pick up in September, a theory reinforced by the recent performance of markets more closely aligned to the UK economy (see pages 6 and 7).

For the above reasons, price growth in prime London will be steady rather than heady in the coming months.

FIGURE 1
Price growth in prime central London



Source: Knight Frank Research

Please refer to the important notice at the end of this report

STAMP DUTY RISES, SALES VOLUMES FALL

There has been a succession of tax changes affecting high-value residential property over the last few years and one of the most prominent was an increase in stamp duty for properties worth more than £1.1 million.

A Knight Frank analysis of £1 million-plus sales in London points to the impact that this change has had and raises questions over the extent to which the stamp duty increase is likely to boost overall government revenues.

The analysis, which has been adjusted for house price inflation, shows there was a 21% decline in the number of £1 million-plus sales in the year to April 2015 compared to the previous 12-month period.

As figure 3 shows, there were fewer sales every month between July 2014 and April 2015 than the previous year, with a noticeable dip after the stamp duty changes in December.

There was also a dip in April 2015 ahead of May's general election, which is partly explained by political uncertainty and the prospect of a 'mansion tax' on properties worth more than £2 million.

Knight Frank sales data for the prime London market indicates there has been a moderate pick-up in the second quarter of the year, though figures remain down on what was a strong Q2 in 2014, as figure 2 shows. In similar fashion to 2014, there was a seasonal dip in July though we expect momentum to increase from September in the way it failed to last year as the election moved onto the agenda.

Indicative figures for housing transactions in England and Wales for the first quarter of 2015 show the extent to which high-value property transactions in London make a growing contribution to stamp duty revenues, in contrast to the volume of deals.

Although London accounted for 13% of all transactions in the first quarter of this year, it contributed 46.9% of stamp duty revenue, up from 43.4% in the same period in 2014 under the old system. Meanwhile, properties worth in excess of £1 million in London accounted for 1% of deals in England and Wales but the revenue contribution has increased to 25.8% from 19.8% last year.

The increase came despite the fact overall stamp duty revenue in England and Wales was down 16% in the first quarter of 2015 compared to last year. The government has instead based its forecast for stamp duty revenue growth on future house price inflation.

The map in figure 4 shows where £1 million-plus sales have increased and decreased over the last year.

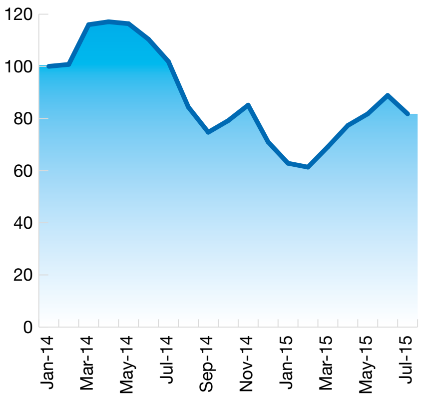
While the changes have been less marked in outer areas, the darker blue areas show the greater impact on prime central London.

However, it is noteworthy that the largest increases have also been in central London, in particular in Victoria, Paddington, Hammersmith, West Kensington and Vauxhall, with rises too in Battersea and Clapham.

This can be explained by two factors. First, the markets on the periphery of central London have benefitted as buyers expand their search in more affordable areas.

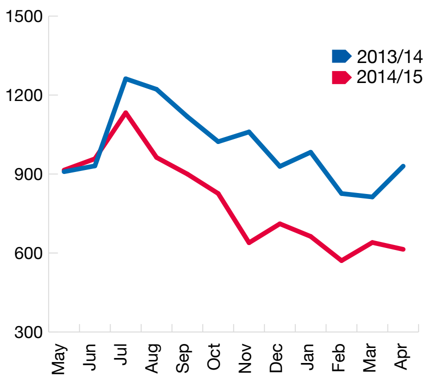
Second, most are also areas with high-quality new-build developments, which demonstrates the strength of demand for the best quality properties and amenities and a less narrow focus on the best London postcodes.

FIGURE 2
Prime London sales volumes decline
(All prices, three-month rolling average, rebased to 100)



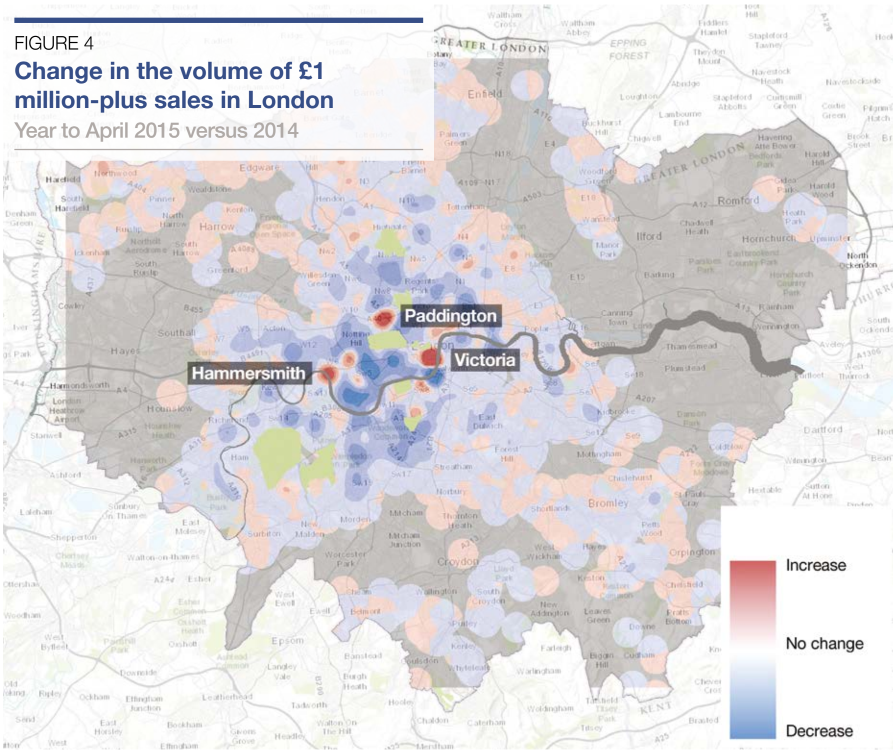
Source: Knight Frank Research

FIGURE 3
£1 million-plus sales in London



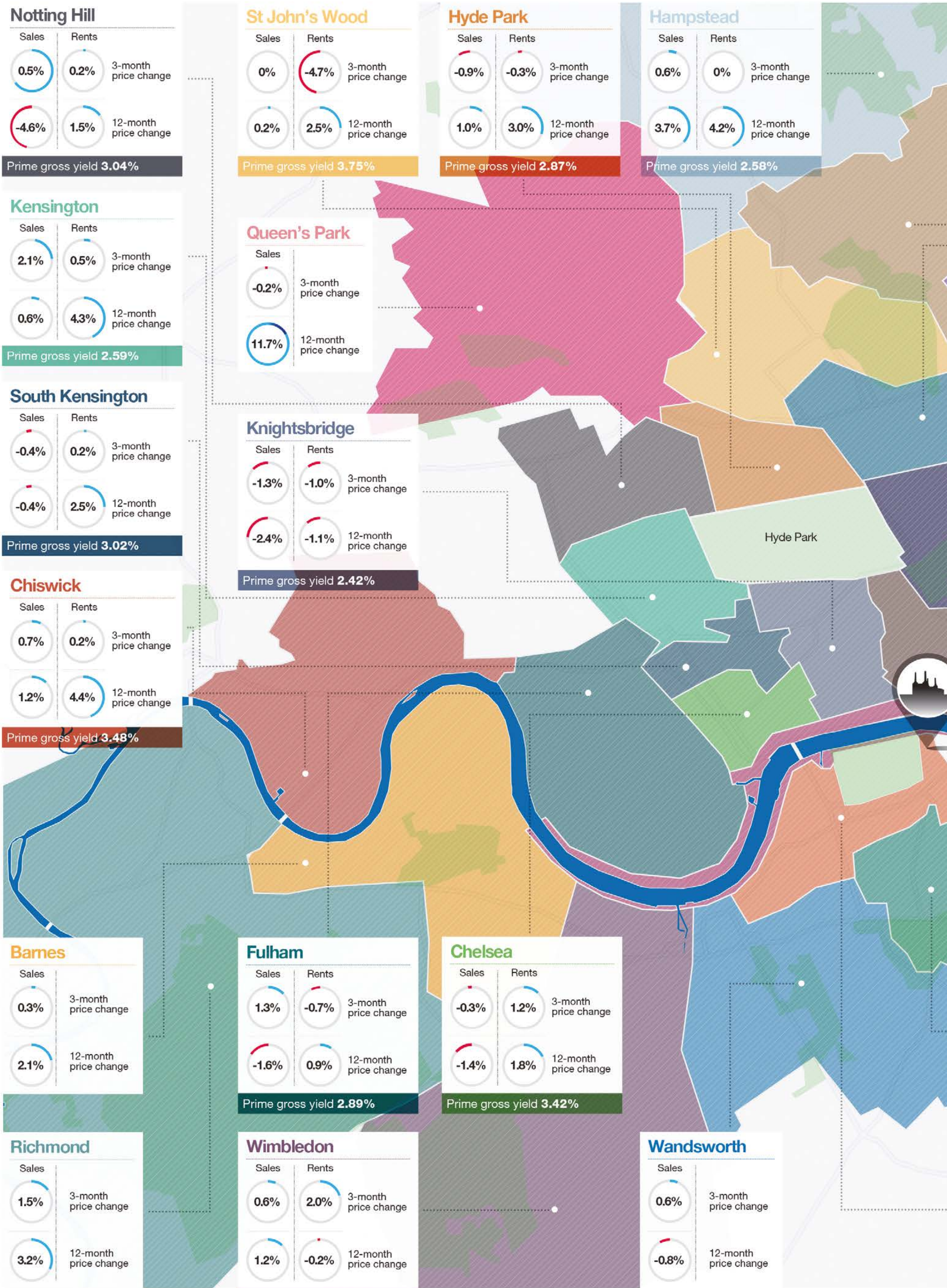
Source: Knight Frank Research / Land Registry

FIGURE 4
Change in the volume of £1 million-plus sales in London
Year to April 2015 versus 2014



Source: Knight Frank Research

PRIME LONDON VALUES SNAPSHOT, AUGUST **2015**



Notting Hill

	Sales	Rents
3-month price change	0.5%	0.2%
12-month price change	-4.6%	1.5%

Prime gross yield **3.04%**

St John's Wood

	Sales	Rents
3-month price change	0%	-4.7%
12-month price change	0.2%	2.5%

Prime gross yield **3.75%**

Hyde Park

	Sales	Rents
3-month price change	-0.9%	-0.3%
12-month price change	1.0%	3.0%

Prime gross yield **2.87%**

Hampstead

	Sales	Rents
3-month price change	0.6%	0%
12-month price change	3.7%	4.2%

Prime gross yield **2.58%**

Kensington

	Sales	Rents
3-month price change	2.1%	0.5%
12-month price change	0.6%	4.3%

Prime gross yield **2.59%**

Queen's Park

	Sales
3-month price change	-0.2%
12-month price change	11.7%

South Kensington

	Sales	Rents
3-month price change	-0.4%	0.2%
12-month price change	-0.4%	2.5%

Prime gross yield **3.02%**

Knightsbridge

	Sales	Rents
3-month price change	-1.3%	-1.0%
12-month price change	-2.4%	-1.1%

Prime gross yield **2.42%**

Chiswick

	Sales	Rents
3-month price change	0.7%	0.2%
12-month price change	1.2%	4.4%

Prime gross yield **3.48%**

Barnes

	Sales
3-month price change	0.3%
12-month price change	2.1%

Fulham

	Sales	Rents
3-month price change	1.3%	-0.7%
12-month price change	-1.6%	0.9%

Prime gross yield **2.89%**

Chelsea

	Sales	Rents
3-month price change	-0.3%	1.2%
12-month price change	-1.4%	1.8%

Prime gross yield **3.42%**

Richmond

	Sales
3-month price change	1.5%
12-month price change	3.2%

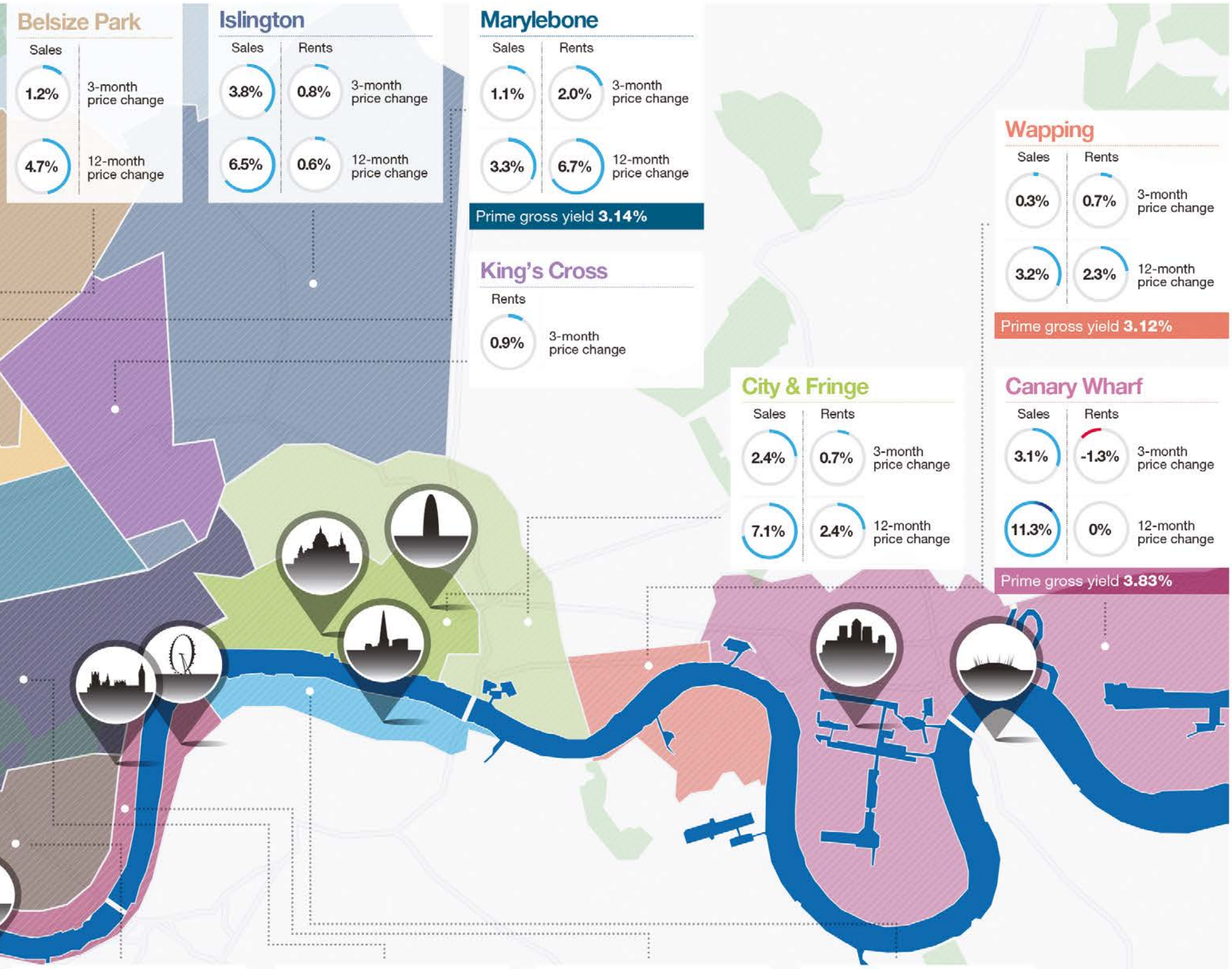
Wimbledon

	Sales	Rents
3-month price change	0.6%	2.0%
12-month price change	1.2%	-0.2%

Prime gross yield **4.42%**

Wandsworth

	Sales
3-month price change	0.6%
12-month price change	-0.8%



Belsize Park

	Sales
3-month price change	1.2%
12-month price change	4.7%

Islington

	Sales	Rents
3-month price change	3.8%	0.8%
12-month price change	6.5%	0.6%

Marylebone

	Sales	Rents
3-month price change	1.1%	2.0%
12-month price change	3.3%	6.7%

Prime gross yield **3.14%**

King's Cross

	Rents
3-month price change	0.9%

Wapping

	Sales	Rents
3-month price change	0.3%	0.7%
12-month price change	3.2%	2.3%

Prime gross yield **3.12%**

City & Fringe

	Sales	Rents
3-month price change	2.4%	0.7%
12-month price change	7.1%	2.4%

Canary Wharf

	Sales	Rents
3-month price change	3.1%	-1.3%
12-month price change	11.3%	0%

Prime gross yield **3.83%**

Belgravia

	Sales	Rents
3-month price change	0%	0.8%
12-month price change	0.9%	4.5%

Prime gross yield **2.87%**

Mayfair

	Sales	Rents
3-month price change	1.0%	0.5%
12-month price change	3.2%	1.7%

Prime gross yield **2.02%**

Riverside

	Sales	Rents
3-month price change	2.8%	-0.2%
12-month price change	9.3%	-0.2%

Prime gross yield **3.23%**

South Bank

	Sales
3-month price change	0.7%
12-month price change	2.7%

Prime gross yield **3.22%**

Clapham

	Sales	Rents
3-month price change	-0.1%	0.6%
12-month price change	-1.5%	1.0%

Prime gross yield **3.37%**

Battersea

	Sales	Rents
3-month price change	1.4%	-0.1%
12-month price change	4.3%	-1.3%

Prime central london

	Sales	Rents
3-month change	0.8%	0.2%
12-month change	1.7%	2.5%

Prime gross yield **2.96%**

Prime outer london

	Sales	Rents
3-month change	1.0%	0.1%
12-month change	3.0%	1.3%

Prime gross yield **3.42%**

SUB-£2 MILLION LONDON MARKET INSIGHT

It was 12 months ago that the general election began to make its impact felt on the prime London property market, with activity and price growth becoming more subdued from summer 2014.

In December, there came a surprise increase in stamp duty for properties worth more than £1.1 million, which dampened demand further.

Though it has been an unsettled 12 months, the sub-£2 million market has been more immune to recent political and economic events, particularly as this price bracket sat beneath the threshold for the proposed 'mansion tax'.

This market is more closely linked to domestic UK demand and the health of the country's economy and it is easy to forget the fact the recovery has been stronger than many predicted, underlined by strong GDP data in July.

In a further recent sign of the improving outlook, cash bonuses in the 2014/15 financial year were up 2.7% on the previous year and just 0.1% below their record level in 2007/08.

The result is that price growth below £1 million and between £1 million and £2 million has been stronger than the average in prime central London and prime outer London, as figure 5 shows.

Properties below £1 million grew 17.5% in prime central London and 21.3% in prime outer London in the two years to August 2015, compared to the respective averages of 9.5% and 15.1%.

Between £1 million and £2 million, prices grew 15.7% in prime central London and 18.5% in prime outer London over the same period.

Demand has also held up better for sub-£2 million properties since December's increase in stamp duty.

There were 3.6% more viewings in the sub-£2 million level in prime London between January and July this year compared to 2014 while there were 10% less at above £2 million.

Demand for London property at below £2 million is set to remain strong, with the city's population forecast to grow by more than 100,000 every year for the next decade.

As house prices grow across London, it will create new markets where properties cross the £1 million threshold.

The map in figure 6 shows the London neighbourhoods that have recently entered the £1 million price bracket.

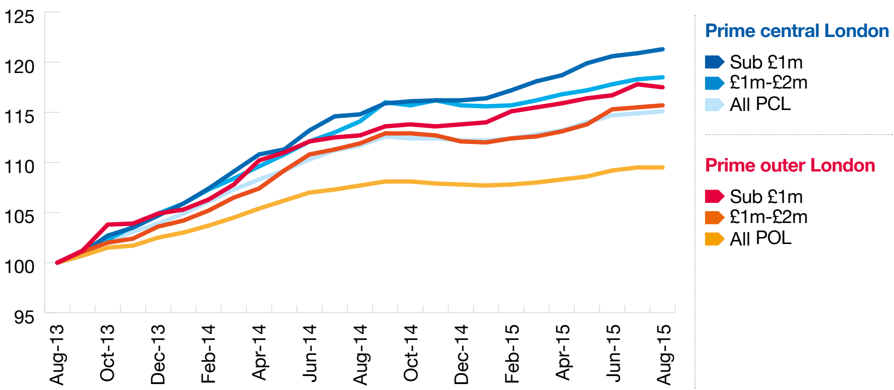
The analysis is based on postcode districts where at least 20% of sales have been above £1 million in at least one quarter since the start of 2014. The minimum threshold was five sales and no postcode district was allowed to have more than one quarter with 20% of sales above £1 million before 2014. The blue areas are existing £1 million markets and the red areas are the new districts.

Hammersmith (W6) had five such quarters since 2014, making it the area that has undergone the biggest transformation in terms of £1 million-plus sales.

Other areas include Maida Vale (W9), Queen's Park (NW6), East Finchley (N2) and Muswell Hill (N10). Further south, Battersea (SW11) and Vauxhall (SW8) have consolidated their positions as £1 million markets.

FIGURE 5

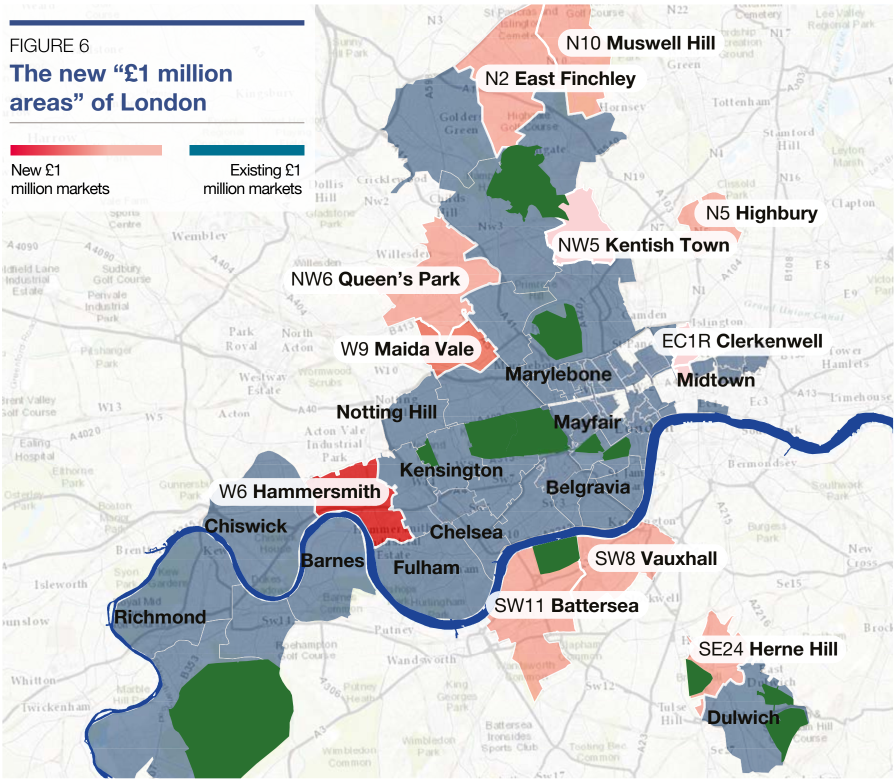
Price growth below £2 million outperforms the wider market (rebased to 100)



Source: Knight Frank Research

FIGURE 6

The new "£1 million areas" of London



Source: Knight Frank Research

PRIME OUTER LONDON MARKET UPDATE

Price growth in prime outer London slowed to 3% in August as buyers remained cautious following the May general election and a rise in stamp duty at the end of 2014.

Following an eventful start to the year, buyers are processing the implications of a majority Conservative government and the increase in stamp duty for properties worth more than £1.1 million, which means some buyers have not rushed to act over the summer.

This is particularly true in higher price brackets, where buyers typically have a global perspective and have been watching financial markets in recent weeks as they react to events in China.

The FTSE 100 dipped below 6,000 in August as a result of weak Chinese manufacturing data and its recent currency devaluation.

However, it is not a consistent picture and UK economic growth is recovering strongly, prompting the Confederation of British Industry to upgrade its forecast in August based on strong household spending.

Indeed, activity in London markets where domestic demand is typically higher, such as the south-west, has been relatively higher in recent months, also driven by a trend of central London buyers looking further afield for value in areas like Barnes and Chiswick. There have even been some instances of sealed bids in markets including Richmond.

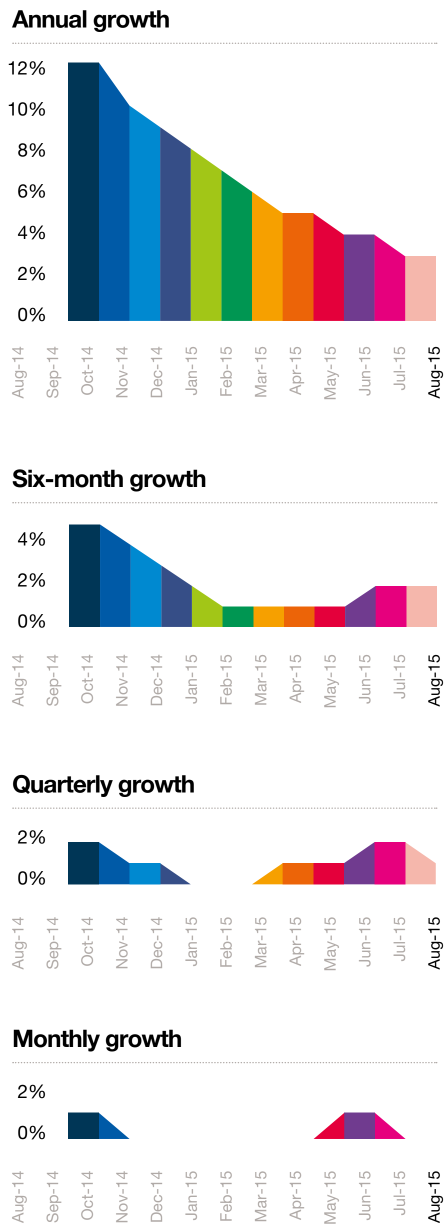
This trend for UK economic buoyancy driving demand was also underlined by Hometrack figures in August showing the highest quarterly rise in 11 years in UK cities, mainly resulting from growth in south-east England markets like Oxford and Cambridge.

In Belsize Park, where demand is strong from buyers in the media and arts, there have also been cases of sealed bids for the best properties though some nervousness remains above £6 million. Elsewhere in north London, international jitters have dampened demand at the top end of the Hampstead market, while Queen's Park has benefitted from buyers seeking better value beyond the centre in the same way as south-west London.

Demand for second-hand stock has been subdued in Canary Wharf in east London due to the fact a lot of demand has been absorbed by recent new-build launches. On top of that, the predominance of bankers means demand has remained subdued over the summer months.

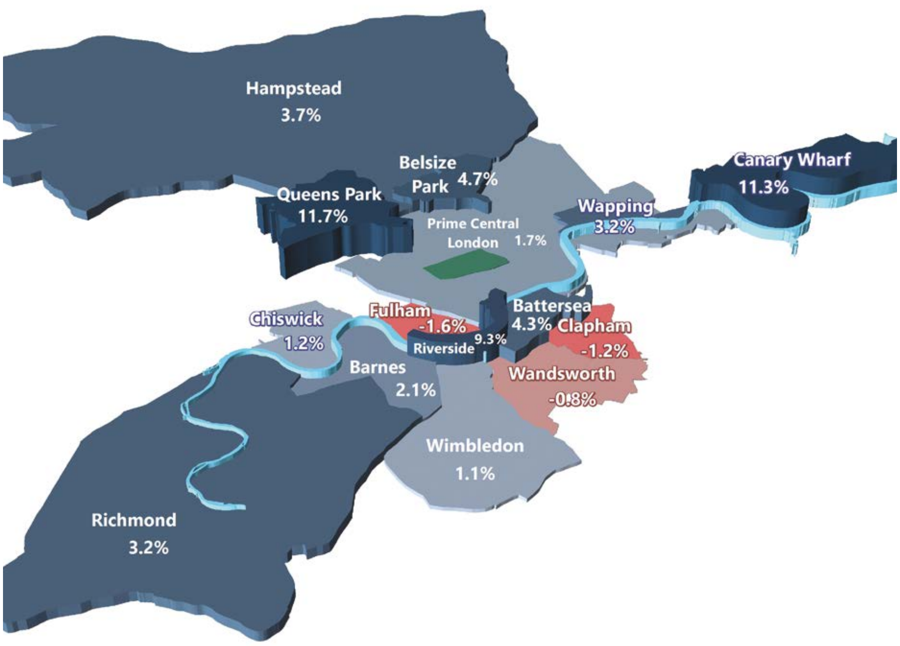
The positive UK economic data and the relative performance of markets underpinned by domestic demand in recent months gives grounds for optimism that activity in the second half of the year will exceed that recorded in first six months.

FIGURE 7
Price growth in prime outer London



Source: Knight Frank Research

FIGURE 8
Annual price growth in prime outer London in August 2015



Source: Knight Frank Research

RENTAL AND INVESTMENT MARKET FOCUS

In similar fashion to the sales market, a period of greater stability appears to be on the horizon in the prime London lettings market as the UK economic recovery takes hold.

However, in recent months there has been a degree of short-term uncertainty due to anxiety in global financial markets and the repercussions of more subdued activity in the sales market.

Tenant demand in the prime London lettings market has traditionally been strong from the financial services sector and optimism among bankers fell sharply in the second quarter of 2015, according to a CBI/PWC survey.

Continued regulatory uncertainty means banks are scaling back spending plans and nervousness surrounds a possible UK exit from the EU, the recent Greek crisis and Chinese stock market and currency volatility.

As a measure of this, the FTSE 350 banks index in mid-August was 5.3% down on 2014 and 15.5% versus 2013.

After climbing to a three-year high of 4.2% in the run-up to May's general election as demand moved across from the sales market, annual rental value growth in prime central London has fallen steadily to 2.5% in August.

Similarly, annual rental value growth in prime outer London fell from a three-year high of 2.1% in May to 1.2% in August.

Despite the recent erratic performance, there are grounds for optimism and there have been signs of activity strengthening in early September. The strength of the UK's recovery was underlined by GDP figures released in July that showed per capita output was back to pre-crisis levels.

It is also easy to overlook the fact the UK's recovery is stronger and has come sooner than many expected, and the appeal of London as a financial centre is growing.

Chancellor George Osborne plans to reduce the bank levy and, in a potentially significant move, Brevan Howard, one of world's largest hedge funds, is reportedly moving senior traders back from Geneva to London.

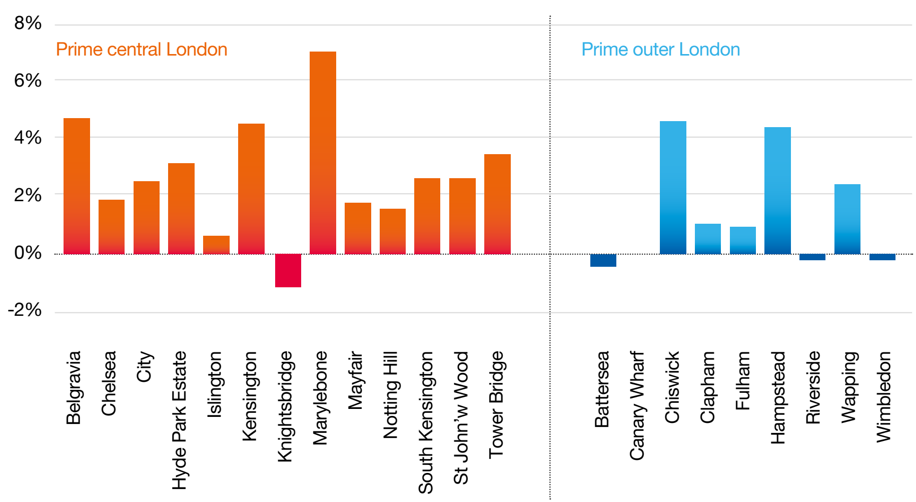
Another factor influencing the rentals market is that stock levels have increased due to the restrained sales market, which is digesting a rise in stamp duty for properties worth more than £1.1 million.

As annual price growth has slowed to less than 2% for the first time in almost six years, more owners have become landlords as they wait for the market to find its feet following a recent succession of tax changes and the general election.

This resulting short-term supply/demand imbalance means two things. First, tenants are shopping around more and securing deals has become more difficult for landlords. Second, landlords have made it more attractive for tenants to remain in place, prompting higher renewal rates.

FIGURE 9

Annual rental value growth in prime London by market in August 2015



Source: Knight Frank Research

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