RESIDENTIAL RESEARCH

THE

LONDON REVIEW

INSIGHT AND COMMENTARY ON THE WORLD'S MOST PRESTIGIOUS RESIDENTIAL MARKET

Knight Frank

SPRING 2011

MARKET UPDATE
Analysis and key data covering the sales and rental sectors' performance

A GLOBAL MARKET
The first-ever comprehensive guide to where London's buyers are from

TRENDS FOR 2011
The definitive market outlook for prime central London

MARKET UPDATE

SPRING, AN EXCITING TIME FOR SALES AND LETTINGS AGENTS ACROSS LONDON, AND A PERFECT OPPORTUNITY TO CHECK THE PULSE OF THE MARKET.

Figure 1
Sales market performance
Monthly sales as a % of available stock

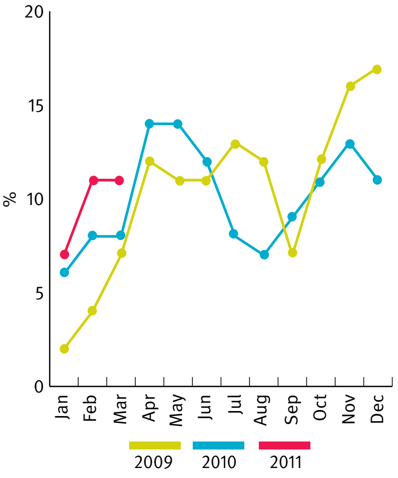


Figure 2
Prices and rents
Prime central London price and rental performance, quarterly growth (%)

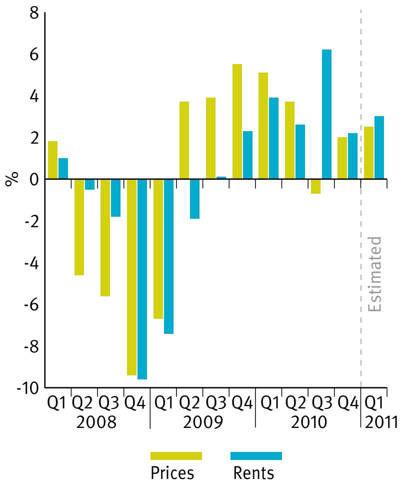
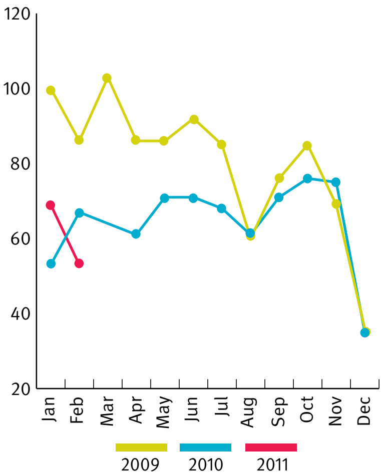


Figure 3
Limited rental supply
Newly available rental properties, prime London, monthly volumes indexed to 100 in January 2009



Source: Knight Frank Residential Research

The headlines are fairly clear: rents are up, prices have recovered from last autumn's hiatus, demand from tenants and buyers is healthy but supply everywhere is stubbornly low.

Behind the headlines there is a more complex picture across the marketplace, with investment requirements and international demand becoming evermore critical in terms of determining the direction of the market.

International buyers, the saviour of the market in early 2009, have now become omnipresent. The desire of Asian, European and Middle Eastern investors to buy into the London market has been soaking up a huge slice of the new-build market and overseas demand is now the biggest single contributor to price growth.

The key issue in the rental sector, as can be seen in figures 3 and 4, is that the new supply of investment stock trickling into the market, funded it has to be said by UK as well as international buyers, is only slowly countering growing rental demand. Aided by London's service sector recovery, demand for rental accommodation by new or relocating workers is acting to push rents higher.

Market performance

London's housing market has continued to follow a very different path to that seen in the wider UK market. While prices began to slip in London last autumn, just as the mortgage market and the economy began to weaken, a notable turnaround in the four months to the end of February led prices to rise by 4%.

The reasons for this recovery, and the divergence of the market from national trends, can be partially ascribed to low stock volumes, and a desire from buyers over recent months to buy now and capitalise on the opportunity to fix their borrowing costs at very low rates.

As we note above, the most important driver behind price growth has been growing demand for London property from international buyers. Over the last 12 months the proportion of £2m+ sales to non-UK buyers hit 52%. The figure was 64% for properties priced above £5m.

To fully gauge the impact of the international buyer, over the next two pages we have provided the first ever comprehensive guide to where London's buyers are from and what they are spending.

Rental market recovery

Firm evidence of the ongoing strength of London's prime rental market is presented by the fact that rents rose by more than 20% in the 18 months to March this year. This reflects a huge improvement since mid-2009, when the market was suffering from massive oversupply and weak tenant demand.

With rents now marginally below their March 2008 peak level – before the impact of the credit crunch was fully reflected in the market – our view, discussed on page 5, is that we will see 2008's peak rental level exceeded in 2011 and rental growth of up to 10% could be a possibility.

Aiding this growth is the fact that the volume of available rental properties has fallen considerably, by almost 20% over the 12 months to March this year, compared to the previous year.

Demand from tenants has held relatively firm, set against this weakening of supply. The reason for this resilience in tenant demand relates to the fact that employment conditions in central London are much healthier than they were 18 or even 12 months ago. Morgan McKinley, the City recruiter, reports job vacancies have increased by 27% over the past year.

Limited stock means that there are a large number of prospective buyers who are still locked out of owner-occupation and renting is their only alternative. While central London sales are outperforming the UK market, even here sales volumes over the past 12 months have been a third lower than they were in 2007.

AGENTS' VIEW

My concern for the market is...

...stock levels are thin at the moment and if buyer activity continues at its current pace the market could become static, with prospective vendors staying put because they can't see purchase opportunities. **Donna Swyers, Canary Wharf Sales**

...the continued short supply of property available to rent. Great news for landlords, but it means that transaction volumes are lower than two years ago and choice for tenants is very limited. **David Mumby, Chelsea Lettings**

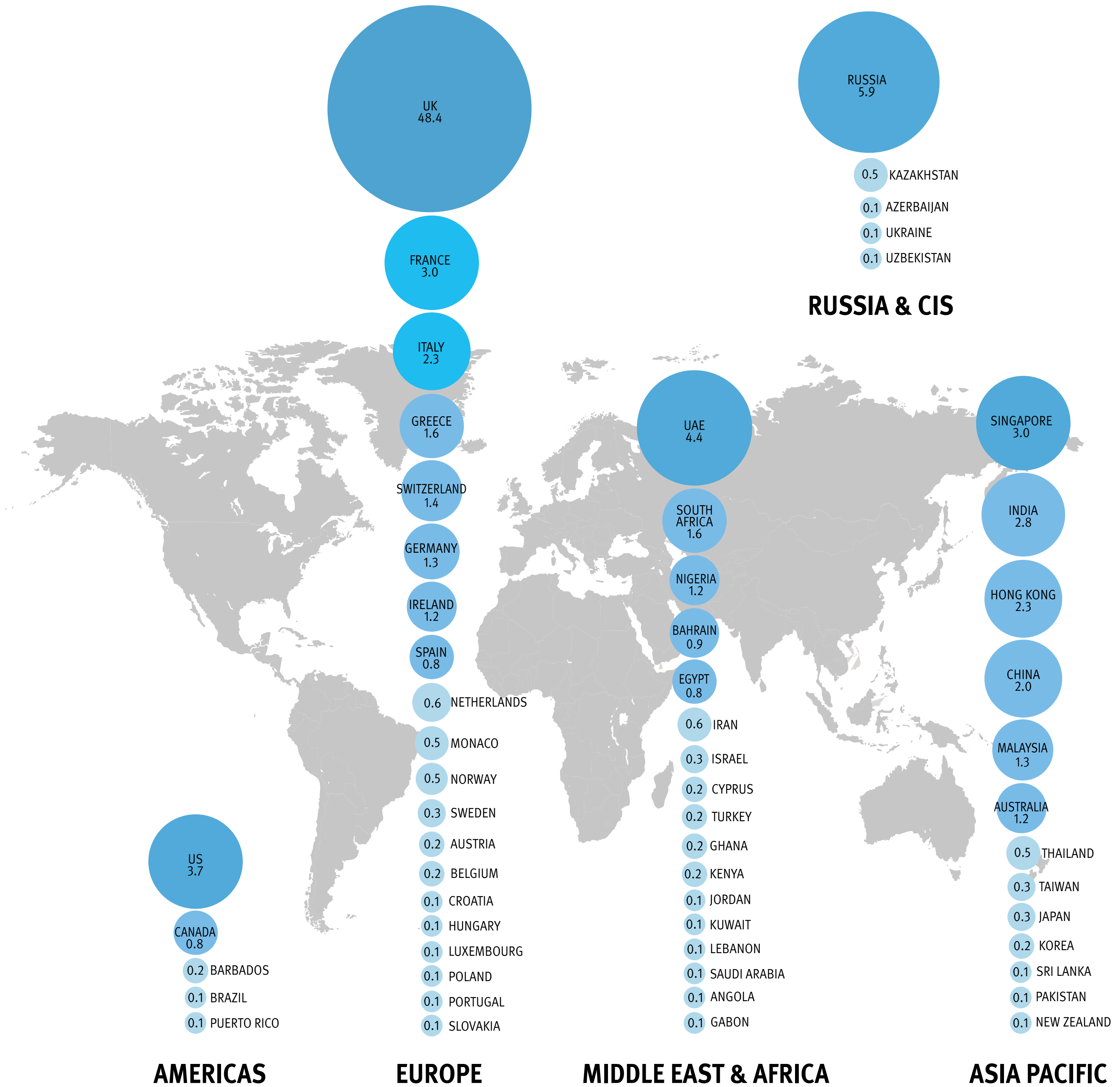
...the lack of good-quality classic rental properties – one and two bedroom flats up to £600 per week. While there are deals being done at the top end of the market, the vast majority of enquiries come in this lower price band. **Greg Bennett, Hampstead Lettings**

A GLOBAL MARKET

The central London residential market is the world's most international city market. In central London around 50% of all £2m+ properties are sold to overseas buyers, compared to 15% in Manhattan and 25% in Singapore and Hong Kong. London, it seems, is where the world wants to live.

Where are they from?

Prime central London purchasers, segmented by nationality, 12 months to end of February 2011, over £2m (%)



Figures may not add up to 100% due to rounding

Mapping London's buyers

Sixty-one nationalities bought residential property in central London in the 12 months to the end of February 2011. Buyers from all of the world's continents are represented.

Europeans form the biggest single bloc of buyers, led by French, Italian, Greek and Swiss nationals. Although in terms of a single country no-one comes close to the Russians – who are buying nearly 6% of all £2m+ sales.

Buyers from Asia Pacific have become much more powerful over the last two years, especially as the investment market restarted after its brief cessation in 2008. Four countries dominate in terms of buyer activity: Singapore, Hong Kong, China and Malaysia; of these China is the key market to watch. After several years of anticipation, 2010 was the year that buyers from mainland China came into the market in force – table 1 looks at "what they are spending" and points to the potential from this market.

With a relatively healthy level of buyers from the Middle East, North America and Africa, the only world region still to make a mark in London is South America. Brazilian buyers have a presence, but it is very limited, Argentinean buyers have begun to show more of an interest, but it is still very early to say there is a real wave of interest from this continent.

While a large proportion of properties purchased by overseas buyers are bought to be lived in, the investment motive is central to the decision to buy, and is something we consider in greater detail on page 5.

With rents on the rise, and supply still limited, a growing number of nationalities are looking to access London's strengthening investment market, and this would appear to be a trend that will continue to grow.

Money flows

Until two years ago the deepest pockets in the central London market were Russian – on average they outspent every other nationality by far. Whenever a seriously desirable property became available, it was a fairly safe bet that a buyer from Russia or one of the CIS states would be the successful bidder.

Russians still take a sizable share of the top properties, but as they have formed a much bigger pool of buyers, with more millionaires joining the billionaire buyers, their average purchase price has fallen.

The other trend to change our league table of biggest buyer budgets (table 1) has been the rise of China and Asian super-wealthy buyers. In terms of the average spend over the past 12 months, Chinese buyers have led the market.

The Chinese experience is following a very similar pattern to that of Russians over the past decade. The early adopters are the super-rich. They are here in small numbers, but will be rapidly joined by compatriots of more modest (although very comfortable) means.

The average prices in table 1 suggest that UK buyers are ninth in the pecking order of spending power. This disguises the fact that, as the biggest single buyer group, their average spend is pulled down by there being many more buyers at the entry level end of the prime London market. In fact most agents in central London would confirm that in the past six months, and especially since the start of 2011, very wealthy UK buyers have been very active in the market and have been the winning bidders on some of the most significant deals.

Table 1
What are they spending?
Prime Central London, average spend by nationality, 12 months to the end of February 2011 (£)

China	6,477,000
Malaysia	6,164,000
Hong Kong	5,477,000
Russia	5,381,000
Egypt	5,092,000
UAE	4,835,000
India	4,031,000
US	3,815,000
UK	3,156,000
Nigeria	3,145,000
Italy	2,648,000
Singapore	2,320,000
Germany	2,234,000
Switzerland	2,233,000
Australia	2,063,000
Greece	1,977,000
France	1,955,000
Ireland	1,429,000
South Africa	1,280,000
Bahrain	1,216,000

AGENTS' VIEW

The most exciting emerging hotspot in my area is...

...West Wimbledon. The Norwegian School is situated in SW20 and lots of Scandinavians want to be within walking distance. Raynes Park is another as it offers excellent value for money and has superb transport links (23 mins to Waterloo). **Ruth Barr, Wimbledon Lettings**

...Stratford. With the Olympics approaching expectations on rents are already rising. **Vanessa Evett-Beesley, Canary Wharf Lettings**

...South End Green, on the fringes of Hampstead, Belsize Park and Dartmouth Park. It has a village feel and is competitive compared to the more established central Hampstead locations. **Greg Bennett, Hampstead Lettings**

...the area between Fulham Road and the river is very fashionable right now. **James Pace, Chelsea Sales**

...Knightsbridge is so well established that it is difficult to find new patches. The most exciting opportunity will be apartments in One Hyde Park. **Juliet Hill, Knightsbridge Lettings**

AGENTS' VIEW

The biggest new trend in my market is...

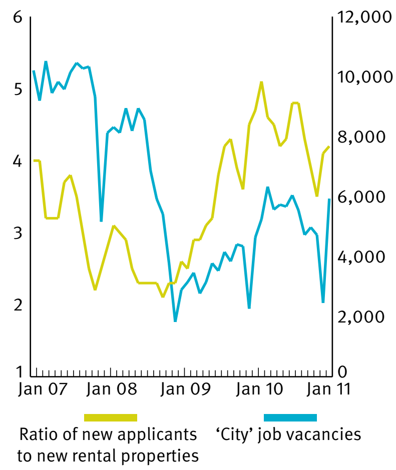
...the demand for penthouses. All but the most ambitiously priced penthouses in the area have now sold. **Donna Swyers, Canary Wharf Sales**

...the desire to have a cinema or media room. This has replaced swimming pools as the most desired feature in larger houses. **Dominic Pasqua, Wimbledon Sales**

...forced tenants – people renting because they simply can't find anywhere they want to buy. **Greg Bennett, Hampstead Lettings**

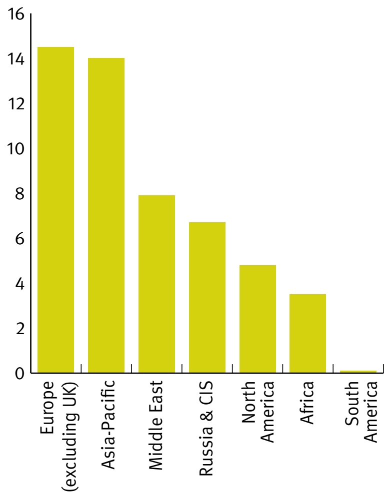
... everyone seems to want to buy a property again! Particularly family houses. **James Pace, Chelsea Sales**

Figure 4
Lettings demand
Demand for rental properties vs. central London employment vacancies



Source: Knight Frank Residential Research / Morgan McKinley

Figure 5
Regional demand
London's £2m+ buyers by world region



Source: Knight Frank Residential Research

TRENDS FOR 2011

Lettings and investment

The biggest trend we anticipate for London's rental market in the coming year is for rents to keep climbing.

There is no evidence so far that rental supply is rising. While high-profile sales of new-build developments to Asian investors are taking place, the reality is that for all the noise from this sector, we are talking about scores rather than hundreds of new prime market units in central London. There simply aren't enough new units coming out of the ground to have anything other than a local impact in terms of depressing rental values.

As long as the mortgage market in the UK remains in its current parlous state, the volume of equity-rich investors is sufficient to be able to compete successfully with prospective owner-occupiers, pushing more would-be buyers into the rental sector. This is one reason why the £400 to £1,000 per week rental sector is particularly strong in terms of tenant demand across London.

With strong rental growth outpacing improvements in capital value for the last year, yields have begun to edge higher, much to the relief of landlords. Despite this it is still difficult in the majority of prime London to achieve much more than a 4% gross yield and 3.5% is probably more realistic. Over time higher yields could be achievable.

The one increasingly common question from prospective investors, especially following a period of strong rental growth, is: how secure are rents at their new levels?

If we step back and take a longer view, we can see that rents haven't risen significantly over time. Not only are they still 3% lower than their early 2008 peak, but remarkably they are only 21% higher than they were a decade ago – surprising when you consider that household incomes in central London have risen by 48% in that time.

This should comfort investors. Even allowing for last year's surge in rents, renting is cheaper now (for tenants), in real terms, than it was in 2000.

Sales

Our view on price growth in central London for 2011 has been revised higher.

In September last year we published our Autumn Market Forecast, in which we stated our view that prices would be likely to remain unchanged in 2011.

There is now growing evidence that low stock volumes are continuing to push prices higher. This, taken together with the impact of improving employment and economic conditions in central London, has contributed to a revision of our forecast to 3% growth this year.

This forecast does not point to spectacular price growth, but it does confirm our view that prices in London will exceed the level they reached at the peak of the 2008 boom.

We also note that the super-prime (£10m+) sector could see growth of between 5% and 10% this year, as stronger demand from wealthy foreign buyers combines again with low stock volumes, but with competition having a disproportionate impact on pricing compared to the prime market.

The impact of the political upheaval in the MENA region at the current time is difficult to gauge with certainty, but there are indications that demand for London property is rising – with evidence of growing applicant enquiries from the Middle East in particular.

If we take a longer-term view, the combination of rental and capital growth will no doubt be attractive to investors. However, the performance of the pound will become evermore important to international buyers, who have been enjoying the fact that they have been able to enter London's market at a 'discounted' level.

Despite becoming a more expensive market to buy into, and with some of the currency advantage from 2009 and 2010 now eroded, prime London property is still attracting global wealth. Such purchasers are attracted by the potential to achieve capital value growth at least at, or ahead of, income growth allied to similar growth in rents. This means that total returns on investments of 8% to 10% could be achievable, before gearing and also before profits from refurbishment and development.

AGENTS' VIEW

The best thing to happen to the market would be for...

...vendors to be more realistic and listen. More sales would be achieved. **Donna Swyers, Canary Wharf Sales**

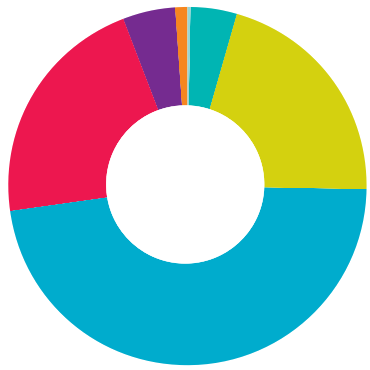
...more new developments to come forward to accommodate tenant demand. **Vanessa Evett-Beesley, Canary Wharf Lettings**

...the banks to relax stringent buy-to-let lending criteria. **Ruth Barr, Wimbledon Lettings**

Figure 6

Mid-life success

Prime central London purchasers, segmented by age



<20	0.3%
20s	4.3%
30s	20.8%
40s	47.5%
50s	21.4%
60s	4.7%
70+	1.0%

Source: Knight Frank Residential Research
Figures may not add up to 100% due to rounding

Figure 7

City winners

Prime central London purchasers, segmented by source of wealth

City/Finance	25.9%
Professional	24.0%
Other	15.8%
Property	11.7%
Inherited	7.7%
Entrepreneur	5.8%
Industry/Commodities	5.6%
Entertainment/Sports	3.6%

Source: Knight Frank Residential Research
Figures may not add up to 100% due to rounding

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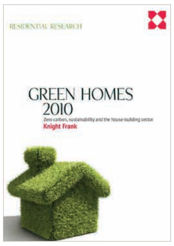
Recent market-leading research publications

Global Residential Market Forecast 2010-11

The Wealth Report 2010

Private View 2010



Green Homes 2010

The Rural Report 2010

The Super-Prime London Report 2011

Our Residential Research team provides strategic advice, forecasting and consultancy services to a wide range of clients including developers, investors, financial and corporate institutions. Further details are available on our website at KnightFrank.co.uk/research

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Knight Frank area definitions – **Prime central London:** Belgravia, Chelsea, Hyde Park, Kensington, Knightsbridge, Marylebone, Mayfair, Notting Hill, Regent's Park, Riverside* and St John's Wood. **Prime London:** All areas in prime central London plus Canary Wharf, Fulham, Hampstead, Richmond, Wandsworth, Wapping and Wimbledon

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*Riverside covers the Thames riverfront from Battersea Bridge in the west running east to encompass London's South Bank