RESIDENTIAL RESEARCH

Knight Frank

SPRING 2013

LONDON RESIDENTIAL REVIEW

HIGHLIGHTS

- Prime central London house prices have risen 53% since March 2009 and are 16.5% higher than the previous market peak of March 2008.
- Hong Kong, Jakarta and Bejing are the only major global cities to have outperformed London in terms of price growth since the financial crisis low in Q1 2009.
- The main international buyers in London in the last three years were from Russia, India, the US, Italy and France.
- Prime central London rents declined in the second half of 2012, taking the annual fall to 3.2% in 2012.
- In 2012, Knight Frank rented properties to 77 nationalities with 66% of all prime lets going to international tenants.

MARKET UPDATE

In prime central London, house prices are rising and have done so for nearly four years. Rents on the other hand have been declining for six consecutive months, and, for the first time since 2007, have posted an annual decline. Liam Bailey reviews last year's market performance and gives his outlook for 2013.

"Investment requirements and international demand are becoming ever more important in terms of shaping the market."

Liam Bailey, Global Head of Residential Research

Prospective buyers and tenants have been fairly evenly matched with available properties in the sales and rental sectors, although stock volumes in the sales market have begun to creep upwards over the past six months as a result of market uncertainty, caused in the main by the threat of new property levies.

Behind the headlines there is a more complex picture, with investment requirements and international demand becoming ever more important in terms of shaping the market.

Indeed, the London market has thus far retained its spark. As you will see later in this report (page 4), the desire of international investors to buy into the sector has continued and overseas demand remains a large contributor to price growth.

Market performance

Unsurprisingly, given its global appeal, London's housing market has continued to follow a very different path to that seen in the wider UK sector. Prices in the prime market, for example, stand 53% higher than the market trough in March 2009.

Compare this to the wider UK market where average house prices fell 1% in 2012 and now stand just 7.5% above their March 2009 low.

However, there was a slowing of house price growth in central London in 2012 compared to previous years despite strong international demand, with the March budget representing a turning point.

The sector has had to absorb a 40% rise in the top rate of stamp duty alongside new rules for an annual charge on £2m+ properties held in certain ownership structures and the reform of non-resident capital gains tax rules.

In spite of this, prime central London residential values rose by an average of 8.7% in 2012, well ahead of rival European cities which have struggled with ongoing economic pressures and the desire of international buyers to diversify away from euro-denominated assets.

We believe the market should now expect price growth to hover around zero this year, particularly as the market absorbs the impact of increased taxation.

Rental market stalls

In contrast to the sales sector, London's rental market has had a difficult year. Having enjoyed a prolonged period of growth throughout 2011 rents declined in ten of the 12 months in 2012. The sector remains closely tied to city employment and until we see a recovery here it is unlikely that any significant turnaround in fortunes will be seen.

Landlords will have been watching with some concern as an increasing number of financial services firms followed through on job cuts first announced back in 2011, but while forecasts suggest that the number of financial services jobs in the city will continue to fall in the coming years, we do see reasons for landlords to be optimistic, despite falls in rents as activity remains good.

The appetite for properties from prospective tenants continues to be high. Landlords will be encouraged to see that the number of new applicants and applicant viewings is up year-on-year by 24% and 4.5% respectively in the year to December for example.

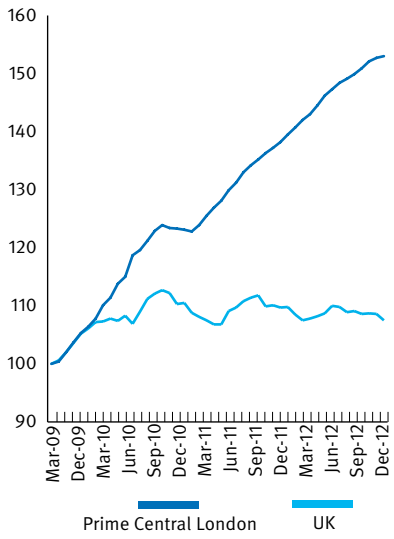
Additionally, the volume of new rental instructions rose by 20% in the year to December, compared to the same period in 2011. This rise has been largely met by an increase in the number of newly agreed tenancies, which have risen by 36% over the same period.

New rental instructions were 21.3% higher between September and December 2012 compared to the same period in 2011.

The balance of supply and demand still favours landlords, with the ratio of new applicants to new instructions, which hit a low of 2.6 in 2008, still holding up at 3.4 between September and December this year.

The number of tenancies started in the three months to the end of 2012 rose by 5.7% year-on-year, while the pipeline of tenancies agreed, which is up by nearly 50%, suggests new lettings volumes will rise in the first quarter of 2013.

Figure 1
Mind the gap
Residential house price movements, indexed to 100 from March 2009



Source: Knight Frank Residential Research, Nationwide

Taxing times

Chancellor George Osborne's assertion during the 2012 Autumn Statement that there would be "no new property taxes" ended a prolonged debate over the potential for future new levies on prime property, but after months of speculation which saw stock volumes rise and sales fall just how will activity in London's prime market bounce back?

Tax is a subject which has received more than its fair share of column inches this year, especially where property has been concerned. The overhaul of the tax treatment of UK residential properties worth in excess of £2m started back in March when the Chancellor announced higher rates of Stamp Duty Land Tax (SDLT).

His introduction of a new 7% SDLT rate for the purchase of residential property worth over £2m, and a rate of 15% for the same properties bought by a "non-natural person" came into effect immediately, but Mr Osborne went further, announcing a consultation on the introduction of an annual charge on residential properties valued at over £2m and owned by "non-natural persons", and an extension of the capital gains tax regime.

As we have noted previously, this helped to foster an air of uncertainty and, while clarity has been restored following the publication of the draft Finance Bill on December 12th, prime central London stock volumes ended the year 44% higher than in 2011 (figure 2).

Exchange volumes were also subdued during the year and sales of £2m+ homes were down 21% in Q4 compared to the last three months of 2011 (see figure 3).

While the year-on-year decline in prime sales may be viewed as a disappointing end to the year, we should point out that this was a marked improvement on Q3 when exchange volumes for all £2m+ homes were down 33% compared to the same period of 2011.

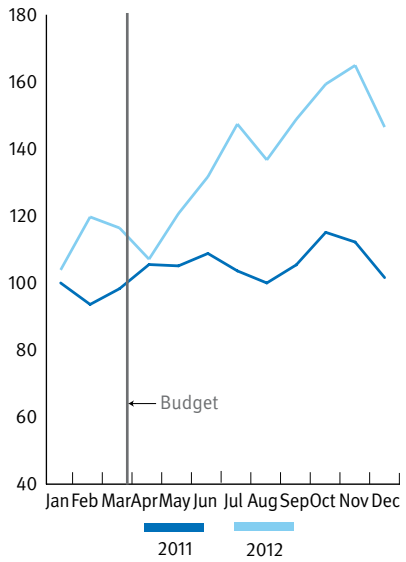
Breaking this down further, sales volumes for properties valued between £2m and £5m fell 44% in the third quarter from a year earlier. In the final three months of the year this gap had been reduced to 23%.

Indeed, there is early evidence that following the Autumn Statement sales have begun to pick up once more. Our data for December confirms this, with exchange volumes in the final month of the year at their highest level since March 2012.

> "There is early evidence that following the Autumn Statement sales have begun to pick up once more."

Higher sales levels are expected to continue as the market gradually adjusts to the new rules and previously hesitant buyers commit to deals. However, in line with our earlier forecasts for the London market the higher levies will weigh on prime central London prices and no significant price movement is expected in 2013 as doubt about the recovery continues to limit property demand.

Figure 2
Residential stock volume
Prime central London, indexed to 100 January 2011



Source: Knight Frank Residential Research

Figure 3
Sales volumes (exchanges) 2012
Year-on-year change for prime London

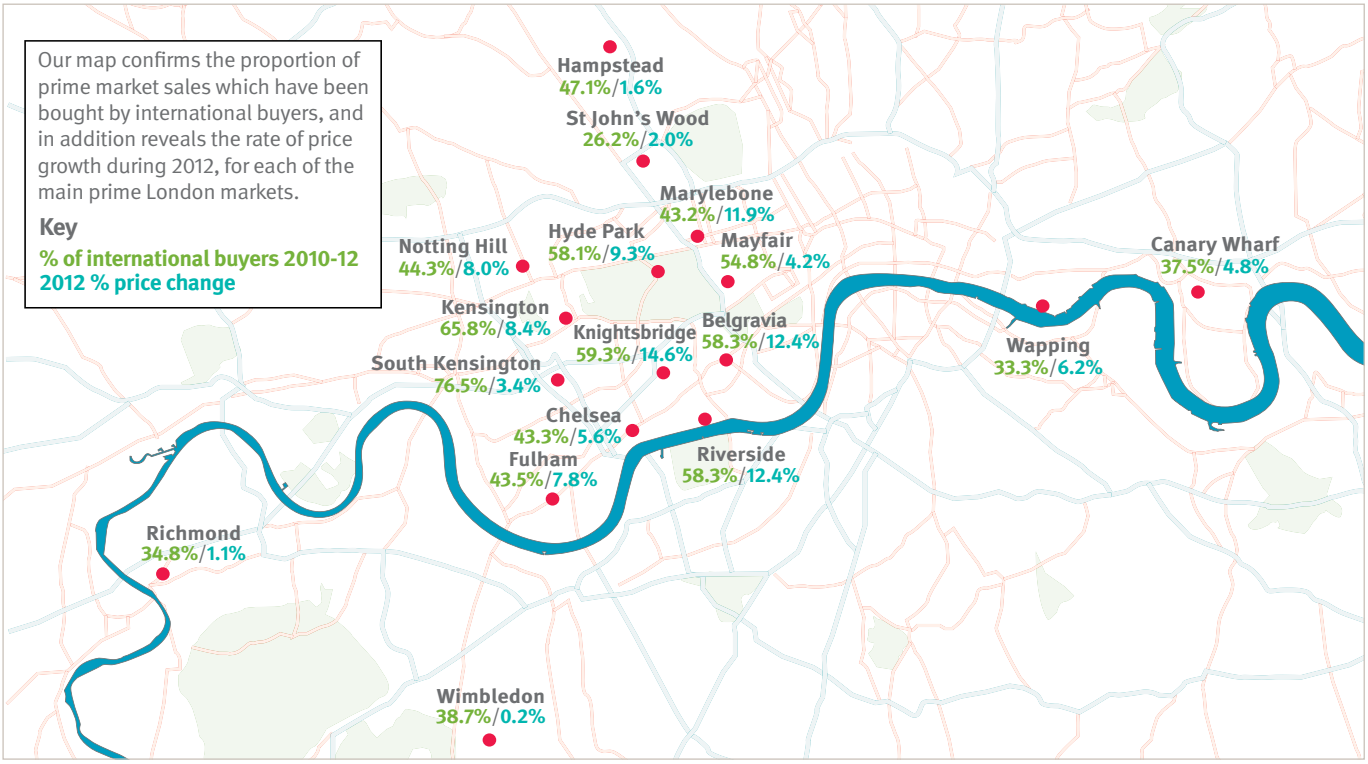
	Sub-£2m	£2m-£5m	£5m+	All £2m+
Q1	10%	-7%	78%	17%
Q2	23%	-14%	-6%	-11%
Q3	13%	-44%	-13%	-33%
Q4	19%	-23%	-27%	-21%

Source: Knight Frank Residential Research

Figure 4
Residential Stamp Duty Land Tax rates

Purchase price/lease premium or transfer value	SDLT rate
Up to £125,000	Zero
Over £125,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000 to £1 million	4%
Over £1 million to £2 million	5%
Over £2 million	7%
Over £2 million (purchased by certain non-natural persons)	15%

Source: HMRC



Global demand

In 2012, price growth in London stood well ahead of other key western city markets, at 8.7%. One of the most important drivers behind price growth continues to be the growing demand for London property from international buyers.

London's relatively healthy rate of price growth compares with a somewhat anaemic -1.4% for New York, -4% for Paris and -6% for Geneva.

Over the last two years the proportion of £1m+ sales in London to non-UK buyers was 51%, rising to 60% for properties priced above £5m. Overseas buyers are also key in the 'new-build' market, as we examine in more depth here.

Our map of local London markets confirms that the world's wealthy are still drawn to London over the many global city alternatives, although some areas are more popular than others when it comes to attracting overseas buyers.

South Kensington drew the largest number of international buyers as a percentage of sales in 2012, while Knightsbridge, Kensington, Hyde Park and Belgravia continued to remain popular with wealthy overseas buyers in search of a sheltered haven in which to store their wealth.

Concurrently, house price performance in these areas has been around, or above, the London average. Belgravia and Knightsbridge, for example, witnessed property values climb by 12.4% and 14.6% respectively in 2012. Hyde Park and Kensington also saw prices rise last year, up 9.3% and 8.4% respectively.

London's reputation as a global financial centre, its political stability and transparency as well as its lifestyle benefits ensure it remains a popular choice for the globetrotting elite. The crisis in the Eurozone has only served to boost interest in the city among Europeans with buyers from Italy and France the most active Europeans in the market in 2012.

Sales to Russians, US and Indian buyers remain the most prevalent however. Between them they made up over 15% of all sales last year (figure 5).

Given that London is such an important global hub, it is not surprising that it is able to attract such large international interest. According to recently-released Census data for 2011, some 40% of London residents were born outside of the UK, highlighting the melting pot of nationalities who consider the city home.

To follow the trends on all of these key global markets and keep up to date with our global analysis at: KnightFrank.com/GlobalBriefing

Figure 5
Who is buying?
Prime London sales by nationality 2012, £1m+

Rank	Country	%
1	United Kingdom	50.7%
2	Russia	6.6%
3	United States	4.8%
4	India	4.4%
5	France	3.3%
6	Italy	2.6%
7	South Africa	2.2%
8	Greece	1.8%
9	United Arab Emirates	1.5%
10	Australia	1.5%
11	Germany	1.5%
12	Switzerland	1.1%
13	Oman	1.1%
14	Turkey	1.1%
15	Saudi Arabia	1.1%

Source: Knight Frank Residential Research

Investors and the London economy

During last year's Autumn Statement the Office for Budget Responsibility downgraded its forecasts for the UK economy in 2013. Oliver Knight examines what the prospects are for London this year, and how they will affect the city's rental market.

"These short-term economic difficulties for the rental market are taking place against a backdrop of a wider shift in demand from tenants."

London is an interesting economic microclimate. The city's recovery from the financial crisis has been much stronger than that of the UK as a whole and while the wider economy has flirted with a triple-dip recession in 2012, London remained resilient, reporting an increase in Gross Value Added (GVA) of 0.9% for the year.

Recent forecasts show this growth continuing, and according to the GLA's medium-term planning projections, London's GVA growth rate is forecast to be 1.8% this year and 2.4% in 2014. Although low, compared to the OBR's forecast economic growth for the UK of 1.2% and 2% respectively, London actually stands out favourably.

Despite ongoing economic difficulties, the city remains one of the leading global financial centres in the world, alongside New York. According to a survey of businesses conducted by R3location, 82% believe London's attractiveness as a place to do business will increase in 2013.

R3location estimates that there are approximately 20,000 international assignees on long-term assignments in London at any one time; a figure it expects will continue to increase over the next five years.

A competitive exchange rate also benefits London's property sector and encourages foreign investment.

London's stature as a global financial centre is unlikely to change in the medium-term. Growth rates for emerging new locations are unquestionably higher, but they still have some way to go before this is challenged.

There is no escaping the fact that some aspects of the short term economic position in London are challenging. The employment situation in the financial service sector remains bleak. Data from Morgan McKinley, the specialist City recruiter, shows job vacancies in the City fell sharply last year and this drop shows no signs of abating. Its London Employment Monitor registered a year-on-year drop in hiring activity in November 2012 of 24%.

As we alluded to earlier in this report, the city's investment market remains closely tied to the performance of the London economy and the escalation of the Eurozone debt crisis has certainly taken its toll on the rental sector.

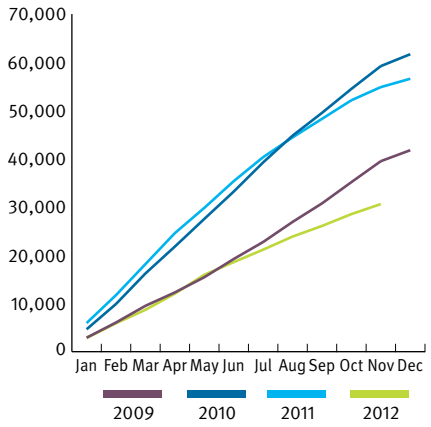
Continued economic uncertainty and threats to employment in the financial sector are affecting corporate relocation budgets. In turn, the £1,000-£2,000 pw rental market, which has traditionally been supported by affluent City workers, has suffered.

We need to be mindful that these short-term economic difficulties for the rental market are taking place against a backdrop of an increase in demand from tenants which has the potential to boost the sector.

Official Census data shows that the size of the private rented sector in central London has risen by 50% since 1991, in line with overall housing demand in the Capital. The sharp rise in house prices during the boom, combined with more recent credit constraints has limited entry to homeownership for younger buyers. The recession and falling real earnings have also constrained purchases. There is a wider move towards the private rented sector that looks set to continue.

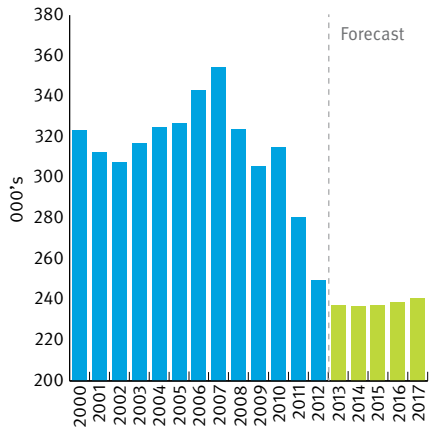
It is important to note that while the City economy is still struggling to gain traction, London's long term investment appeal is confirmed by the recent growth of the technology and media sectors, a process which should serve to increase tenant demand. This trend helps inform our positive outlook for prime rents in London (figure 8).

Figure 6
Central London employment
Cumulative "new jobs" count



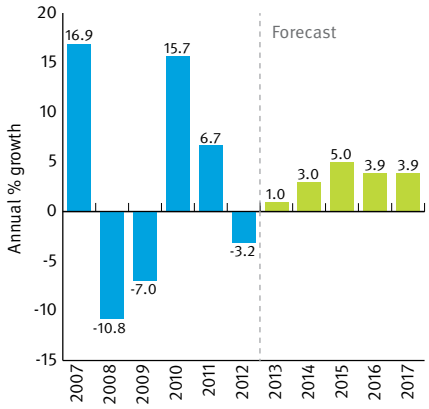
Source: Morgan McKinley

Figure 7
No of 'City' type jobs in London



Source: Cebr

Figure 8
Annual and forecast price growth for prime central London rents



Source: Knight Frank Residential Research

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Knight Frank area definitions: 'Prime central London' is defined in our Prime Central London Sales Index as covering: Belgravia, Chelsea, Hyde Park, Kensington, Knightsbridge, Marylebone, Mayfair, Notting Hill, Regent's Park, St John's Wood, Riverside* the City and the City Fringe. 'Prime London' comprises all areas in prime central London, as well as Canary Wharf, Fulham, Hampstead, Richmond, Wandsworth, Wapping and Wimbledon.

* Riverside covers the Thames riverfront from Battersea Bridge in the west running east to include 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.

Front cover image: Sussex Gardens