RESIDENTIAL RESEARCH

Knight Frank

LONDON RESIDENTIAL REVIEW

THE PRIME LONDON RESIDENTIAL MARKET AND A CHANGING GLOBAL ECONOMY

SPRING 2014

LOCAL SALES AND LETTINGS MARKET PERFORMANCE

CHINESE BUYERS MAKE THEIR MARK

THE INVESTMENT CASE FOR PRIME LONDON

KEY FINDINGS

A 37% increase in prime central London transactions shows more money is being spent as global economic threats recede

Annual growth of 7.5% in prime central London, a rate now at its most consistent in two decades

Chinese replace Greeks in the top-ten list of prime central London buyers in 2013

Price growth of 11% in prime outer London is higher than prime central London as the 'ripple effect' returns

Total return of 15.1% in prime outer London exceeds other mainstream asset classes

TOM BILL
Associate, Residential Research

"There are today more reasons people buy a home in London than there are stops on the tube map."

A NEW NORMAL IN LONDON

Slowing price growth in central London, double-digit rises in outer London and a marked jump in transactions indicate a 'less abnormal' market, argues Tom Bill.

It is tempting to say the last 12 months marked a return to normality for the prime London property market.

But the term 'normal' is difficult to apply to a market affected as much by global financial markets as it is by UK politics.

A reputation as a safe investment, cemented during the financial crisis, and recent periods of political instability all over the world, means there are today more reasons people buy a home in London than there are stops on the tube map.

It would be more accurate to say 2013 and the start of 2014 have been marked by less abnormality than the years of double-digit growth that followed the financial crash. Knight Frank data certainly suggests prime central London's appeal is widening beyond its so-called 'safe haven' status.

First, the number of transactions has jumped markedly. A 37% increase in prime central London sales last year shows more people are spending more money as global economic threats, like the euro zone sovereign debt crisis, recede and the U.S. begins tapering its stimulus programme.

Transactions increased across all price bands, including a 33% jump between £1 million and £2 million, an 88% rise between £4 million and £5 million and a 42% increase for £10 million-plus homes.

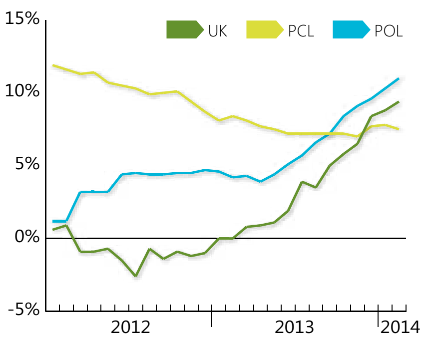
Further proof that the market has evolved beyond a defensive investment is that European buyers fell from 16% to 11% last year, suggesting concerns over the break-up of the euro zone are easing, underlined by the fact there were no Greek-domiciled buyers in 2013 for the first time in four years.

However, despite the broadly calmer picture in Europe and the UK, Knight Frank web traffic data suggests inflows from emerging markets could rise as volatility grows in regions like South America and the Far East, unsettled by the withdrawal of economic stimulus in the U.S., China's transition to a consumer-focussed economy and events such as the situation in Ukraine.

The second piece of evidence pointing to a steadier market is that price growth in prime central London slowed to a moderate 7.5% in the year to February, partly as a result of buyers and sellers digesting the impact of a recent series of tax changes.

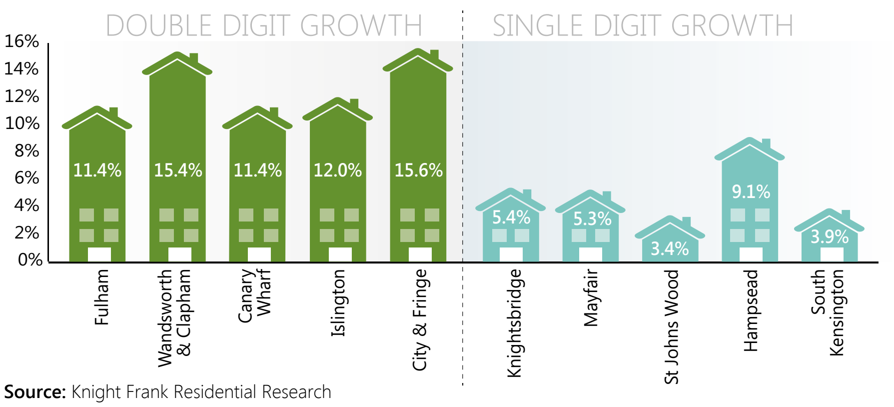
The figure has varied little in the last 12 months, resulting in the sort of regular single-digit growth not seen since the mid-1990s. We forecast a slowdown this year and zero growth next year as the UK general election campaign gets underway and political and uncertainty over the outcome grows.

FIGURE 1
Mainstream UK growth exceeds prime central London Annual % growth



Source: Knight Frank Residential Research

FIGURE 2 **Double digit vs single digit price growth in London**
12 month price growth to February 2014



Source: Knight Frank Residential Research

THE RIPPLE RETURNS

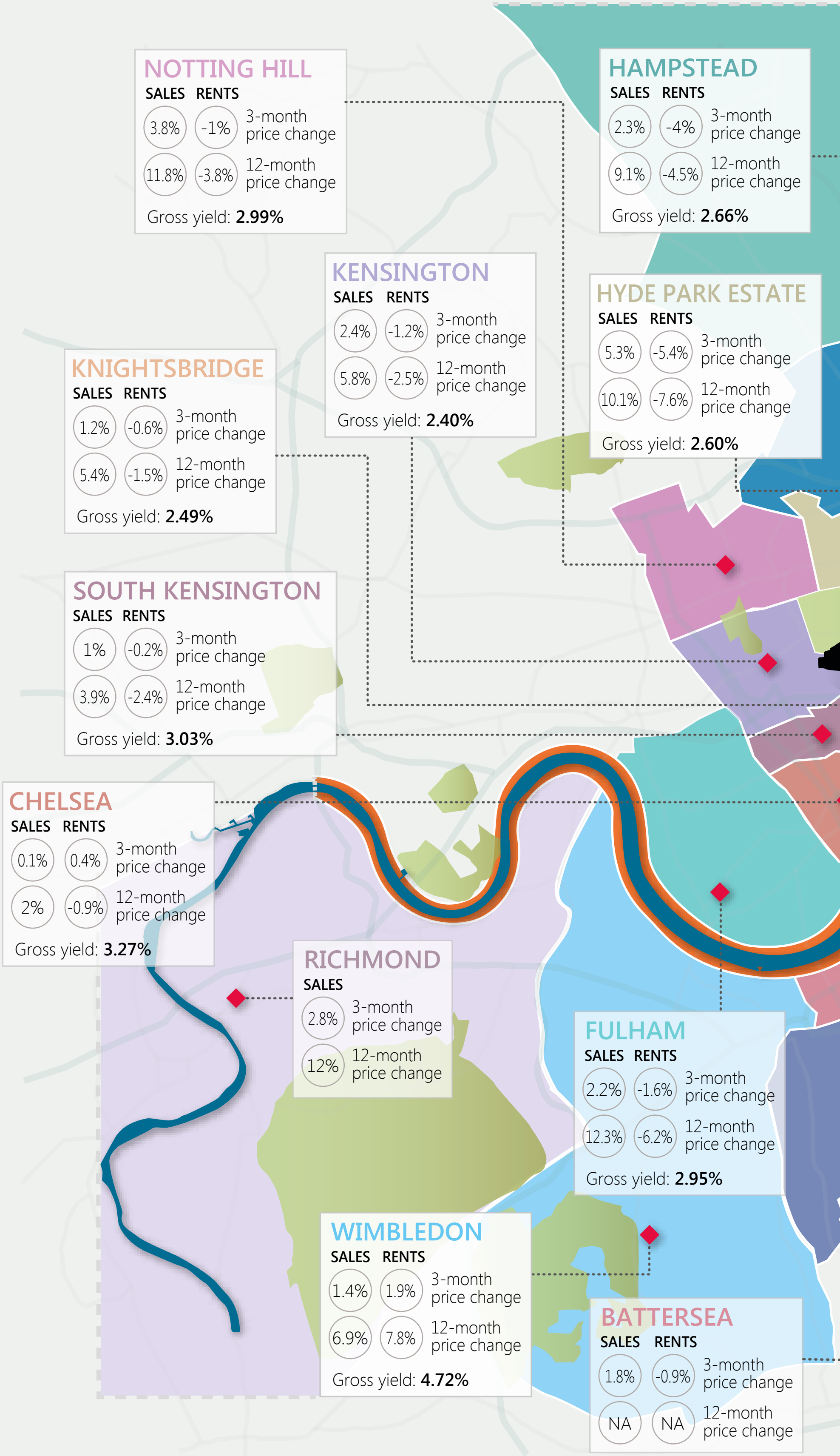
The third indicator of 'more normality' is the re-emergence of the so-called ripple effect seen during previous UK property cycles. House price growth typically spreads outwards from the country's economic epicentre of central London, but that did not happen as prime central London prices rose between 2009 and 2012.

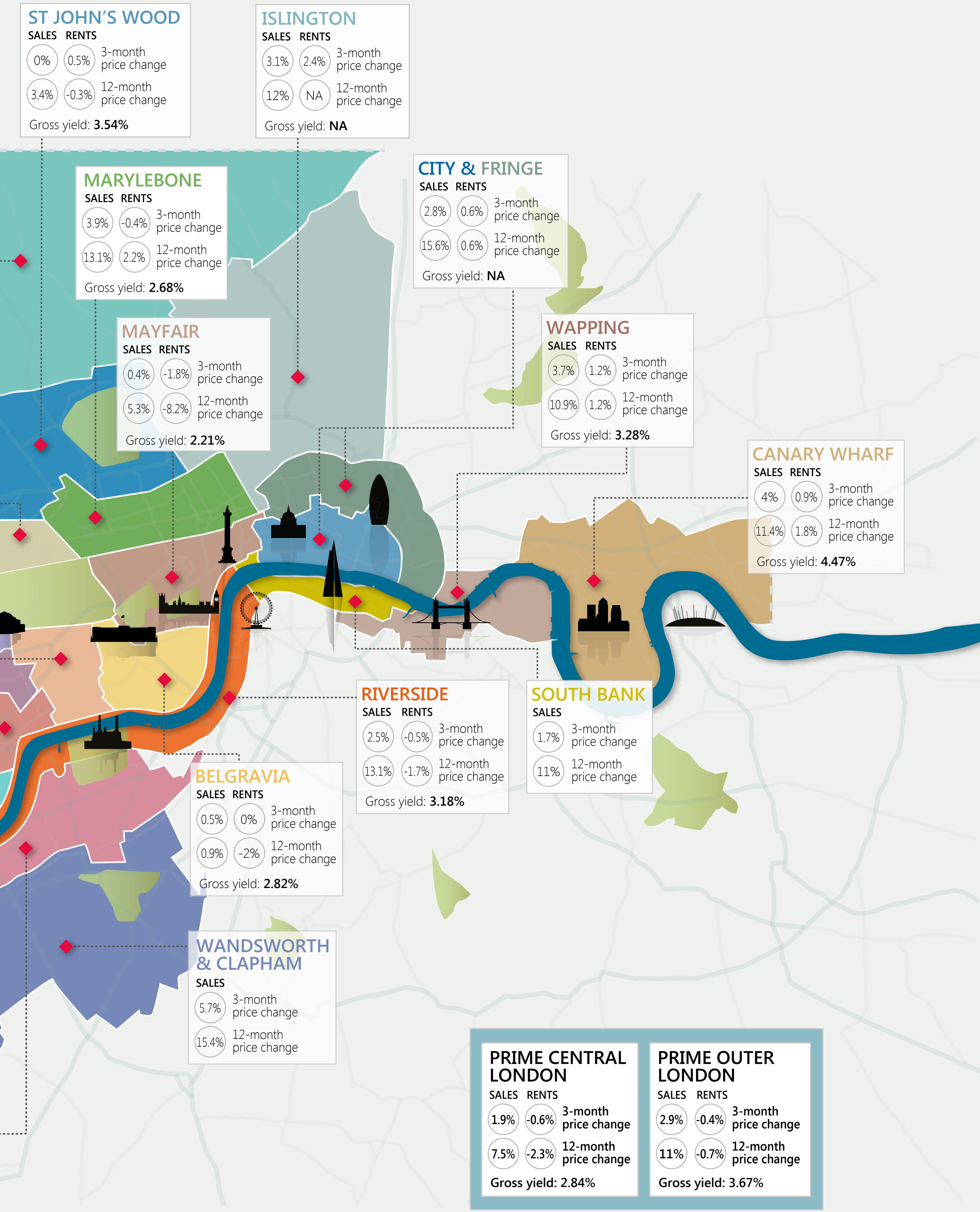
This situation changed last year, when price growth in prime outer London overtook prime central London, as the UK's economic outlook improved. Our prime outer London index grew 11% in the 12 months to February versus a 7.5% rise in prime central London. Growth in the national mainstream market also now exceeds prime central London (see figure 1).

It is not a straight split between central and outer areas, but rather a two-speed market is developing in London as buyers seek better value for money beyond the traditional core areas. The result is that some districts are experiencing slowing or steady single-digit growth, while others seeing rising double-digit increases (see figure 2).

Rental value declines are easing as the tentative recovery in the financial sector continues. In 2013 letting volumes rose by a fifth on the levels seen in 2012. Total investment returns remain strong however and for more detail on how prime London property is outperforming other asset classes see page 6.

Prime London sales and rental market performance, year to February 2014




ST JOHN'S WOOD
SALES RENTS
0% 0.5% 3-month price change
3.4% -0.3% 12-month price change
Gross yield: 3.54%
ISLINGTON
SALES RENTS
3.1% 2.4% 3-month price change
12% NA 12-month price change
Gross yield: NA
MARYLEBONE
SALES RENTS
3.9% -0.4% 3-month price change
13.1% 2.2% 12-month price change
Gross yield: 2.68%
CITY & FRINGE
SALES RENTS
2.8% 0.6% 3-month price change
15.6% 0.6% 12-month price change
Gross yield: NA
MAYFAIR
SALES RENTS
0.4% -1.8% 3-month price change
5.3% -8.2% 12-month price change
Gross yield: 2.21%
WAPPING
SALES RENTS
3.7% 1.2% 3-month price change
10.9% 1.2% 12-month price change
Gross yield: 3.28%
CANARY WHARF
SALES RENTS
4% 0.9% 3-month price change
11.4% 1.8% 12-month price change
Gross yield: 4.47%
RIVERSIDE
SALES RENTS
2.5% -0.5% 3-month price change
13.1% -1.7% 12-month price change
Gross yield: 3.18%
SOUTH BANK
SALES
1.7% 3-month price change
11% 12-month price change
BELGRAVIA
SALES RENTS
0.5% 0% 3-month price change
0.9% -2% 12-month price change
Gross yield: 2.82%
WANDSWORTH & CLAPHAM
SALES
5.7% 3-month price change
15.4% 12-month price change
PRIME CENTRAL LONDON
SALES RENTS
1.9% -0.6% 3-month price change
7.5% -2.3% 12-month price change
Gross yield: 2.84%
PRIME OUTER LONDON
SALES RENTS
2.9% -0.4% 3-month price change
11% -0.7% 12-month price change
Gross yield: 3.67%

THE CHINESE ARE COMING – SLOWLY

80%

Growth of Chinese dollar billionaires between 2013 and 2023

Chinese developers have made their mark in London in the last year with several headline-grabbing deals. The impact of Chinese buyers on the prime residential market is likely to be significant but more gradual, argues Tom Bill.

Two milestones were passed last year that demonstrate the growing importance of mainland Chinese buyers in London.

First, China replaced Greece (see page 2) as one of the ten largest groups of buyers in prime central London. The top-ten, headed by the UK, the United Arab Emirates and Russia, was otherwise unchanged from 2012, and China was in joint fourth place with Italy.

Second, China overtook Russia as the country granted the most tier one investor visas in the UK since the scheme started in 2008. The UK government grants the visas in exchange for investments of between £1 million and £10 million and 187 were issued to Chinese nationals in 2013, the highest ever total to a single nationality in one year (see figure 3).

The reasons behind the increase include a government-initiated austerity drive that is cooling spending in China on luxury items.

Other factors include the growth of foreign travel and social media, the strength of the Chinese Renminbi versus Sterling and a desire to escape air pollution in some areas of China. All of that comes against the uncertain backdrop of a US$10 trillion economy that is shifting its focus away from heavy industry towards consumerism.

Chinese buyers prize London for its heritage, schools and universities, growing levels of new-build homes and the fact residents are not taxed on their global wealth, unlike the United States. The fact Canada scrapped its immigrant investor programme this year will also benefit London as the North American country had been a popular destination.

Burgeoning wealth levels in China suggest demand will remain strong. Knight Frank's Wealth Report indicates the number of US dollar billionaires in China will grow 80% by 2023, placing the country second behind the United States by number of billionaires.

Several major commercial and development deals in the last year underline the appeal of London in China, including Chinese developer Greenland buying the Ram Brewery in Wandsworth for £600 million and a deal by Advanced Business Park for a 35-acre site at Royal Albert Dock.

Despite strong demand, controls on outflows of capital from China suggest there won't be a sudden step-change among buyers in the prime London residential market.

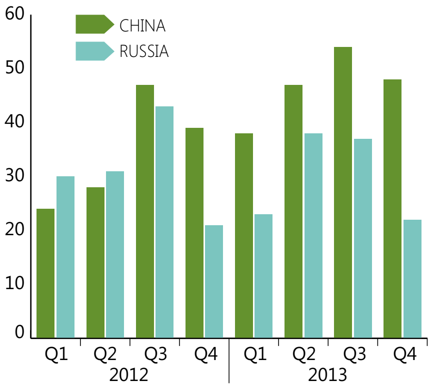
Instead, as Knight Frank data shows, a steadier build-up is underway. It is most noticeable in the sub-£1 million price bracket, where the percentage of Chinese buyers in prime central and outer London grew to 7.5% last year from 2.7% in 2010 (see figure 4).

It is the highest percentage of any foreign buyer since 2008 in a price bracket that typically marks an entry point to the London market. Chinese nationals bought more sub-£1 million London homes in 2013 than over the previous five years combined.

Over the same period, the figure grew to 2.7% from 1% in the £2 million to £5 million price bracket, and from zero to 1.1% for properties between £5 million and £10 million, indicating Chinese buyers are increasingly active in the higher price brackets as they become familiar with the market.

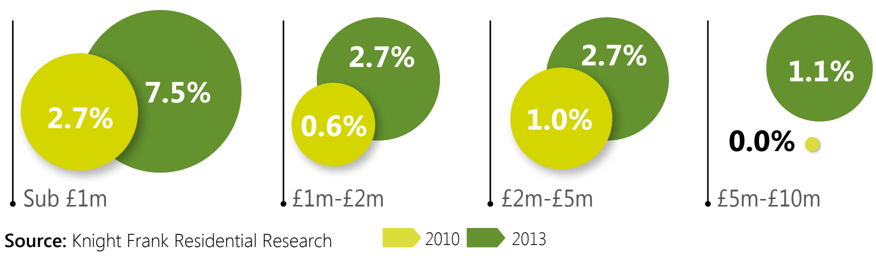
The fact Chinese buyers are the fourth largest group in prime central London even with outflow restrictions in place suggests minor changes in Beijing in future could well have a significant positive impact in London.

FIGURE 3
Tier one investor visas: number granted to Russian and Chinese nationals



Source: UK government data

FIGURE 4 **Growth of Chinese buyers as a percentage of prime London total**



Source: Knight Frank Residential Research

RENTAL AND INVESTMENT MARKET FOCUS

Prime central London rents fell -2.3% in the year to February and -0.7% in prime outer London, as the impact of job cuts in the financial industry kept demand in check.

Widespread redundancies in a sector that has traditionally buoyed demand means prime central London rents have been falling on an annual basis since June 2012, the month before the start of the London Olympic Games, an event that caused its own short-term disruption in the city's lettings market.

Economic data has improved since June 2012, which marked the end of a three-month period when GDP fell -0.4%, and average forecasts point to growth of 2.7% this year and 2.4% in 2015.

Knight Frank data shows rental declines are easing, which suggests the market is catching up with this positive underlying trend. Prime central London rents rose for the first time in 21 months in January and the average fall over the last three-month period is the lowest since the Olympic baton was passed to Brazil in summer 2012.

A further sign of reviving demand is the prevalence of relocation agents, which many companies use to move staff overseas. Enquiries from relocation agents to Knight Frank more than doubled between December and January to reach the highest ever monthly level.

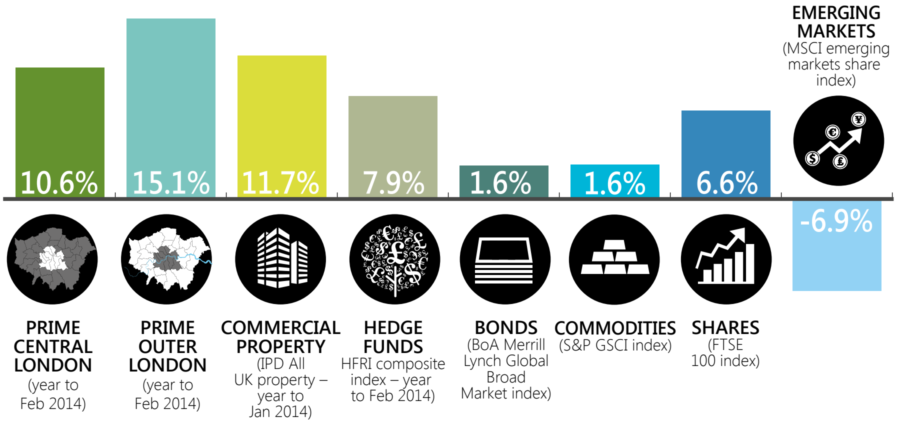
Furthermore, lettings volumes in prime central and outer London are up 20% in the year to the end of February, while viewings and applicants are up more than 10% and 7% respectively. The rises coincide with data from recruiter Astbury Marsden that shows London's financial services sector created 25% more jobs in February this year than the same month in 2013.

One explanation why the positive data is not translating more quickly into rising rental values is that personal budgets and corporate largesse are not as high as before the crash. One anecdotal sign of this increased prudence is that more tenants are now doing a "pounds per square foot per week" calculation.

Rental yields were 2.84% in prime central London and 3.67% in prime outer London in February. Though low by real estate standards, capital value growth means that total returns over the same period were 10.6% in prime central London and 15.1% in prime outer London. The latter was the highest among a set of mainstream asset classes in the last year, see figure 5.

It underlines how price growth is spreading beyond central London as the UK economic recovery takes hold. In a world where stock markets are skittish, many commodity prices are falling and hedge fund managers are struggling to second-guess central bankers, it underlines the strength of London residential property as an investment class.

FIGURE 5
Prime outer London outperforms other investment classes
Total return (year to 10 March 2014 unless otherwise stated)



Source: Knight Frank Residential Research

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