RESIDENTIAL RESEARCH

# THE LONDON REVIEW

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

**Knight Frank**

SUMMER 2010

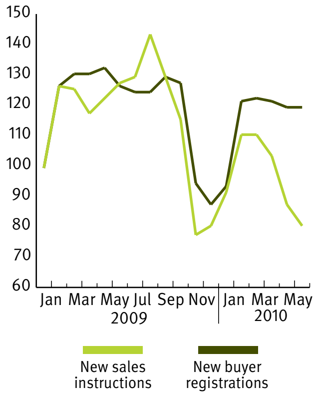
# THE MARKET IN BRIEF

**In the following four charts we have provided a tightly edited selection of the key trends in supply, demand and activity from both the sales and the lettings markets. In addition our London map provides a visual guide to the global make-up of demand for prime London property.**

Figure 1

**Decline in supply**

New sales instructions and new buyer registrations, prime London, indexed to 100 in January 2009



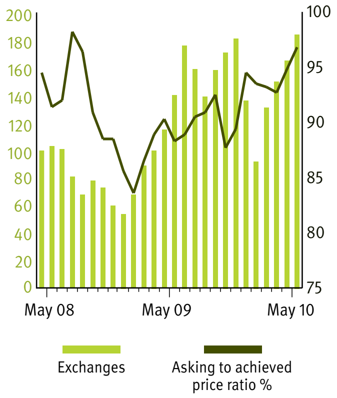

Source: Knight Frank Residential Research

The London sales market has slowed since April. While new buyer volumes are only down marginally from their peak, anecdotal evidence confirms that they are more reticent to commit to purchases than they were pre-election. It is the marked decline in supply which has helped prices to continue rising.

Figure 2

**Sales market resilience**

Volume of exchanges (indexed to 100 at May 2008) and average achieved to asking price ratio, prime London



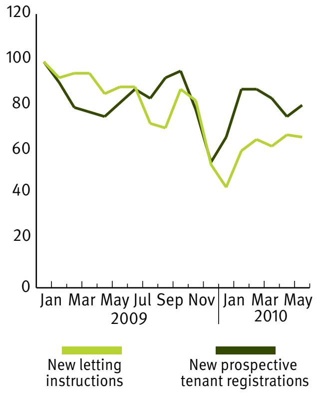

Source: Knight Frank Residential Research

Volumes of exchanges are still rising strongly, up almost 100% since February, but at the same time the asking to achieved price ratio has been climbing steadily and hit 97% in June. This strength reflects the market health up to April, we expect both measures to soften over the summer.

Figure 3

**Rental stock in short supply**

New lettings instructions and new prospective tenant registrations, prime London, indexed to 100 in January 2009



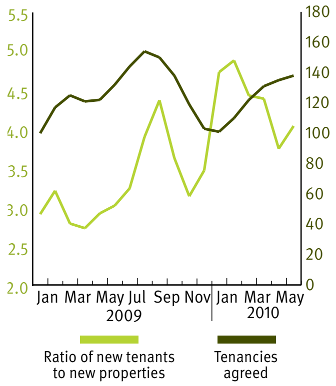

Source: Knight Frank Residential Research

The number of prospective tenants in the market has declined slightly over the past 18 months, with an increasing number finding their way into the purchase market. The real story for lettings has been the 25% decline in stock volumes over the past year, which has contributed to strong rental growth.

Figure 4

**A landlords' market**

Ratio of new prospective tenants to newly available properties, and volume of tenancies agreed (indexed to 100 at May 2007)

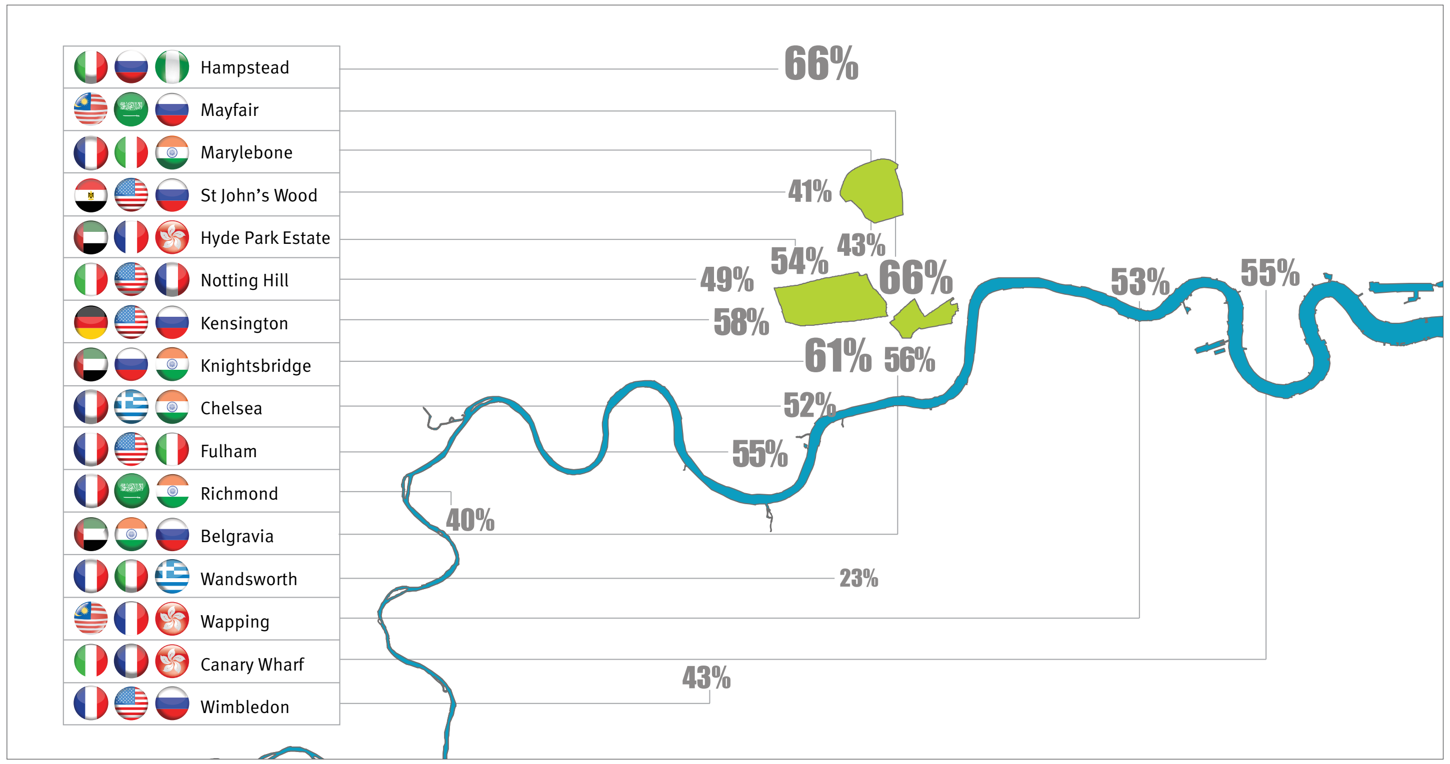



Source: Knight Frank Residential Research

Despite falling rental stocks the number of tenancies agreed has continued to rise over the past year, up 5%, contributing to a weakening of tenants' negotiating power. The ratio of new prospective tenants to newly available rental properties rose by a third, to 4.14, in the year to June.

**Global demand**

Prime London (£2m+) international purchasers' market share and key buyer nationalities, 12 months to June 2010










## * AFTER A BULL RUN LASTING OVER A YEAR, QUESTIONS ARE NOW BEING ASKED AS TO WHETHER PRICES IN CENTRAL LONDON WILL CONTINUE TO RISE OR WHETHER THEY ARE SET FOR A FALL.

**Liam Bailey**
Head of Residential Research

## KEY FINDINGS



THE LONDON REVIEW 2010

Against a backdrop of global financial market turmoil, potential sovereign debt defaults in Europe, and a risk of a double dip recession at home in the UK, this is one of the most difficult times I have experienced for forecasting the central London market. It is also, however, the first time I have realised that whether prices rise or fall increasingly doesn't matter.

Outside central London, in the rest of the capital, and most definitely in the rest of the UK, whether prices turn the corner and begin to fall does matter. Price falls matter because they influence who can obtain a mortgage and they confirm how much of an owners' hard-earned equity has been eroded. Conversely they also create opportunities for new buyers to access the market.

Inside central London the dominance of demand from the global wealthy means that short-term pricing trends are becoming an irrelevance. This globalisation of the market – a long-term trend in London, but one that became super-charged during the long 2000s boom – was finally confirmed as an almost irreversible factor during the recent crash.

To understand this point, let's travel back to early 2009. This was the time when the previous UK government was desperately trying to undo its reputation as a cheerleader for wealth creation. We had the announcement of a new 'non-dom' tax, a new 50% higher rate of income tax and even the 'one-off' bonus tax. The explicit message was that the world's wealthy were no longer welcome here.

The world's wealthy, however, didn't get the message. Spurred by a 30% devaluation in Sterling, the moment the UK attempted to become unwelcoming to new wealth was the exact moment foreign buyers began to pour back into the market. Between December 2008 and March 2009 international buyers' share of the £5m+ London market soared from 39% to 48%. By June this year it had hit 68%.

Central London is now a market apart, not only is demand seemingly immune from wealth attacks, but so too is supply. The proportion of un-mortgaged owners in central London is 59%, compared to 41% for the UK. Central London is dominated by discretionary owners, they can sell when they choose to, meaning that when prices fall so too does supply.

Three years after the credit crunch began, London's international links, global business base, and unrivalled lifestyle has ensured that interest in the city's best houses from the world's wealthy elite remains as strong as ever.

With prices rebounding strongly on the back of this demand, the separation in performance between London and the rest of the UK has now turned into a chasm. So too has the divide between London and its international peers. Arguably no other market, including Manhattan or Hong Kong, which we feature on page 8, can compete with the breadth or depth of demand experienced at the top end of the London market.

The real lesson from the past three years in central London is that demand for property here is so large, and supply so limited, that short-term price shifts no longer matter to anyone other than the developer or the, now rather rare, highly geared speculator.

Knight Frank's Elena Norton, the leading property advisor to the Russian wealthy, reports on page 10 that London is losing potential buyers to Switzerland, among other locations. This sounds like a vote of no-confidence, but is actually the reverse. With so few London owners needing or wanting to sell properties in her clients' target £15m to £25m bracket, they are finding it harder than ever to find what they want. With Switzerland offering one of the only acceptable alternatives to the UK in terms of schooling for the children of the Russian elite, it is becoming the new target of frustrated buyers who have been denied access to the top of the London market.

The prime London market is becoming ever more difficult to access – with choice so limited in some areas as to make suitable purchases a virtual impossibility.

Over the past six weeks, amid renewed concerns over the health of the global banking system and rumours of radical action by the world's central banks, there is a heightened sense of nervousness in the London market.

We know that if the storm comes that no market is immune, and not a day goes by without someone asking me whether prices are set to rise or fall. Our headline forecast is provided overleaf, increasingly, however, to a growing number of property owners in prime London, the real answer appears to be – 'who cares'?

# MARKET OUTLOOK

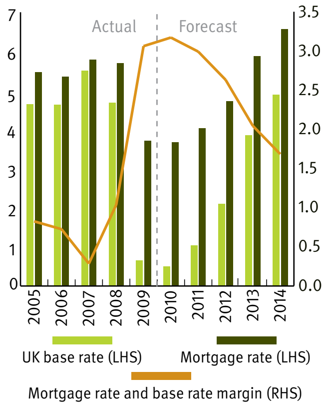
**In this section we have drawn together the critical datasets which will help determine the future performance of the prime London residential market.**

"WE HAVE SEEN THE NUMBER OF NATIONALITIES IN THE LONDON MARKET RISE FROM AROUND 30 IN 2008, TO THE HIGH 40S IN 2009 AND MORE RECENTLY TO OVER 50."

Figure 5

**Falling margins**

Average annual UK base rate, mortgage rate and margin

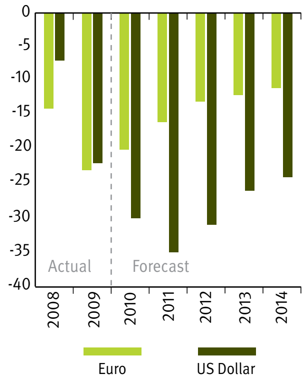



There have been two key factors underpinning rapid price growth in London over the past 15 months. The first has been the stimulus provided by record low interest rates. Although mortgage margins, over the UK base rate, have widened considerably from 100 basis points in 2007 to over 300 more recently, the expectation is that as rates rise over the short and medium-term, margins will begin to fall back and help absorb some of the pain for borrowers.

Figure 6

**Currency discount**

Shift in the value of the pound versus Euro and US Dollar, benchmarked against the end of 2007 position (%)

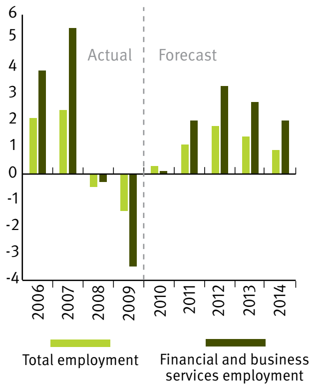



The second factor aiding the London market recovery, has been the fall in the pound and the related "discount" offered to international buyers. In 2009 it was European buyers who were the key beneficiaries. As the Euro has weakened it is buyers with US Dollars, or with currencies pegged to the Dollar, who have led the market. Most forecasts point to continued strength for the Dollar, which should help to underpin the London market.

Figure 7

**Slow jobs recovery**

Central London employment, annual change (%)

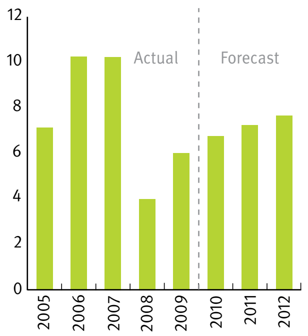



As the stimulus from low interest and exchange rates begins to weaken, a critical factor influencing demand and pricing for prime London sales and rental property will be the performance of the central London employment sector. Following two years of decline and negligible growth this year, it will be 2013, if not 2014, before we see employment back at 2007 levels, although the direction of growth ought to be positive from the end of 2011.

Figure 8

**Bonus season**

London's financial sector bonus pool, year end, actual and estimate (£bn)




Profitability In London's financial sector will determine the ability of buyers to maintain and even increase current price levels in central London. This chart shows the Centre for Economic and Business Research's latest estimates and forecasts for London's financial sector bonus pool up to 2012. Renewed turbulence in global financial markets points to growing uncertainty over the ability of this performance to be achieved, irrespective of the political moves to cap bonuses and to levy additional taxes on the banks.

Figure 9

**International demand**

Prime London £2m+ purchasers, split by broad international region, excluding UK buyers, 12 months to June 2010

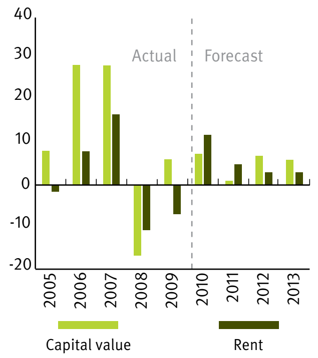
| | |
|---|---|
| Africa | 4.4% |
| Asia | 8.8% |
| Australasia | 2.9% |
| CIS | 3.6% |
| Europe | 27.0% |
| India | 8.0% |
| Middle East | 16.8% |
| North America | 12.4% |
| Russia | 13.9% |
| South America | 2.2% |

The sheer diversity of demand in the London market has been a significant reason for the recovery in the market. We have seen the number of nationalities in the London market rise from around 30 in 2008, to the high 40s in 2009 and more recently to over 50. Above £2m more than 50% of sales are now going to international buyers. The growing weakness of the Euro and concerns over the Eurozone economy are likely to put pressure on the ability of European buyers (who account for 27% of all international purchases) to access the London market in late 2010 and 2011.

Figure 10

**Price and rent forecast**

Prime central London capital value and rental value forecast (%)




Our prime London price forecast for 2010, at 7.5%, allows for price falls in the second half of the year which will go some way to moderating the double digit rate of growth we saw in the first half. The combined impact of rising interest rates and a slowly strengthening pound will conspire to limit growth in 2011, before economic recovery leads to stronger, yet still moderate, growth in 2012. The outlook for rents is more positive in the short term as the market claws back some the of 20% decline in 2008 to 2009.

Sources: Knight Frank Residential Research, Bank of England, Oxford Economics, ONS, CEBR







# NEW ORDER

**Liam Bailey looks at what the emergency budget on 22 June told us about the thinking of the UK's coalition government and how it will shape the future of the central London economy and housing market.**

The most obvious point to take from George Osborne's first budget was the seriousness of intent. It was a more hard-hitting statement than had been expected, with the objective of reducing the UK's budget deficit from 11% of GDP to 2% by 2015. No other country is planning public spending cuts of anything like the size required to meet the new government's deficit targets.

The impact of the fiscal retrenchment is significant, representing 6.3% of GDP over a five-year period, and the risk this poses for the UK economy is significant, especially as the country is barely moving out of recession.

The budget wasn't all about spending cuts, taxpayers will need to bear some of the pain due to the severity of the problems the country is facing. By virtue of the heavily trailed advance warnings from the government, Capital Gains Tax (CGT) was always going to be the main story from this budget. In reality the rise to 28% for higher rate tax payers is a non-issue for the housing market.

The rise came into play overnight, meaning that there was no opportunity for a sudden sell-off of second homes or investment properties. The new rate effectively takes us back to a level last seen under the pre-2008 rules, when taper relief enabled a 40% headline rate of CGT to be reduced to 24%.

With higher-rate CGT at 28% the argument for property investment still looks strong, and capital gains still compare very favourably with income tax at 40% or even 50%.

While the budget confirmed that the new 5% higher rate of Stamp Duty would be introduced for residential property purchases from April 2011, there was a tacit acceptance that Stamp Duty rates are beginning to hit levels where purchasers are being encouraged to exploit more creative opportunities for avoidance. The government announced that they would examine whether changes to the rules on stamp duty land tax on high value property transactions are needed to prevent a reduction in tax take.

## Wealth taxes back in the spotlight

As set out in the coalition agreement, the government announced that it will review the taxation of non-domiciled individuals. This review will assess "whether changes can be made to the current rules to ensure that non-domiciled individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK." The ultimate impact of this review will be difficult to pre-judge, there is a sharp divergence of opinion regarding 'non-doms' between the Conservatives and the Lib-Dems.

The budget also announced that the government is looking to take "action to tackle unacceptable bank bonuses." The announcement confirmed that the Independent Commission on Banking will "look at structural and non-structural measures to reform the banking system and promote competition". In addition, the government confirmed that it would consult on a "remuneration disclosure scheme... [and would] explore the costs and benefits of a Financial Activities Tax on profits and remuneration."

There is potential from both of the above to weaken demand for prime property, especially in London. The evidence from the past two years is that raising taxes on wealthy UK residents does tend to encourage people to look overseas for alternative residency options – so far most have not actually taken up the opportunity – but the government would be wrong to assume that there would be no risk of a flight of wealthy people if these reviews were clumsily handled.

The rather clean approach taken with CGT, with the avoidance of the need to reintroduce taper and indexation, suggests that we may well be seeing the beginning of a welcome return to tax simplification.

The housing market was thought to be at significant risk from measures in this budget. In reality, the changes announced seemed to be carefully considered, and the certainty created by the announcement will serve to underpin the market.

It was noticeable that the budget contained strong GDP growth forecasts for 2011 and 2012. The inference from this is that the Bank of England will be encouraged to maintain a very loose monetary policy well into 2011, if not longer.

This requirement to offset fiscal tightening through monetary policy, suggests that interest rates at their current levels could well be maintained for longer than was previously thought likely. This will underpin house prices and also contribute to ongoing low supply in the market as potentially distressed owners are protected by low mortgage payments.

With the imposition of the new 20% VAT rate being delayed until January 2011, the risk that this change might add to inflationary pressures is reduced considerably.

# NEXT NEIGHBOURHOODS – FIVE OF THE BEST

**Even in a market as well developed as central London there are always areas on the rise. Our local market experts present a carefully curated selection of the key locations set to outperform in the future.**

## 1 Leman Street, E1

Sarah Shelley, Head of Knight Frank Wapping sales

Regeneration along the eastern fringe of the City of London has been progressing for decades. Despite considerable improvements in locations like Wapping and Spitalfields, there has been an ongoing problem that these areas have tended to be created as isolated pockets of gentrification.

This dislocation highlights the importance of the regeneration of Leman Street. This process effectively creates an arc of new and emerging prosperity from Spitalfields in the north, through Brick Lane, Whitechapel and Aldgate and then south towards Wapping.

The new attention from developers and retailers along and around Leman Street suddenly has made a big difference. Only five years ago Leman Street was a very run-down location with little on offer to attract new residents. In recent years developers, retailers and even restaurateurs have begun to pay attention to Leman Street itself as well as neighbouring streets.

One of the biggest catalysts for change has been the Berkeley Homes' City Quarter and Sugar Homes development which has improved the physical fabric of the area and imported several hundred new residents. Suddenly there is a real feeling of sustainable change in the air.

Incomers to Leman Street and the surrounding area are well provided for, with a Waitrose supermarket at St Katherine's Docks, and new shopping, bars and restaurants closer to hand. The appeal of the area is also underpinned by a theatre, cinema, art, music and events provided by the Whitechapel Art Gallery and the increasingly popular Wilton's Music Hall.

Currently a large portion of residential demand comes from the 'City' market, with a strong requirement for weekday crashpads and pied-a-terres. As the area matures we expect a more mixed demand base to develop, including families, as we have experienced in Wapping over the past two decades. The English Martyrs Catholic Primary School in St Mark Street has proved a key driver of demand, particularly in the case of French families re-locating to London.

## 2 Brook Green, W6

Rupert des Forges, Partner, Knight Frank Knightsbridge sales

Brook Green is an area that has grown a serious following from those looking for high-quality family living. The presence of attractive streets with a good mix of family properties – from two bedroom cottages to seven bedroom family houses with good gardens – have been the main driver for pulling in new demand. Schooling and easy access to the West End have also been strong contributory factors.

Local schools are excellent, and for girls in particular Brook Green is host to arguably the best schools in the UK, with St Paul's Girls School, Godolphin & Latymer and Bute House all in very close proximity. In terms of accessibility Brook Green is a 5-minute drive from Kensington High Street and Holland Park. There is excellent access to underground lines at Hammersmith, Shepherds Bush, Kensington Olympia and on to Heathrow Airport.

One of the big influences on demand and pricing comes from the growing number of corporate headquarters in the area, especially at Hammersmith Broadway, with Coca Cola, T-Mobile, L'Oreal and Disney among others. The expansion of local employers offering high paid senior positions has had a notable effect on pricing at the top end of the Brook Green market together with spillover from the Holland Park and Notting Hill areas, with prices for the best houses hitting £4m.

Key streets in demand include: Luxemburg Gardens and Rowan Road, south of the Green, and Caithness Road and Girdlers Road, to the north. Smaller but attractive houses around Masbro Road and Faroe Road are also hugely favoured. With some excellent shopping and restaurants, including one of the original gastro pub's the Havelock Tavern on Masbro Road, the lifestyle offer in the area is very strong.

During the recent market recovery, prices have risen here by around 20% to 25%, and the best houses now exceed the peak of the market in mid-2007, although with pricing at around £700 to £800 per sq ft accommodation is effectively half price compared to Notting Hill.

## 3 Heaver Estate, SW17

Luke Pender-Cudlip, Head of Knight Frank Wandsworth & Clapham sales

Wandsworth has carved a justified reputation for offering a spacious and more relaxed alternative to more central locations north of the river. With over 500 acres of parks and commons the area is perfect for family living.

There are so many different parts of Wandsworth that have grown in popularity over recent years, but one area that stands out in terms of growth in both prices and demand has been the grid of streets around Ritherdon and Elmbourne Roads that form the Heaver Estate.

The estate was built towards the end of the nineteenth century by Lord Alfred Heaver as large family homes, many of which overlook the common. This provenance lends the area an architectural integrity and a high quality streetscape that partially explains its popularity, but also contributed to the area becoming Balham's first conservation area. With their red brick façades, decorative window panes and intricate wrought iron railings, the houses are fine examples of late Victorian architecture. The famous Tooting Lido, built in the 1920s, is a short walk away and the common also boasts tennis courts, a café and several ponds for fishing as well as weekend football matches for adults and children. Tooting Common is the largest open space in Wandsworth and there are wildlife areas, woods and paved walks.

With large family houses in the estate selling at £1.75m in mid-2009, and a year later hitting around £2m price performance here illustrates the market's positive view of the area.

The Heaver Estate has become a target for the more cosmopolitan buyer who has become a recent feature of Wandsworth generally. There have always been lots of local buyers looking to upsize, but over the past 18 months the volume of Chelsea buyers who have been coming into the market has risen, as too has the number of European buyers – with Italians and French in particular becoming a notable part of the market over the past year.

The most significant long-term draw for the Heaver Estate is the volume of attractive, perfectly proportioned, family-sized properties on offer. While prices have risen strongly over the past year, they still only stand at half the level achieved for similar properties north of the river. The outlook for the estate looks positive over the long-term.

## 4 Parsons Green, SW6

Anne Soutry, Head of Knight Frank Fulham sales

Parsons Green is perhaps the most established of the five areas selected in this review, and readers might be surprised to find that we think there is more room for growth and improvement in the future. The lesson here is the power that schools have to create residential demand.

While Parsons Green has benefitted from the presence of Fulham Prep and Kensington Prep (the 2009 Sunday Times Independent Prep School of the Year), in recent years the area has become home to two more very high profile arrivals – Thomas's Prep and l'Ecole Marie d'Orliac.

This cluster of well-regarded prep schools has served to reinforce the well established pattern for young families to move out of Kensington & Chelsea and into Fulham. The difference now is that the move is prompted by a desire to access local schools as much as the opportunity to make a significant saving on housing costs.

For new arrivals Parsons Green offers the benefit of a village environment. There are a host of independent shops, cafes and restaurants along New King's Road and easy access to open spaces. In addition to the eponymous green itself, Hurlingham Park, South Park and Bishops Park are only a few minutes walk away.

One of the key targets for new arrivals is the grid of streets that makes up the Peterborough Estate, in particular Quarrendon, Chiddingstone and Bradbourne streets. The strength of demand for the estate was clearly evidenced through the downturn, when the number of skips designating the latest rash of huge basement excavations and loft extensions never even declined.

Despite the improvement to local schooling, and the corresponding rise in prices and demand, the price differential with areas further east is not only as wide as ever, but arguably has actually widened in recent years.

Prices for the best properties in Parsons Green hit a ceiling of around £950 per sq ft; move east and prices very quickly rise up to £1,500 per sq ft in Chelsea, meaning that many more buyers in central London are jumping straight here as their first move for family accommodation.

## 5 Portman Estate, W1

Christian Lock-Necrews, Head of Knight Frank Marylebone sales

The regeneration of Marylebone High Street's retail offer by the Howard de Walden Estate and its beneficial impact on local residential prices is well known. An area long overlooked as a prime residential location in favour of areas further south and west, it took off on the back of high quality independent shops and restaurants.

What is less well known is that the positive impact of retail-led regeneration is being taken up with aplomb in new locations by the Howard de Walden Estate and the neighbouring Portman Estate.

The Portman Estate, which controls much of the western part of Marylebone, has started its own improvements in the Portman Village, to the north of Marble Arch tube station, and also with improvements to Portman Square for the lead up to 2012.

The opportunity for the Estate is to harness the attraction that the set-piece Bryanston and Montagu Squares hold for buyers, where sales of £1,300 per sq ft are common, and to translate this into the neighbouring streets like Wyndham and Upper Montagu Street where prices are more like £900 per sq ft.

What we have seen over the past few months is buyers who would have only considered the squares or something closer to Marylebone High Street are now looking at the streets around the main squares. The key driver for this shift in demand is the belief that the streetscape and retail improvements are creating concrete and permanent change in the locality.

One key sign of the change in the area has been in developer activity, which has been much more evident in the area south of Crawford Street in the last 12 months.

The biggest change in Marylebone over the past two years has been the volume of people looking to relocate here from areas further south and west. Exiles from Notting Hill have long been a feature of the market, and buyers moving out of neighbouring Mayfair are to be expected, but there has been a noticeable increase in interest from Kensington and Knightsbridge. Looking at where values moved in those locations over the recent past it should be an interesting time for Marylebone over the next few years.

# LEARNING LESSONS FROM NEW YORK AND HONG KONG

**London's housing market recovery, on the back of low interest rates and an improving global economy, is not unique. Most of the main world cities have seen improving fortunes over the past 12 months. If the recovery is not unusual, neither are the emerging problems surrounding the requirement to plan for deficit reduction and the need to manage the future trajectory of inflation and interest rates.**

**To understand how other major cities are coping with economic and housing market turmoil we spoke to the most influential commentators in two of the biggest markets.**

## Manhattan shifts sideways

**Jonathan Miller, CEO of Miller Samuel Real Estate Appraisers, New York**

The Manhattan market has not experienced the bounce in pricing you have seen in central London, although the market is a lot healthier than it was 12 months ago. One way in which the market did improve over the past year was in sales volumes, which rose rapidly from the second quarter of 2009 to the end of the first quarter of 2010.

However, one of the federal stimulus measures that aided the growth of sales volumes was the Tax Credit on house purchases, which came to an end at the end of April. The expiration of the Tax Credit has meant that the pace of sales volume growth began to ease in April after unprecedented growth in the first three months of the year. The market is now beginning to return to more expected seasonal patterns.

Prices have been fairly flat for around 12 months, although there does seem to be the beginning of growth at the upper end of the market ($2m+) where the recovery in bonuses and earnings on Wall Street is feeding into demand and competition for the best properties.

The big problem in the market, which reflects the London experience, is financing. Mortgage lenders are still putting obstacles in the way of everyone but the very best purchasers and confidence within the banks is still fragile.

For those who can access them, mortgage rates in New York, as in London, are low by historical standards. The recent Eurozone crisis has acted to push longer term rates even lower – 30-year fixed rates at 4.89% are available and these are helping to encourage some buyers into the market.

The new-build market in New York is still a major problem for the wider market. My understanding is that in London the majority of available new-build units sold steadily through 2009 after developers slashed prices to get the market moving. In Manhattan the volume of available new-build stock – the so-called shadow inventory – is still equivalent to around seven years' worth of expected annual take-up.

Until developers or funders decide to tackle the issue of overpricing in this market this overhang of stock will continue to act as a drag on the market.

As an example, in 2006 57% of all Manhattan sales were new-build units, in 2010 to date the figure is closer to 17%.

The prospects for the second half of 2010 look fairly benign for Manhattan. Prices are likely to edge up, but significant price growth does not appear likely. In fact the most probable outcome is for the market to move sideways for the remainder of this year and next .

## Hong Kong cooling

**Xavier Wong, Head of Research, Knight Frank Hong Kong**

Like London, Hong Kong saw a dramatic recovery in the residential property market after the credit crunch and the downturn in 2008. However, the rate of price growth experienced in London pales by comparison to that in Hong Kong. In the 16-month period up to April 2010, prices of prime residential properties in the city rose by about 50%. Residential property has not been alone in experiencing the asset price boom, the value of Hong Kong Grade-A office accommodation rose by over 70% during the same period.

The factors driving this growth are I am sure familiar to you in London. Very low interest rates have pushed demand higher, mortgage rates of sub 2% are common and strong demand has been set against limited supply.

Despite these positives, it was inevitable that price growth at this level could not continue for long. Market pricing turned down in May, and prices fell by 2-3% through the month. Understanding why prices have fallen is useful to help understand the differences between Hong Kong and London.

In addition to a worsening sovereign debt crisis in Europe and unsettled global financial markets, capital flows into Hong Kong from the Mainland have also been reduced due to liquidity in the Mainland property market drying up.

Another key driver for the slowdown in Hong Kong's housing market is government action. The Hong Kong government has shown its willingness to actively cool the residential market. There was considerable popular support for some form of government response to rapidly growing prices, and a three-pronged approach has been introduced to attempt this.

Firstly, the maximum loan to value ratio for luxury homebuyers has been lowered to 60%. Secondly, the government has tried to increase land supply, with a view to changing price expectations as well as demand-supply dynamics. Finally, developers are now virtually barred from phasing the release of new developments into the market, in an attempt to try to push prices higher as successive phases are sold, pretty much a standard practice across the world. Developers now have to release 50% of each development's units in the first phase.

With the Hong Kong authorities taking actions to slow the market, I believes that a major market downturn could be avoided. I do expect that prices will fall another 5% before the end of 2010, wiping out the price gains recorded in the first few months of the year.

My relatively confident outlook for the Hong Kong market is based on the assumption that low interest rates will be maintained through this year and well into 2011. In addition, demand for accommodation is still outstripping supply, and while the Hong Kong authorities are committed to releasing more development land, this process will be slow and the new projects will not come onto the market until 2013 at the earliest.

This experiment in direct government action on the housing market will be an interesting case-study to watch over the next year – we may see similar attempts in other countries and not just in Asia.

"THIS EXPERIMENT IN DIRECT GOVERNMENT ACTION ON THE HOUSING MARKET WILL BE AN INTERESTING CASE-STUDY TO WATCH."

# MARKET INSIDERS

**Insight and expertise from key players at the top of the market**

1 Andrew Giller

2 Elena Norton

3 Willie Gething

4 Simon Gammon

## 1 Changing buyer requirements

The burgeoning market for private buying services provides an opportunity for Andrew Giller, Head of London Buying at The Buying Solution, to reflect on the changes to his market over recent years.

The buying business has changed significantly in the 10 years that I have been operating. Most obviously the market has become bigger. More people have decided that instructing a buying agent is not a luxury, but a smart move to get one-step ahead in the market.

It is no longer just the global elite who retain buying agents, our client base has become more diverse and the price point at which we act for clients has decreased over time. Five years ago we did very little below £2m in London, and while we are busier than ever in the £5m, £10m and £15m+ price brackets, the fastest growing side of our work in the last 12 months has been the £1m to £3m bracket.

The key attraction from the client's perspective is the speed of action from the buying agent. We can get our clients the first viewing on houses that are coming to the market. In the market we have experienced over the past year this has been critical, because it is the person who views first who has the option to say "yes" or "no", the second viewer risks only being able to counter or better a previous offer.

On average it takes between 6 and 12 months to search, identify and finally buy a property, bearing in mind lots of our clients are out of the country for long periods this reflects a real time saving for them. During this period we build a very strong relationship with our clients with telephone calls or meetings at least two to three times a week.

If I could point to one change that has occurred over the past seven years, it is that while the buying world has become a little more democratic, in terms of the people who can now access the service, the demand from buyers has become ever more demanding. It was the Russian invasion that caused it.

When Russian buyers came into the UK in the early 2000s they wanted expensive properties, and they got them. By 2004 and 2005 the Russians who were buying were much more sophisticated in terms of taste and expectation than those who came over five years earlier. If you want to see modern craftsmanship in homes, go to Moscow. Only in the last three years has the same quality and attention to detail been brought to UK. It has served not only to push up their expectations, but has also pushed up the expectations from UK buyers and all nationalities in London.

The critical point that serves to limit the market is the management of conflicts. Buying agents can only act for one client at a time looking in a single price bracket in a single part of London or the country. It is this factor that to my mind means that for all the growth of my market over the past decade, high-quality buying services will always remain niche, or at least boutique service rather than transferring over into the mass market. This will ensure that demand for our service will always outstrip supply.

I always say to clients that I have the best job in property – because rather uniquely I don't sell anything.

## 2 Russian frustration

With demand for London property as high as ever from Russia, Kazakhstan, Ukraine and the other former Soviet states, Elena Norton, the Head of Knight Frank's Russian and CIS desk, considers a new source of frustration from her clients.

For over 18 months there has been very little to buy at the top end of the London market. In fact so tight has the market been that buyers have shifted their focus to St John's Wood and Hampstead, and even here there has been little to tempt them, so they have been moving further out to prime Surrey locations like St George's Hill and Wentworth.

This frustration with slim pickings in London has encouraged some of my buyers to look overseas for alternatives to London. The only location that really works for them is Switzerland, where education facilities, especially at school age, are on a par with England's best, and where taxation advantages add to the attraction.

There has been a recent trend for Russian children to consider the best US universities, as an alternative to UK institutions. In my experience this trend is generally resisted by parents who have become used to the unique combination that London offers, with ease of access and excellent universities located next door to a prime residential market. The problem in the US is that the desirable Ivy League universities are not generally adjacent to the best business and residential locations.

Looking to the future, Russian buyers are very positive in terms of their views on the outlook for London's economy. With most buyers being both non-resident and non-domiciled, tax changes are almost irrelevant, and there is an unshakable belief in London's global position for finance and business. My view is that demand will remain strong and is one of the key reasons why I would be very surprised to see prices falling at the top end of the London market.



## 3 Investment opportunities

Willie Gething, co-founder of Property Vision and now Executive Chairman of Lennox Investment Management, explains his strategy for navigating the market. He describes what is going on as "the most difficult time ever in my experience to call the market."

The opportunity offered by central London property investment remains undimmed. Neither the 2008 crash, which shook the faith of many buyers, nor the rebound in 2009, which removed the opportunity for bargain hunting, has undermined the long-term case for investment. That said, the market today requires a more nuanced and careful approach from the investor.

In early 2009, the view from almost everybody in the market was that prices would fall 30% to 40% peak to trough, and that there would be blood on the streets in the same way that it flowed in 1989-1992. Buying opportunities would be there for the taking.

It didn't happen, and the key reason was the reaction of the Bank of England and the Federal Reserve. Interest rate policy in late 2008 repeated the move by Alan Greenspan after 9/11 that has become known as "The Greenspan Put". With rates at historic lows and the pound devaluing daily against an over-valued Euro, the London market bounced so that most of the 2008 losses have already been recovered.

There is a possible correlation between what is happening now and what occurred during the Greenspan heyday. The recent central London price bounce means that, as in 2002, most of the price growth we would have expected over the recovery period has already happened. This means that, very much as we saw in the 2003 to 2005 period, prices could easily track sideways through 2011 and 2012. They are certainly not cheap.

This sober reality has to be the starting point for any investment strategy. There are two drivers that contribute to investor returns; firstly external, in terms of market movements, and secondly internal, in terms of what steps we take to add value to each asset. In the short-term, the former is unlikely to deliver an appreciable result. So the investor has got to focus on improving the asset.

This is our strategy. The central London investment market is once again all about hard graft, buying high quality properties in the best positions, and adding value through comprehensive refurbishments. This is not a time for 50% value uplifts, but 15%-25% on the back of increased floor area, improved layouts and saleability.

Where are we concentrating our efforts? I have never been entirely convinced by 'area plays'; some go right and some don't. Paddington has never really performed in the way the pundits predicted, and Bayswater has still to prove its potential. So we focus on the best assets in the best locations and roll up our sleeves to improve them – which has proved to be a good strategy through the rises and falls of the London market over the past three decades.

## 4 Money into property

Simon Gammon, Head of Knight Frank Finance, provides his outlook on the prime mortgage market, and examines trends in lending.

As the high street lenders slowed down their lending activity following the credit crunch, the private banks stepped up their activity. In fact the private banks have seen the last year as an opportunity to pick up clients they would normally not be coming into contact with. Although the banks have remained as choosy as ever it is just that this has been an opportunity to see who else is out there.

While the private banks have been expanding their client base, they have not had to become more competitive, they have largely maintained their spreads over base rate, it is that the high street lenders have widened their spreads and have become by default less competitive over time.

The private banks have demonstrated a much more flexible attitude to risk more recently than the high street, with loan to values of 85% being offered at good rates. The banks have become more savvy, they recognised their power and they tightened up their criteria and actively have gone out to widen their client pool.

By targeting clients they have been able to pull considerable wealth into their net, one bank offers very good rates, but insists that in return for accessing the rates, that borrowers must agree to deposit at least an equivalent pool of funds under management from day one of the loan commencing.

The high street lenders have also been under pressure from foreign lenders. There was a lot of noise about the Bank of China when it came into the market in early 2009, but there have been others, especially those from the Middle East and Asia.

The high street is beginning to relax its criteria a little and buy-to-let products are beginning to filter through with some interesting products from the likes of Clydesdale.

Until recently the majority of our borrowers were opting for variable rates, there has been a noticeable shift toward fixed options, but in reality it is the five-year options that are taking people's attention, two and three years are not creating a huge amount of attention.

There is plenty of scope for lenders to shrink their margins, thereby shielding borrowers from rising rates. There has been precious little opportunity to over extend on borrowings since the second half of 2008 and this more cautious environment is set to remain with us.

> "THE PRIVATE BANKS HAVE DEMONSTRATED A MUCH MORE FLEXIBLE ATTITUDE TO RISK MORE RECENTLY THAN THE HIGH STREET, WITH LOAN TO VALUES OF 85% BEING OFFERED."

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**Knight Frank area definitions** – **Prime central London:** Belgravia, Chelsea, 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