London Residential Review

Q3 2023

Knight Frank's quarterly analysis of the prime London sales and lettings markets

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Prime London Sales Market

Economic picture darkens but prime market resilient

The air continued to slowly come out of the prime London property market in the second quarter of 2023.

It is a process that began last summer as inflation approached double digits and it became clear that interest rates were heading back towards their long-term average of closer to 5% than 1%.

The UK's return to more normal lending conditions after 14 years of near-zero rates was not unexpected.

However, the journey was not supposed to be this volatile.

While the previous government went too far, too fast for financial markets, the Bank of England has been accused of doing too little, too late.

The result has been a chaotic lending market over the last eleven months that has unsettled buyers, sellers and anyone re-mortgaging.

Mortgage lenders have cut rates following July's better-than-expected inflation reading and the cycle of 14 consecutive rate hikes may be nearing its conclusion.

The prime London property market has not been immune to this uncertainty, and price growth has flattened (fig. 1).

What impact has the spike in mortgage costs and speculation around falling prices had in the capital in Q2? The answer is not a particularly dramatic one. The economic mood has darkened but the market is far from grinding to a halt. The number of new prospective buyers in London in Q2 was 30% above the five-year average (excluding 2020).

The resilience is perhaps no surprise given that around half of sales inside zone 1 are typically in cash. The market will also be supported by greater levels of affluence, the relatively weak pound and the fact overseas travel is returning to pre-Covid levels.

Higher price-brackets have certainly proven more robust due to less reliance on mortgage debt (fig. 2). However, the higher-end of the property market does not operate in a vacuum and sentiment has suffered.

Sensitivity around asking prices is higher than it was at the start of the year and nervousness among lenders is rising. We expect average prices to decline by 3% in prime central London (PCL) and 4% in prime outer London (POL) this year.

That said, this will be by less than mainstream UK markets as the capital continues to benefit from the fact its housing market experienced a relatively subdued period during the pandemic, with prices flat.

30%

The increase in the number of new prospective buyers registering with Knight Frank in London in Q2 versus the five-year average (excluding 2020)

6.1

The ratio of new prospective buyers (demand) to instructions (supply) in the capital was 6.1 in June compared with 7 a year ago, underlining the prime London market's resilience

10%

Exchanges were up by 10% in London in June versus the five-year average (excluding 2020)

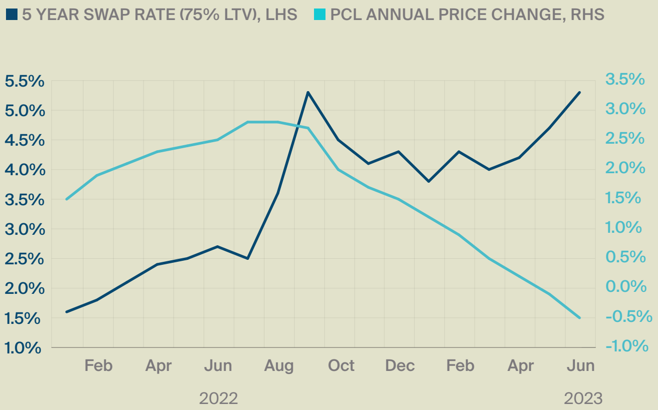
3%

Expected decline in the average price of a property in PCL this year

"The air continued to slowly come out of the prime London property market in the second quarter of 2023."

Tom Bill, Head of UK Residential Research

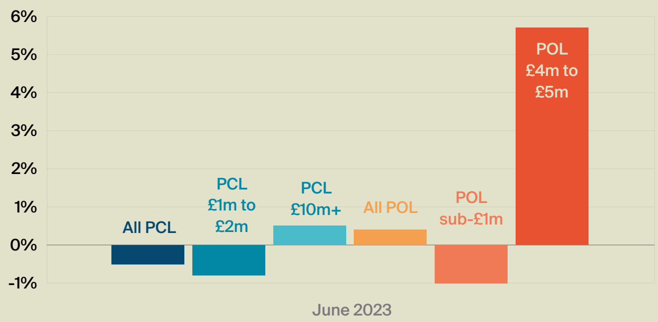
Fig 1: PCL prices flatten as borrowing costs rise



Source: Knight Frank Research

Fig 2: Prices more resilient in higher price brackets

Annual % change in June 2023



Source: Knight Frank Research

Prime London price and rental growth

June 2023, 3 month % change

Prime central London

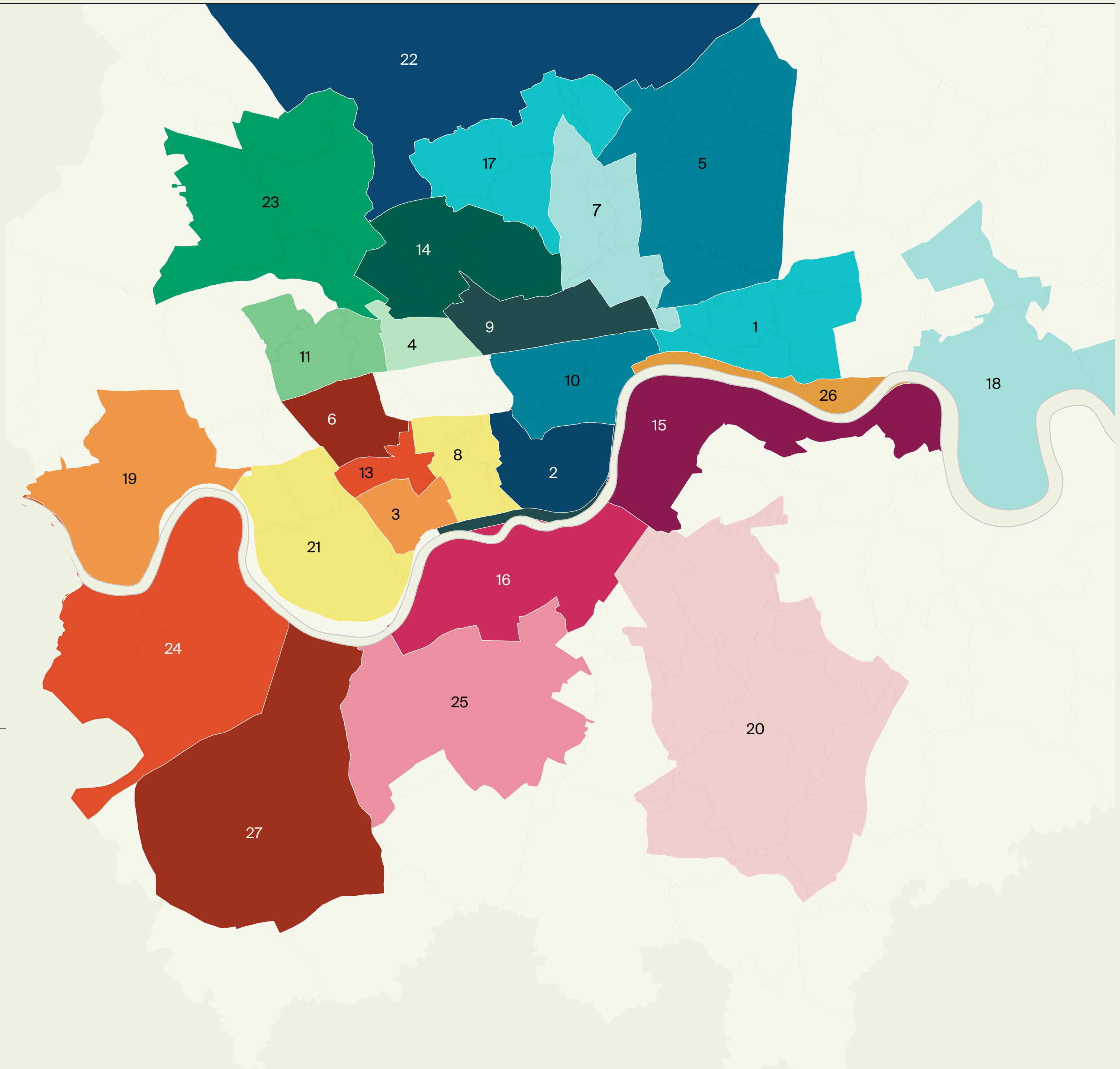
Sales	Rents
-0.3%	2.7%

District	Sales	Rents
1 Aldgate	-1.3%	1.6%
2 Belgravia	0.4%	3.6%
3 Chelsea	-0.7%	1.8%
4 Hyde Park	1.2%	3.6%
5 Islington	0.0%	3.5%
6 Kensington	-0.3%	3.4%
7 King's Cross	-0.9%	1.9%
8 Knightsbridge	0.1%	5.0%
9 Marylebone	-1.0%	2.2%
10 Mayfair	-1.6%	2.2%
11 Notting Hill	0.2%	2.7%
12 Riverside	-1.5%	2.8%
13 South Kensington	-0.1%	-0.1%
14 St John's Wood	0.6%	2.2%
15 Tower Bridge	0.1%	3.0%

Prime outer London

Sales	Rents
-0.7%	2.2%

District	Sales	Rents
16 Battersea	-1.8%	2.8%
17 Belsize Park	0.3%	1.8%
18 Canary Wharf	-0.7%	0.6%
19 Chiswick	-0.6%	
20 Dulwich	1.3%	
21 Fulham	-0.2%	0.9%
22 Hampstead	-0.4%	2.4%
23 Queens Park	-1.4%	5.4%
24 Richmond	-1.2%	1.8%
25 Wandsworth	-0.8%	0.1%
26 Wapping	-0.4%	0.3%
27 Wimbledon	-1.2%	4.9%



Increase Decrease No change

Prime London Lettings Market

Supply finally building in the capital as sales market cools

The story of low supply in the prime London lettings market appears to be coming to an end.

It will be welcome news for tenants, who face rents that are more than 25% higher than they were at the start of the pandemic.

The primary cause is the recent uncertainty in the sales market, which means more owners are letting out their property after failing to achieve their asking price.

Mortgage rates have risen sharply since December 2021 and following an increase to 5.25% in August now stand at a 15-year high.

"The preference for many owners is still to sell," said Gary Hall, head of lettings at Knight Frank. "But more are open to the rental option given the recent wobbles in the sales market.

The number of new prospective tenants registering was 13% above the five-year average (excluding 2020) in the second quarter of 2023, underlining the strength of demand from students and businesses. Meanwhile, gross yields reached 3.99% in prime central London (PCL) in June, which was the highest figure since 2009.

On the supply side, the combined number of lettings listings in PCL and prime outer London (POL) was the second highest level in May since September 2021, Rightmove data shows.

That's a trend that looks set to run, with Knight Frank data showing that market valuation appraisals to let in the capital were up 53% versus the five-year average (excluding 2020) in Q2.

A noticeable shift in stock from the sales market to the lettings market is now underway across central London (fig. 4).

As a result of the imbalance between supply and demand becoming less pronounced, annual rental value growth in PCL fell to 13.7% in July, the lowest level since October 2021. In POL, a figure of 12%, which exceeded the growth of 11% seen over the decade before the pandemic.

Stock levels began to rise early this year due to the negative impact of the mini-Budget on the sales market. However, sales activity rebounded more strongly than anticipated and lettings supply stayed low.

Whether supply continues to build this time depends on how protracted the mortgage market instability remains, which if it endures will ultimately boost lettings supply.

53%

Increase in the number of market valuation appraisals to let in prime London in Q2 2023 versus the five-year average (excluding 2020)

3.99%

Gross rental yields reached their highest level in June in PCL since 2009

13%

New prospective tenants were up 13% versus the five-year average (excluding 2020) in prime London in Q2 2023 versus the five-year average (excluding 2020)

12%

Annual rental growth declined by 0.9% in POL in July to 12% as supply shifted from the sales to the rental market

"The story of low supply in the prime London lettings market appears to be coming to an end."

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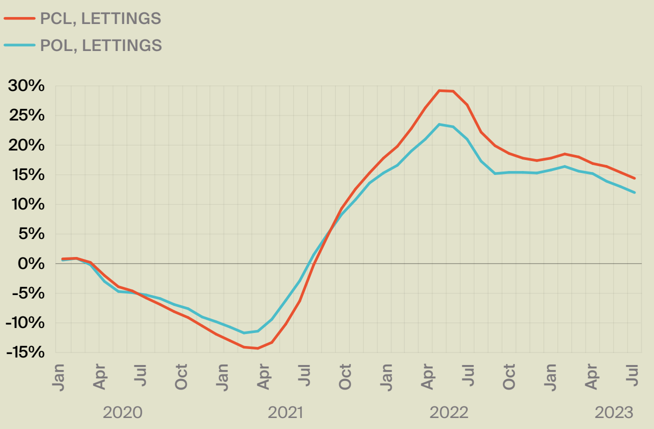
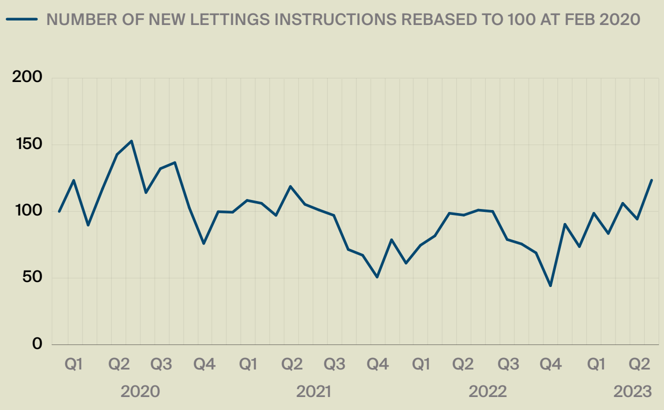
Fig 3: London annual % rental change



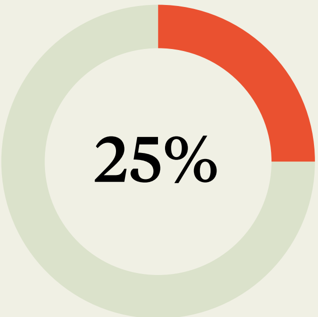
Source: Knight Frank Research

Fig 4: Lettings supply rises as sales market stutters

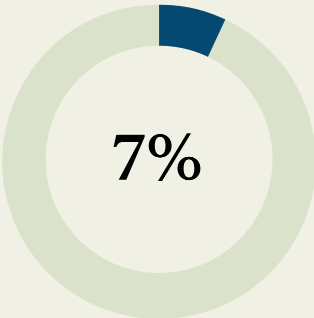


Source: Knight Frank Research

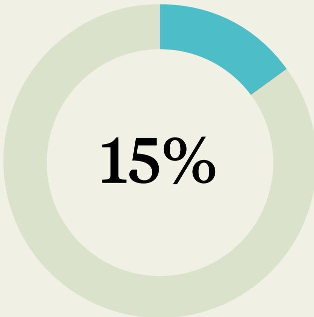
Prime London in numbers



The number of market valuation appraisals for sale in London were up by 25% in June versus the five-year average (excluding 2020). The increase in market valuation appraisals was strongest under £1m, with an increase in the period of 39%, however even at £10m+ the increase in June was 25%, as the capital's property market maintained its momentum.



The increase in total supply in London in the 12 months to June 2023 versus the previous year. The reading turned positive in the year to May 2023 for the first time in 18 months, as market valuation appraisals were converted into new instructions. As of June, the number of properties for sale in prime London was at its highest level in two years.



Tenancies commenced were down by 15% in the first four months of the year versus the five-year average (excluding 2020), as demand continued to outstrip supply and act as a bottleneck preventing more activity taking place in the lettings market. With supply now increasing and demand still strong, activity will increase in the second half of the year.

Got a question? Do get in touch, and you can sign up for more analysis at knightfrank.com/research.

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