RESIDENTIAL RESEARCH

Knight Frank

LONDON RESIDENTIAL REVIEW

FRESH STAMP DUTY UNCERTAINTY JUST AS MARKET FINDS ITS FEET

WINTER 2015/16

IMPACT OF STAMP DUTY REFORM ON THE PRIME LONDON MARKET

LONDON'S HIGHEST-GROWTH MARKETS OVER THE LAST 20 YEARS

PRIME SALES AND RENTAL VALUE MAP OF LONDON MARKETS

KEY FINDINGS

Annual price growth in prime central London declined to 0.9% in November as stamp duty reform dampened demand

The volume of transactions in central London boroughs fell by more than a quarter between January and July 2015 compared to 2014

The strongest performing markets over **the last 20 years produced net growth of 2,264%,** with the majority of growth outside central London

Annual price growth in prime outer London eased to 3% in November though asking prices increasingly reflect more subdued demand levels

Annual rental value growth in prime central London declined to 1.2% against the backdrop of global economic uncertainty

TOM BILL
Head of London Residential Research

"It highlights concerns over the financial viability of the stamp duty reform, which had the welcome aim of increasing liquidity and affordability below £1 million but runs the risk of becoming a counter-productive deterrent above that level."

FRESH STAMP DUTY UNCERTAINTY EMERGES AS MARKET FINDS IT FEET

A second stamp duty increase inside a year raises fresh questions about the financial sustainability of recent reforms

Only a year since George Osborne raised stamp duty rates for properties worth more than £1.1 million, the Chancellor announced an increase in stamp duty for buy-to-let investors and second home buyers.

The new measure is an attempt to address concerns surrounding affordability and house price inflation but raises fresh questions over the dampening effect on tax revenues just as buyers and sellers in prime London were showing tentative signs of absorbing the previous increase.

As we explore in more depth on page three, transactions and revenue have declined across London in the period following the December 2014 increase. It highlights concerns over the financial viability of the stamp duty reform, which had the welcome aim of increasing liquidity and affordability below £1 million but runs the risk of becoming a counter-productive deterrent above that level.

The latest proposals are still subject to change but mean buyers will pay an extra three percentage points in stamp duty from April 2016, which is likely to have several possible outcomes for the prime London market.

Combined with timely new measures on housebuilding and home ownership in the Autumn Statement, it squarely addresses what will become the political battleground during the 2016 London Mayoral campaign, leaving central government less open to accusations it is not tackling affordability concerns.

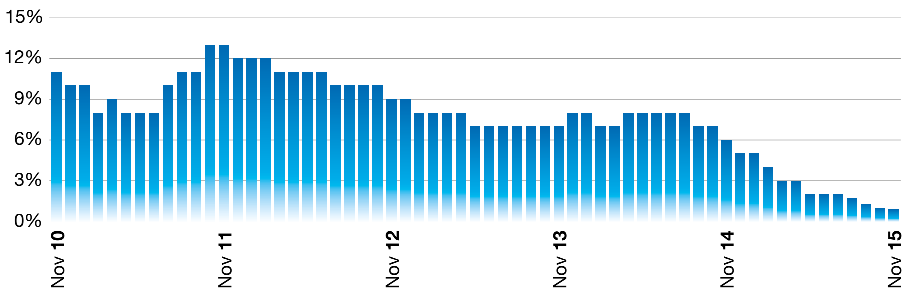
It could be argued that a second stamp duty hike within 12 months provides George Osborne a degree of political cover should revenues remain weak and calls intensify for a wholesale reassessment of rates.

In the short-term, it is likely to produce an upturn in activity as buyers act before the April 2016 deadline and there is already anecdotal evidence of added impetus during transactions.

November also saw the release of Knight Frank's global tax report, which showed London in the middle of the pack compared to other major global cities in relation to prime property tax and holding costs. The latest stamp duty change appears unlikely to alter this position materially.

Furthermore, a growing number of vendors are setting asking prices that reflect the heightened sensitivity to pricing among buyers since last December's stamp duty change and where asking prices have come down, the market is operating in a relatively normal manner and tapping into underlying demand that remains resilient.

FIGURE 1
Annual growth in prime central London in the last five years



Source: Knight Frank Research

Please refer to the important notice at the end of this report

SALES VOLUMES DIP AFTER STAMP DUTY REFORM

Changes to stamp duty rates last December have raised questions around the viability of a system that has dampened transaction levels and lowered the tax take in London.

The new rules mean that buyers will pay £153,750 in stamp duty for a property worth £2 million versus to £100,000 before the change.

The result is that £1 million-plus transactions in London in the first seven months of this year fell 25% compared to the same period in 2014.

A Knight Frank analysis of sales volumes across London local authorities shows the biggest impact has been felt in prime central London.

Between January and July this year, the volume of transactions fell -28.6% in the borough of Westminster compared to 2014, as figure 4 shows. Meanwhile, the drop was -27.5% in Kensington & Chelsea and -27.9% in Tower Hamlets, which includes the Canary Wharf district.

Accordingly, the total value of transactions in central London has fallen disproportionately, as the map in figure 2 shows.

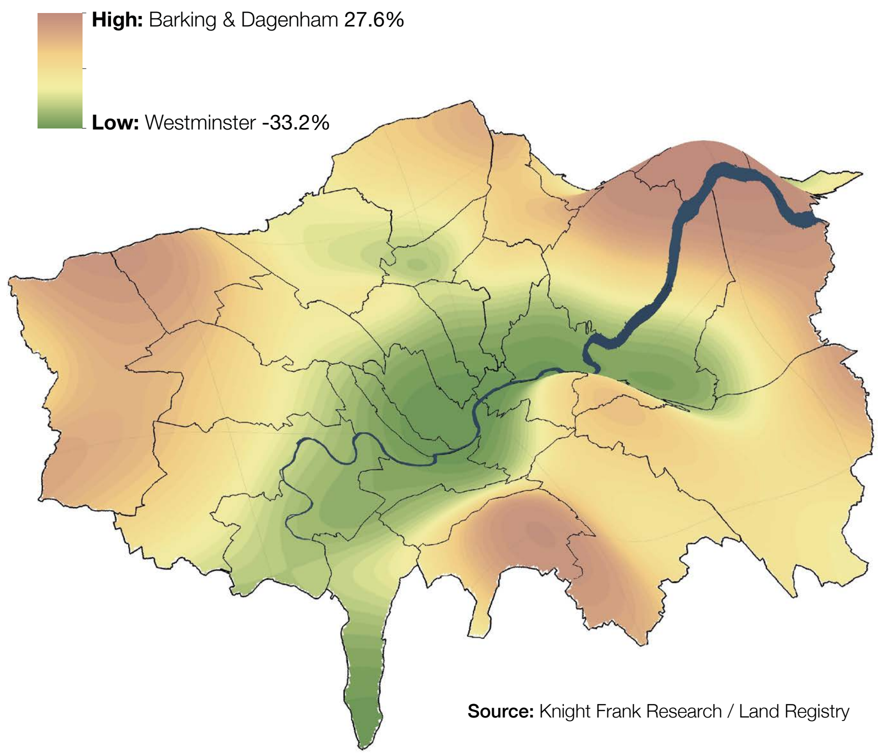
The chancellor's decision to undertake the long-overdue reform was welcome. A progressively-structured tax means more first-time buyers and home-movers will pay less when they buy a home and there is every indication policymakers are now turning their attention to supply, making sure there are enough new homes to meet demand across London and the rest of the country.

However, the volume of transactions only rose in three out of London's 32 boroughs between January and July this year. Furthermore, the value of transactions only rose in 11 boroughs.

FIGURE 2

The value of transactions has fallen in central London

Change by local authority, January to July 2015 vs 2014



Source: Knight Frank Research / Land Registry

As a result, the stamp duty tax take was down -8.7% across London, which included a decrease of -17.5% in Westminster, -33.8% in Tower Hamlets and -19.1% in Wandsworth. The stamp duty take only fell -1% in Kensington & Chelsea due to the impact of the higher rates.

Meanwhile, the combined tax take of Westminster and Kensington & Chelsea represented 11.7% of all stamp duty in England and Wales in the first seven months of the year, an increase from 10.9% in the same period in 2014.

It means the government is increasingly reliant for stamp duty revenue on the local authorities where transactions are declining at the steepest rate, which raises questions over the future viability of the new rates.

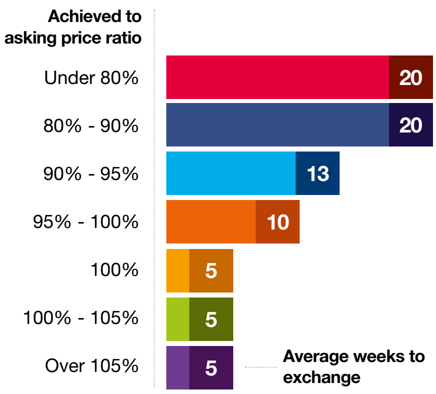
Higher transaction costs have led to a stand-off between buyers and sellers in some markets during what is typically a more active time of year. However, there are tentative signs vendors are adapting to the new reality and reflecting this in asking prices, though a clear-cut pattern of behaviour has not emerged.

Other risks being factored in by buyers include an interest rate rise late next year as well as the wider political backdrop. The London property market is likely to remain a live issue in the run-up to the Mayoral elections in May 2016.

In this markedly more price-sensitive environment, Knight Frank data shows correct pricing is key and properties sell more quickly when the asking price is close the final sale price, as figure 3 shows.

FIGURE 3

Realistic pricing is key



Source: Knight Frank Research

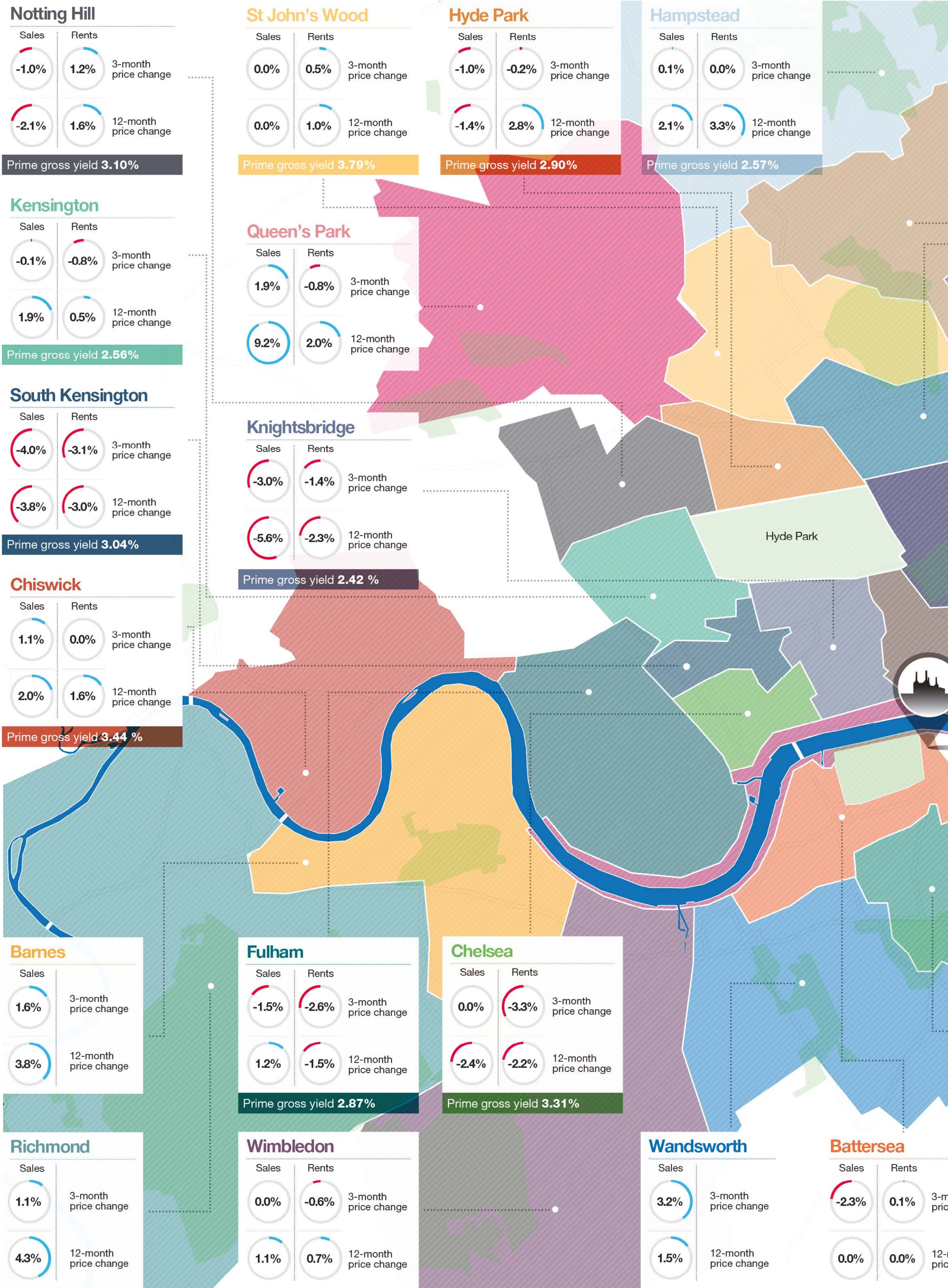
FIGURE 4

Transaction volumes: the biggest declines January to July 2015 vs 2014

1	Westminster	-28.6%
2	Tower Hamlets	-27.9%
3	Kensington and Chelsea	-27.5%
4	Hammersmith and Fulham	-26.5%
5	Camden	-22.4%
6	Islington	-22.2%
7	Greenwich	-20.8%
8	Wandsworth	-20.0%
9	Richmond upon Thames	-18.5%
10	Southwark	-18.3%
11	Kingston upon Thames	-16.2%
12	Merton	-15.8%

Source: Knight Frank Research

PRIME LONDON PRICE AND RENTAL GROWTH, NOVEMBER **2015**



Notting Hill

	Sales	Rents
3-month price change	-1.0%	1.2%
12-month price change	-2.1%	1.6%

Prime gross yield **3.10%**

St John's Wood

	Sales	Rents
3-month price change	0.0%	0.5%
12-month price change	0.0%	1.0%

Prime gross yield **3.79%**

Hyde Park

	Sales	Rents
3-month price change	-1.0%	-0.2%
12-month price change	-1.4%	2.8%

Prime gross yield **2.90%**

Hampstead

	Sales	Rents
3-month price change	0.1%	0.0%
12-month price change	2.1%	3.3%

Prime gross yield **2.57%**

Kensington

	Sales	Rents
3-month price change	-0.1%	-0.8%
12-month price change	1.9%	0.5%

Prime gross yield **2.56%**

Queen's Park

	Sales	Rents
3-month price change	1.9%	-0.8%
12-month price change	9.2%	2.0%

South Kensington

	Sales	Rents
3-month price change	-4.0%	-3.1%
12-month price change	-3.8%	-3.0%

Prime gross yield **3.04%**

Knightsbridge

	Sales	Rents
3-month price change	-3.0%	-1.4%
12-month price change	-5.6%	-2.3%

Prime gross yield **2.42 %**

Chiswick

	Sales	Rents
3-month price change	1.1%	0.0%
12-month price change	2.0%	1.6%

Prime gross yield **3.44 %**

Barnes

	Sales
3-month price change	1.6%
12-month price change	3.8%

Fulham

	Sales	Rents
3-month price change	-1.5%	-2.6%
12-month price change	1.2%	-1.5%

Prime gross yield **2.87%**

Chelsea

	Sales	Rents
3-month price change	0.0%	-3.3%
12-month price change	-2.4%	-2.2%

Prime gross yield **3.31%**

Richmond

	Sales
3-month price change	1.1%
12-month price change	4.3%

Wimbledon

	Sales	Rents
3-month price change	0.0%	-0.6%
12-month price change	1.1%	0.7%

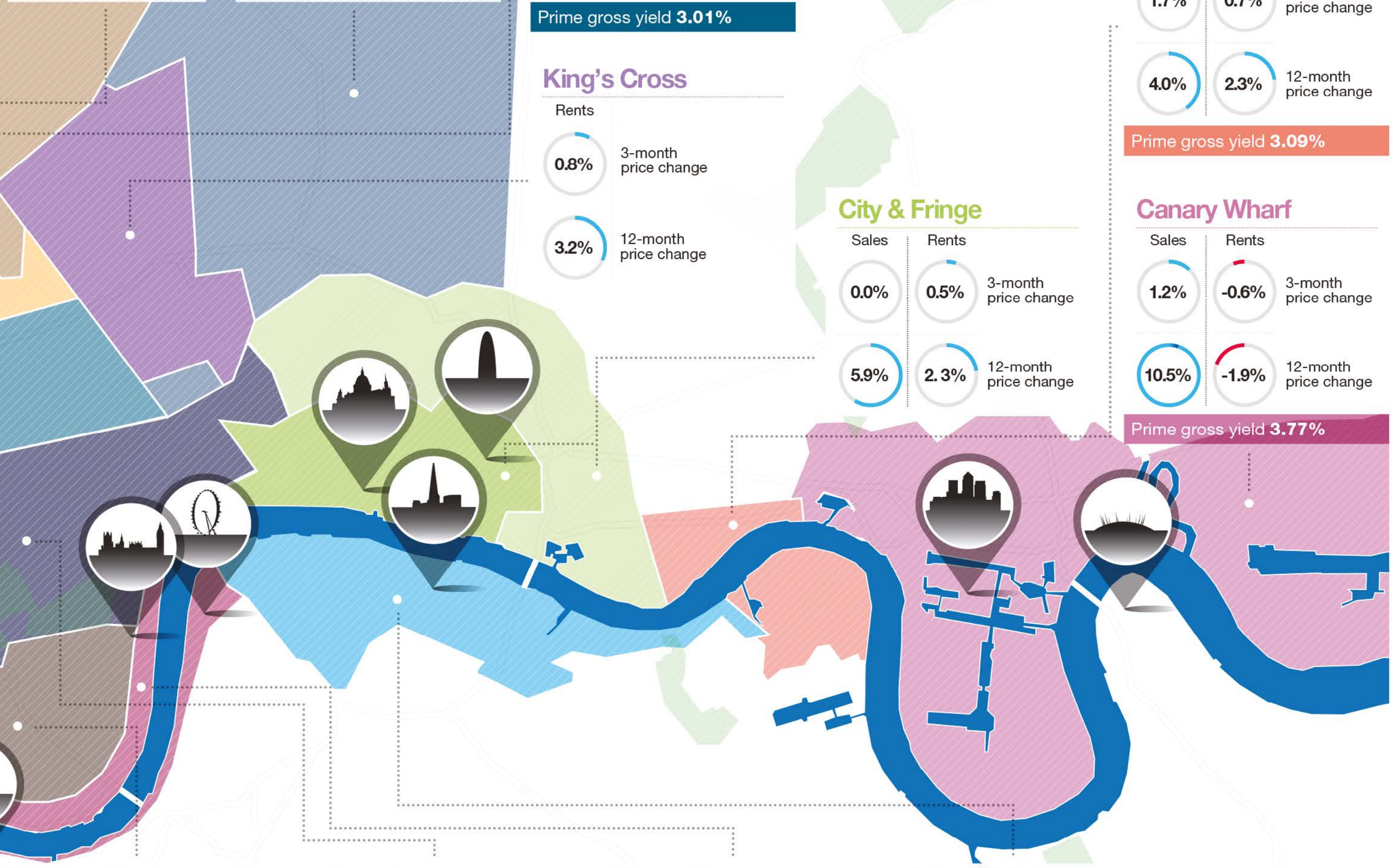
Prime gross yield **4.40%**

Wandsworth

	Sales
3-month price change	3.2%
12-month price change	1.5%

Battersea

	Sales	Rents
3-m pric	-2.3%	0.1%
12- pric	0.0%	0.0%



Belsize Park

	Sales
3-month price change	-1.5%
12-month price change	0.8%

Islington

	Sales	Rents
3-month price change	0.0%	-1.2%
12-month price change	6.5%	0.2%

Marylebone

	Sales	Rents
3-month price change	0.8%	-1.3%
12-month price change	4.4%	5.4%

Prime gross yield **3.01%**

King's Cross

	Rents
3-month price change	0.8%
12-month price change	3.2%

Wapping

	Sales	Rents
3-month price change	1.7%	0.7%
12-month price change	4.0%	2.3%

Prime gross yield **3.09%**

City & Fringe

	Sales	Rents
3-month price change	0.0%	0.5%
12-month price change	5.9%	2.3%

Canary Wharf

	Sales	Rents
3-month price change	1.2%	-0.6%
12-month price change	10.5%	-1.9%

Prime gross yield **3.77%**

Belgravia

	Sales	Rents
3-month price change	-0.2%	-0.4%
12-month price change	-0.2%	3.0%

Prime gross yield **2.86%**

Mayfair

	Sales	Rents
3-month price change	0.7%	-0.5%
12-month price change	2.9%	1.7%

Prime gross yield **1.98%**

Riverside

	Sales	Rents
3-month price change	-0.9%	0.8%
12-month price change	3.7%	1.3%

Prime gross yield **2.99%**

Tower Bridge

	Rents
3-month price change	0.0%
12-month price change	1.6%

Prime gross yield **0.00%**

Clapham

	Sales	Rents
3-month price change	1.9%	0.7%
12-month price change	1.5%	3.5%

Prime gross yield **3.33%**

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Dulwich

	Sales
3-month price change	0.0%
12-month price change	4.3%

Prime central London / Prime outer London

	Prime central London Sales	Prime central London Rents	Prime outer London Sales	Prime outer London Rents
3-month change	-0.6%	-0.5%	0.6%	-0.3%
12-month change	0.9%	1.2%	3.0%	0.9%

Prime central London: Prime gross yield **2.95%**

Prime outer London: Prime gross yield **3.33%**

SUB-£2 MILLION LONDON MARKET INSIGHT

The sub-£2 million market outperformed the rest of prime London in the second half of 2015, continuing a trend of recent years.

In particular, properties worth less than £1 million have grown by more than any other price bracket, as figure 6 shows.

First, it is a market that is less exposed to regulatory change. There have been a series of tax changes in recent years that affect the prime London market, the most recent of which was a higher rate of stamp duty for buy-to-let investors and second-home purchases, announced in November.

It would add £30,000 to the current stamp duty rate for a second-home buyer of a £1 million property, though this sum would be matched by house price inflation in less than a year at current growth rates.

It is also a market that is less exposed to global economic volatility and more closely aligned with the performance of the mainstream market, where demand continues to outstrip supply on the back of a London population forecast to grow by more than 100,000 every year for the next decade.

As figures 5 and 7 show, the highest growth has largely been outside the higher price brackets of prime areas of central London over the last 20 years.

The analysis highlights the markets where price growth was strongest during each year since Q1 1995 and on a journey that began in Lambeth Walk and ends in Turnpike Lane, £50,000 would have become £1.18 million after stamp duty and moving fees are taken into account, representing a rise of 2,264%.

The theoretical journey began in south London before moving further east to areas like Barking and Dagenham in the early 2000s as east London matured as a residential market.

It then moved to prime central London in the run-up to and immediate aftermath of the financial crisis, including Marylebone, Belgravia and Fulham. Finally, as price growth pushed outwards from central London as the UK economic recovery consolidated after 2013 the strongest growth was found in the north London markets of Walthamstow and Turnpike Lane.

FIGURE 5
When and where you should have moved in London to achieve maximum house price growth

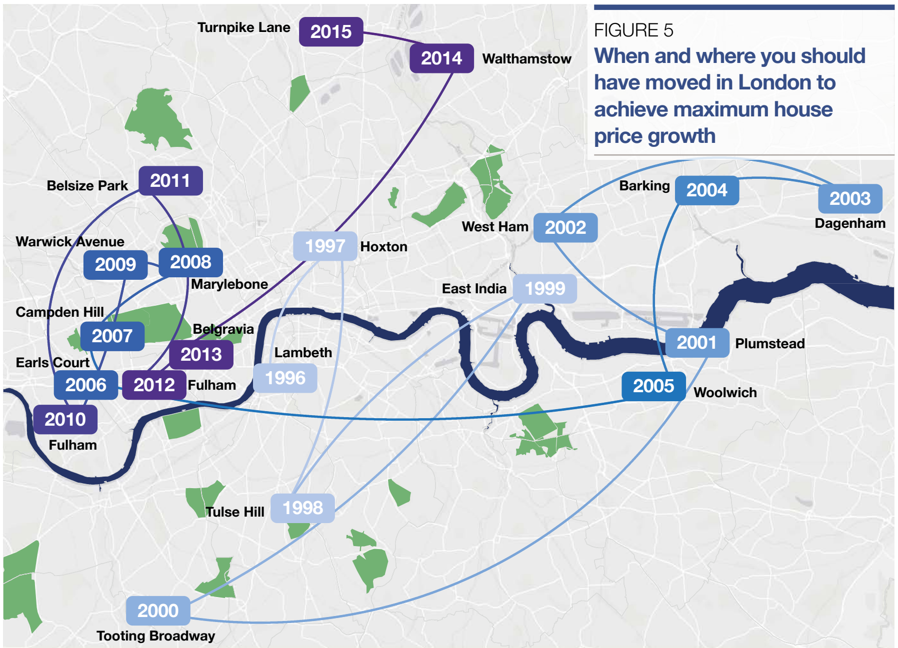
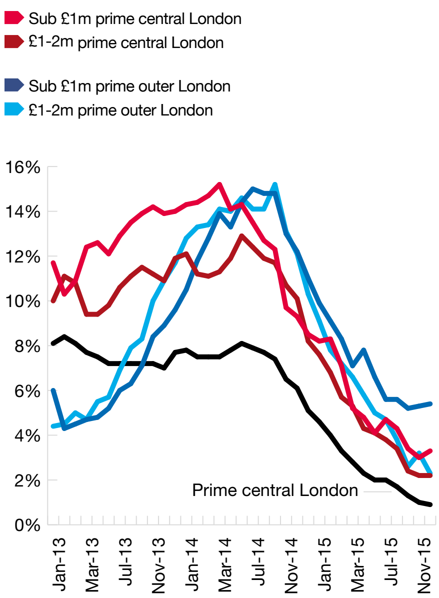


FIGURE 6
Sub £2 million annual growth



Source: Knight Frank Research

FIGURE 7
The biggest price rises over the last 20 years in London

Year	Change %	Location	Equity after costs
			Initial equity: £50,000
1995-96	24%	Lambeth Walk	£59,207
1996-97	34%	Hoxton	£75,716
1997-98	30%	Tulse Hill	£94,350
1998-99	25%	East India	£113,656
1999-00	44%	Tooting Broadway	£157,800
2000-01	27%	Plumstead	£194,056
2001-02	30%	West Ham	£238,888
2002-03	34%	Dagenham	£303,167
2003-04	15%	Barking	£330,944
2004-05	15%	Woolwich Barracks	£362,739
2005-06	14%	Earls Court	£394,564
2006-07	32%	Campden Hill	£489,951
2007-08	23%	Marylebone	£569,259
2008-09	-4%	Warwick Avenue	£515,838
2009-10	24%	Fulham	£601,588
2010-11	14%	Belsize Park	£643,991
2011-12	18%	South Gloucester Road	£713,199
2012-13	19%	Belgravia	£800,629
2013-14	35%	Walthamstow	£1,011,567
2014-15	28%	Turnpike Lane	£1,182,045

Source: Knight Frank Research

PRIME OUTER LONDON MARKET UPDATE

Annual price growth in prime outer London was flat at 3% in November. Growth has eased from 7% since January but is levelling out in a sign that last December's stamp duty changes have started to become absorbed by the market.

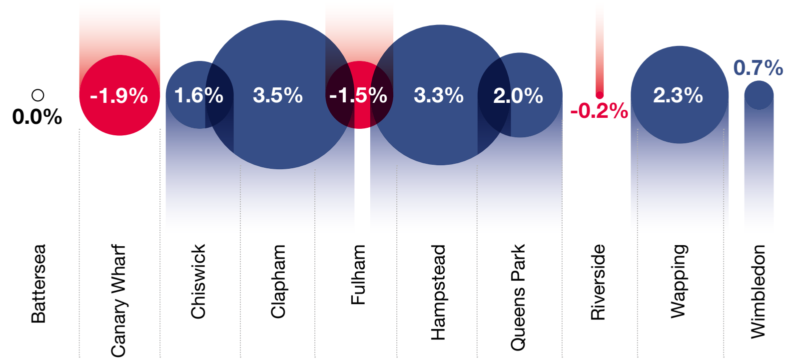
The changes increased the rate of stamp duty for properties worth more than £1.1 million in a move that has had a less marked impact than in prime central London due to the fact prices are lower.

Following the release of pent-up demand after the general election in May, activity slowed over the summer and start of the autumn, with transaction levels down by 31% in the six months to November.

However, activity has picked up in recent months due to the fact more vendors are setting asking prices to reflect the heightened mood of price sensitivity and, in many cases, because they are motivated by a need to purchase their own property.

While the number of viewings and new prospective buyers were down -14.7% and -14.4% respectively in September compared to the same month in 2014, viewings and new prospective tenants were 2.7% and 1.4% higher in November than the same month last year.

FIGURE 8
Annual rental value growth in prime outer London by area Year to November 2015



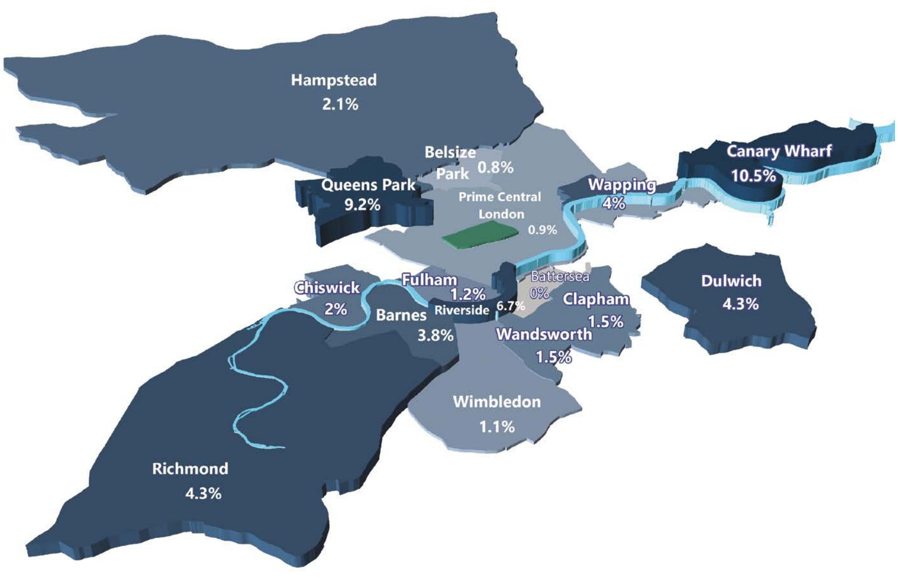
Buyers have also become more cautious and a number of deals are taking longer or failing to complete. It is a situation compounded by the fact financial services companies are still reducing headcount and this fragility means price growth is likely to remain modest.

It has led to lower budgets for corporate tenants in the rental market, with the continued low oil price dampening demand in Wimbledon, where demand has been historically strong among energy companies.

In November Chancellor George Osborne added three percentage points to the rate of stamp duty for buy-to-let investors and second home purchases. The change, which comes into effect in April 2016, is likely to have a less marked impact in prime outer London than more central areas, in similar fashion to the 2014 changes.

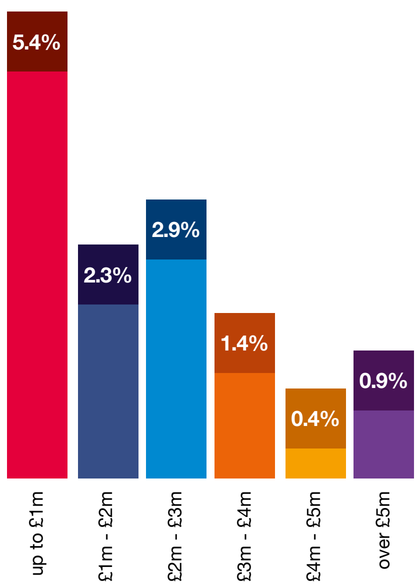
Demand in markets like south-west London and Queen's Park, Belsize Park and Hampstead tends to be more owner-occupier focussed. Meanwhile, in Canary Wharf, there are early signs of greater impetus to transact ahead of the April 2016 deadline, a trend likely to be replicated elsewhere in London in the first months of 2016.

FIGURE 9
Annual price growth by area in prime outer London Year to November 2015



Source: Knight Frank Research

FIGURE 10
Annual growth in prime outer London by price band
Year to November 2015



Source: Knight Frank Research

RENTAL AND INVESTMENT MARKET FOCUS

It has been a year of two halves for the prime London lettings market.

Annual rental value growth in prime central London peaked at 4.2% in May, the month of the general election, as demand transferred from the sales market.

However, anxiety around the global economy has dampened demand in the second half of the year. The uncertainty has centred on events in China, which has caused companies to curb relocation budgets and recruitment plans. The falling oil price has also impacted sentiment among energy companies.

Advertising giant WPP, whose performance is a useful barometer of how much companies are either cutting costs or spending, said in October firms were feeling risk-averse due to geo-political concerns and headcount reductions at major banks have continued.

Furthermore, stock levels have risen as more owners adopt a wait-and-see approach to pricing trends in the sales market, which has tipped the balance in the favour of tenants and put downwards pressure on rents.

Against this background, rental values in prime central London declined for the second month in a row in November, with a seasonal end-of-year decline in demand also having an impact on values.

It meant annual rental value growth dipped to 1.2%, the lowest level since August 2014, while rental yields were flat at 2.95% as annual capital value growth dipped below 1%.

However, while anxiety in financial markets has dampened demand at the 'senior executive' level, it remains strong in lower price brackets for individuals on the first or second rung of their career, driven by affordability constraints in the sales market.

Demand is also strong at the super-prime level of above £5,000 per week, amid uncertainty around taxation including recent changes for second home purchases.

The result is a three-tier market where demand is stronger in higher and lower price brackets than it is in the middle.

The recent changes announced by Chancellor George Osborne mean that buy-to-let investors and second home purchases will be subject to an extra three percentage points on the rate of stamp duty from April 2016. In the short-term, it could have a dampening effect on rents as landlords buy properties before the deadline, increasing supply. However, it could ultimately lead to fewer rental properties and put upwards pressure on rental values.

Whatever the short-term risks, which include rhetoric during the London Mayoral campaign around rent controls, the positive medium to long-term outlook for the UK economy will keep upwards pressure on rental values.

The charts below show the correlation between the prime central London rental index and the FTSE 100 and GDP and both signal a broader upwards momentum.

FIGURE 11
UK economy underpins rental demand
Correlation between quarterly changes in GDP and prime central London rental index

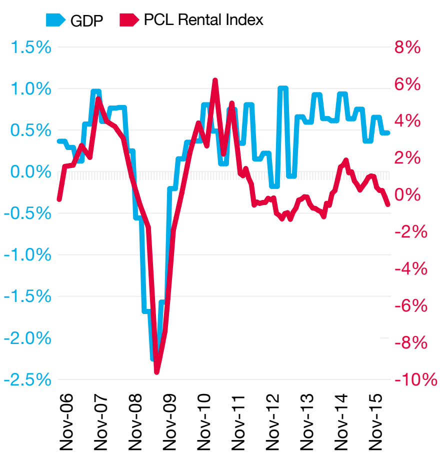
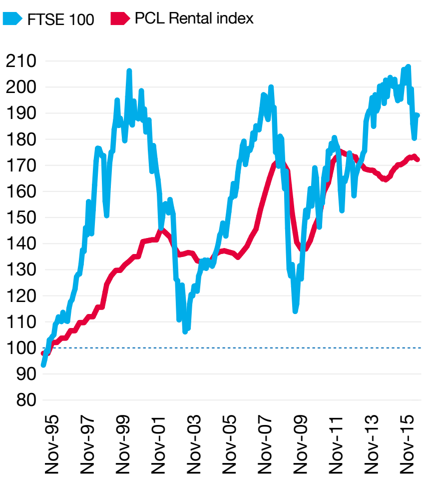


FIGURE 12
Correlation between the stock market and prime central London rents



Source: Knight Frank Research

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