RESIDENTIAL RESEARCH

PRIME CENTRAL LONDON RENTAL INDEX

Knight Frank

This report analyses the performance of single-unit rental properties in the second-hand prime central London market between £500 and £5,000-plus per week. For an analysis of the build-to-rent market and the institutional private rented sector in London and the rest of the UK, please see our Private Rented Sector Update report here.

August 2016

The number of new rental properties placed on the market in the **three months to July rose 38.9%**

The number of new prospective tenants increased 7.2% in the three months to July

The number of tenancies agreed **increased by a fifth**

Rental values declined **-4.1% in the year to July 2016**

Average gross prime yields were **flat at 3.1%**

Macro View: Brexit and the new-build market

ACTIVITY INCREASES AS RENTAL VALUES DECLINE IN PRIME CENTRAL LONDON

Landlords in prime central London are having to show increased levels of flexibility as stock levels rise, says Tom Bill

Transaction volumes remained strong in the prime central London lettings market in August, as rising supply kept the balance of power tipped in favour of tenants.

Supply has increased steadily over the last year due to uncertainty over price growth in the sales market following a series of tax rises and, to a lesser extent, the potential impact of the UK's decision to leave the European Union.

As a result, the number of new properties placed on the market in the three months to July 2016 increased 38.9% versus 2015, as figure 2 shows.

At the same time, viewing levels and the number of tenancies agreed were both up by a fifth.

Meanwhile, demand has grown among tenants who are opting to rent rather than pay increased levels of stamp duty until more certainty returns in the sales market. The number of new prospective tenants increased 7.2% over the same three-month period.

As supply increases at a faster rate than demand, it means landlords have to show increased levels of flexibility when negotiating with tenants. In addition to levels of rent, this includes flexibility around break clauses, works to the property, levels of furnishing and payment arrangements.

The last time the balance of power was so firmly with the tenant in prime central London was in the immediate aftermath of the financial crisis, although demand is stronger now than it was in 2008 and 2009.

Annual rental value growth in July was -4.1%, which is the lowest it has been since December 2009. However, activity is stronger in lower price brackets, as figure 4 shows, and demand remains stronger for apartments than the family house market. Demand from corporate tenants also remains stronger than it was in 2015.

August was a strong month in the super-prime £5,000-plus per week market, with deal volumes up on the same month last year. However, due to the mood of cautious optimism returning to the sales market, some would-be landlords plan to wait until later this year before renting out their property in the expectation that demand in the sales market will strengthen.

TOM BILL
Head of London Residential Research

"The last time the balance of power was so firmly with the tenant in prime central London was in the immediate aftermath of the financial crisis"

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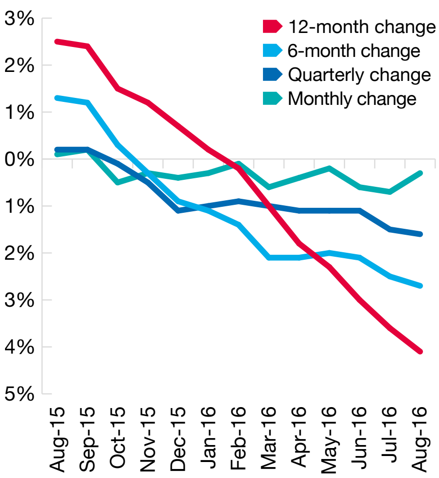
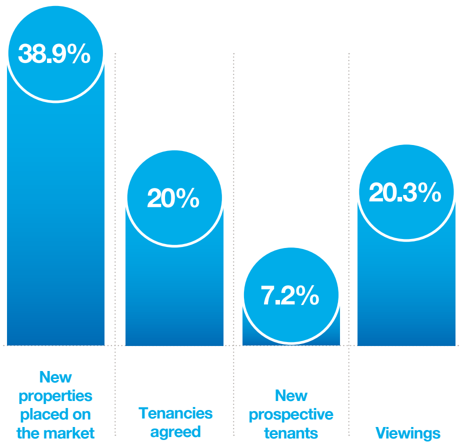
FIGURE 1
Rental value growth in prime central London



Source: Knight Frank Research

FIGURE 2
Lettings market key indicators
Three months to July 2016 versus 2015



Source: Knight Frank Research

FIGURE 3
Rental value growth in prime central London by area in the year to August 2016

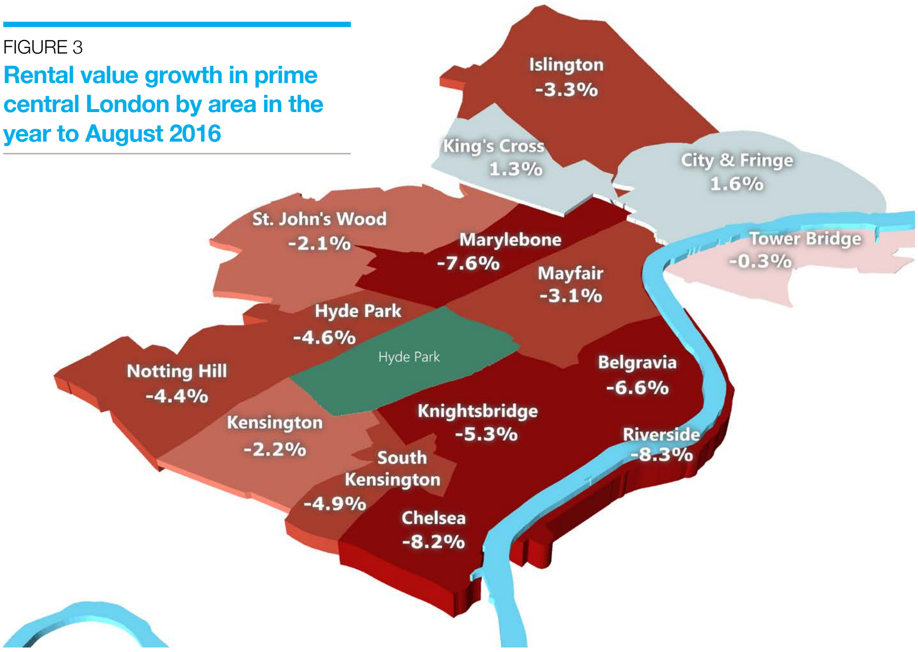


FIGURE 4
Rental value growth in prime central London by price bracket and property type

Prime Central London Index **170.2**

	£500 - £1,500 pw	£1,500 + pw	Flat	House
1 month	-0.5%	-0.4%	-0.3%	-0.4%
3 months	-1.7%	-2.0%	-1.3%	-2.3%
6 months	-2.9%	-3.3%	-2.4%	-3.5%
1 year	-3.8%	-5.5%	-3.4%	-5.8%
YTD	-3.3%	-4.0%	-2.8%	-4.2%

POST-BREXIT LONDON AND THE NEW-BUILD MARKET

The conflicting economic data since the UK voted to leave the European Union are shaping a consensus view that it remains too early to assess the impact of Brexit.

The same is true of the residential development market in prime central London.

Brexit has brought pre-existing dynamics into sharper relief but is otherwise having a relatively minor bearing on a market that is still digesting a series of tax changes that included two stamp duty rises in 18 months.

"Brexit is not having a particularly adverse or positive impact on the market," said Ian Marris, Knight Frank's joint head of residential development. "What the market is dealing with is the fiscal drag of taxation."

"Developers are managing their margins by focussing on details like containing construction costs and refining their schemes so capital values are at the right pricing point," he said. "They are accepting of development risk but are not prepared to take on legal, technical or planning risk without an appropriate level of margin."

Average residential development land prices fell for the third consecutive quarter in Q2 this year, dropping by 6.9%, as higher taxation impacted the viability of schemes. Average values were down 9.4% on an annual basis, meaning the index has returned to 2014 levels after several years of exceptional growth.

"We have come out of a bull market and now we are operating in normal market conditions," said Marris. "These are the circumstances when you see very different relative levels of performance across prime central London. Product that is not best-in-class cannot be priced at a premium."

In a market where demand is so sensitive to price and the quality of individual developments, it is misleading to generalise about particular locations or price brackets.

"Two schemes side-by-side can be performing very differently. The assessment of risk needs to factor in multiple characteristics but for developers who have benchmarked properly and done their homework deals are being done."

DATA DIGEST

The Knight Frank Prime Central London Index, established in 1995 is the most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks rental values of prime central London residential property. 'Prime central London' is defined in the index as covering: Belgravia, Chelsea, The City& Fringe, Hyde Park, Islington, Kensington, King's Cross, Knightsbridge, Marylebone, Mayfair, Notting Hill, South Kensington, St John's Wood and Tower Bridge. 'Prime London' comprises all areas in prime central London, and in addition Canary Wharf, Fulham, Hampstead, Richmond, Riverside*, Wandsworth, Wapping and Wimbledon.

* Riverside in prime central London covers the Thames riverfront from Battersea Bridge in the west to Tower Bridge in the east, including London's South Bank. The City Fringe encompasses the half-mile fringe surrounding most of the City including Clerkenwell and Farringdon in the west and Shoreditch and Whitechapel in the east.

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