RESIDENTIAL RESEARCH

PRIME CENTRAL LONDON RENTAL INDEX

RENTAL VALUES EDGE LOWER IN PRIME CENTRAL LONDON AS FINANCIAL MARKET NERVES RISE

Demand from the financial services sector has become more subdued but London's appeal as a financial capital is rising, as Tom Bill explains

JULY 2015

Rental values fell -0.1% in July due to subdued demand and higher stock levels

After the first monthly fall since February 2014, **annual rental value growth slowed to 2.9%**

Short-term optimism among bankers fell but the appeal of London is growing

Prime gross yields **remained flat at 2.95%**

New monthly Macro View section: The impact of the impending interest rate rise and Chinese stock market volatility

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Head of London Residential Research

"Brevan Howard, one of world's largest hedge funds, is reportedly moving senior traders back from Geneva to London, underlining the city's dominance as a global financial centre"

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Rental values in prime central London fell in July as stock levels held up while demand from the financial services sector became more subdued against a jittery global economic backdrop.

A fall of -0.1% was the first decline since February 2014 and meant annual growth slowed to 2.9%, having peaked at 4.2% in May. Prime gross yields were flat at 2.95%.

Stock levels have been buoyed to some extent by a restrained sales market, where an increase in stamp duty for properties worth more than about £1.1 million has dampened activity and price growth.

As annual price growth has slowed to 2%, more property owners have opted to become landlords as they wait for the market to digest a succession of recent tax changes.

This short-term supply/demand imbalance means two things. First, tenants are shopping around more and securing deals has become more difficult for landlords, even after initial agreements are in place. Second, landlords have made it more attractive for tenants to remain in place, prompting higher renewal rates.

While seasonal demand from students has remained strong, corporate demand has become more muted despite some pockets of stronger performance.

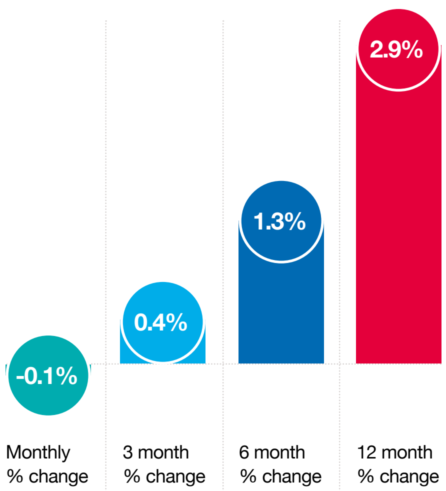
Demand in the prime central London lettings market has traditionally been strong from the financial services sector and, as figure 2 shows, optimism among bankers fell sharply in the second quarter of 2015, according to a CBI/PWC survey.

Continued regulatory uncertainty means banks are scaling back spending plans and nervousness surrounds a possible UK exit from the EU, the recent Greek crisis and Chinese stock market volatility, which is explored in more detail in a new monthly section called The Macro View on page 2.

However, there are longer terms grounds for economic confidence, and the UK's recovery was underlined by strong GDP figures in July.

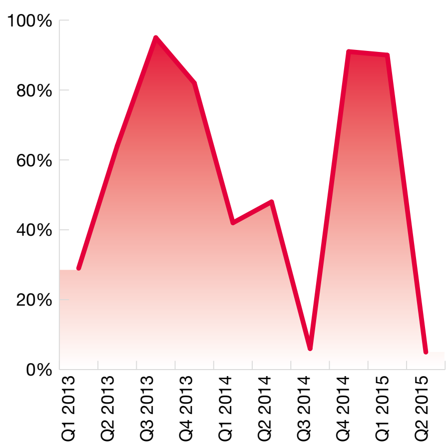
Furthermore, in an attempt to increase the appeal of London, Chancellor George Osborne plans to reduce the bank levy. Meanwhile, Brevan Howard, one of world's largest hedge funds, is reportedly moving senior traders back from Geneva to London, underlining the city's dominance as a global financial centre.

FIGURE 1
Rental value growth in prime central London



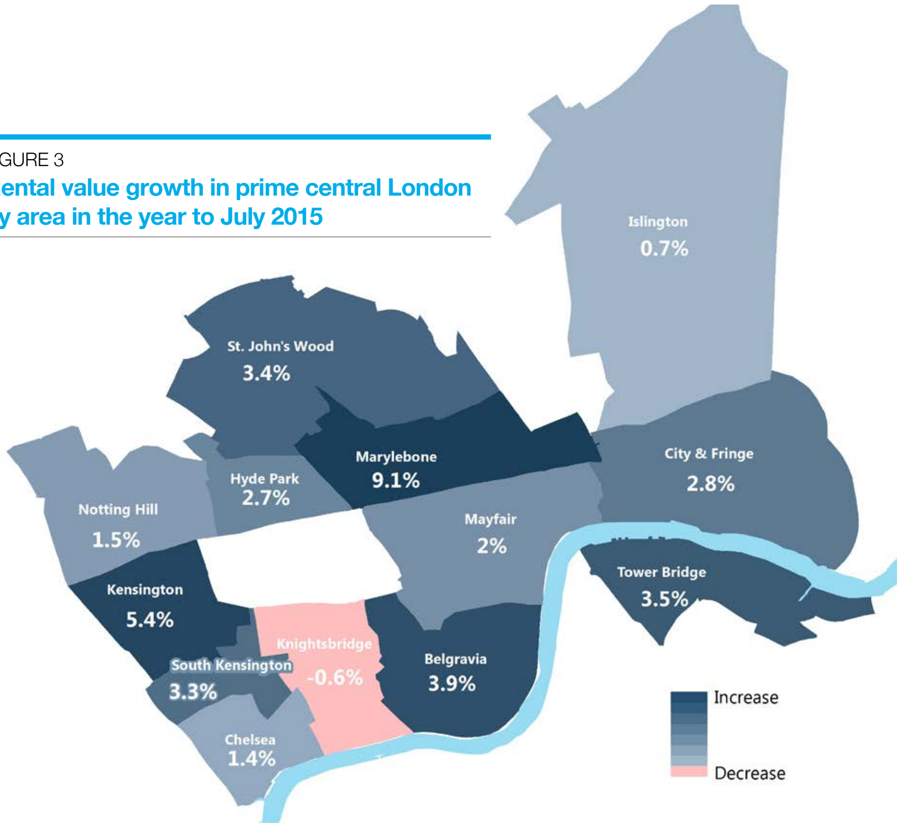
Source: Knight Frank Residential Research

FIGURE 2
Banker optimism falls in Q2 2015
CBI/PWC survey, balance of those expressing more and less optimism vs three months ago



Source: Knight Frank Residential Research

FIGURE 3
Rental value growth in prime central London by area in the year to July 2015



DATA DIGEST

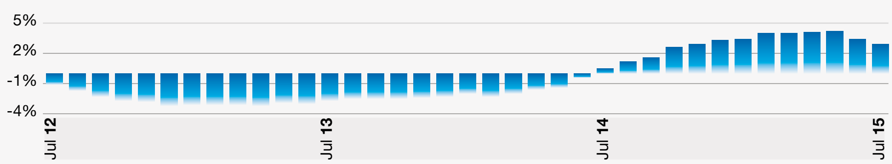
The Knight Frank Prime Central London Index, established in 1976, is the longest running and most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks capital values of prime central London residential property. 'Prime central London' is defined in the index as covering: Belgravia, Chelsea, Hyde Park, Islington, Kensington, Knightsbridge, Marylebone, Mayfair, Notting Hill, South Kensington, St John's Wood, Riverside* the City and the City Fringe. 'Prime London' comprises all areas in prime central London, as well as Barnes, Canary Wharf, Chiswick, Clapham, Fulham, Hampstead, Richmond, 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.

THE MACRO VIEW JULY 2015

Prime Central London Index | 176.6

Annual rental value growth in prime central London - last three years



July 2015 was the month the UK began to focus more intently on the implications of an interest rate rise.

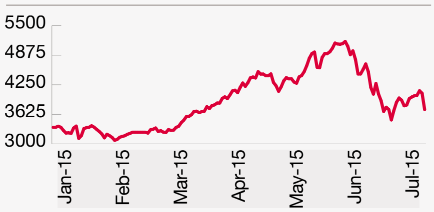
Bank of England governor Mark Carney said a decision on whether to raise rates would "come into sharper relief" at the end of 2015.

Speculation rose that record-low mortgage deals would begin to dry up and the country should brace itself for higher monthly bills.

The base rate fell to 0.5% in March 2009 and has remained there since in an attempt to stimulate the UK economy following the financial crisis. However, Carney's words should be placed in context.

First, many economists still don't believe rates will rise until the first or second quarter of 2016, including more than 50 polled by Reuters after the governor's latest remarks.

Shanghai stock exchange 2015 to date



Second, Carney indicated that rates would rise to about 2.25% over a three-year period, which would be welcomed by the property industry, said JP Morgan real estate analyst Tim Leckie.

"It is half the historical average, with a fairly long glide time, which I think most people would agree is great news for the residential property market," he said.

Elsewhere, as the intensity of the Greek crisis reduced by a notch or two, gyrations on the Chinese stock market caused some to consider the effectiveness of state intervention in the country's stock market and the ramifications for other markets.

Safe-haven outflows from China may not be the only response to a falling stock market, said Leckie. "Further downside in equity markets could trigger a need to bolster balance sheets in China, which, combined with higher rates of stamp duty in the UK for homes above £1.1 million, could see some Chinese investors think twice before investing in prime London residential property."

However, there is anecdotal evidence that Chinese interest in safe-haven property markets including London has intensified since the stock market's strong run ended in June.

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