PRIME CENTRAL LONDON RENTAL INDEX

Knight Frank

HIGHER SUPPLY CURBS RENTAL VALUE GROWTH IN PRIME CENTRAL LONDON

A greater supply of property means landlords are increasingly willing to reduce asking rents in prime central London, says Tom Bill

March 2016

Annual rental value growth in prime central London fell to -1% in March, the lowest rate since May 2014

The number of tenancies agreed in the first two months of 2016 was **12% higher than 2015**

Total return of 4% in the year to February **outperformed a series of other benchmark indices**

Knight Frank forecasts 2.5% annual rental value growth in eastern areas in 2016

Macro View: Bonus season in prime central London

TOM BILL
Head of London Residential Research

"Greater supply has taken a period of time to have an impact on rental values because landlords were initially more prepared to withstand void periods."

Follow Tom at @TomBill_KF

For the latest news, views and analysis on the world of prime property, visit Global Briefing or @kfglobalbrief

Annual rental value growth in prime central London slowed to -1% in March. It was the lowest rate since May 2014, shortly before a transition began in the prime central London property market.

July 2014 marked the start of a 19-month run of positive annual rental value growth as demand transferred from the sales market due to uncertainty surrounding the UK general election and property taxation.

However, supply also rose as a growing number of vendors decided to let their properties for the same reasons.

This uninterrupted period of growth ended in February this year, partly as a result of higher supply, which put downwards pressure on rental values.

The greater level of supply has taken a longer period of time to have an impact on rental values because landlords were initially more prepared to withstand void periods.

That began to change at the start of 2016, and asking rent reductions led to an increase in deal volumes. The number of tenancies agreed in the first two months of this year was 12% higher than in 2015.

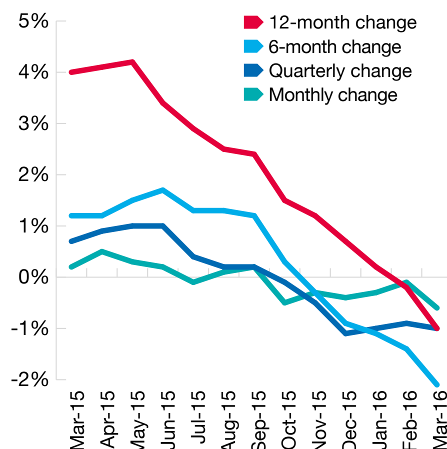
However, demand has also been dampened by fragility in global financial markets. Banks have reduced headcount and relocation budgets as a result of the slowing Chinese economy, falling commodity prices and the prospect of negative interest rates. The EU referendum in June is likely to heighten this mood of uncertainty in the short-term.

However against this volatile macroeconomic backdrop, prime central London property has performed strongly, as figure 2 shows. The total return, which combines the rental yield and capital value growth, was 4% in the year to February, outperforming benchmark indices including hedge funds and stock markets.

Beyond the headline numbers, the rental market has become more geographically polarised over the last year (figure 3). This is partly due to the fact demand from financial services tenants has moved east, where rental values are lower and the City financial district is closer.

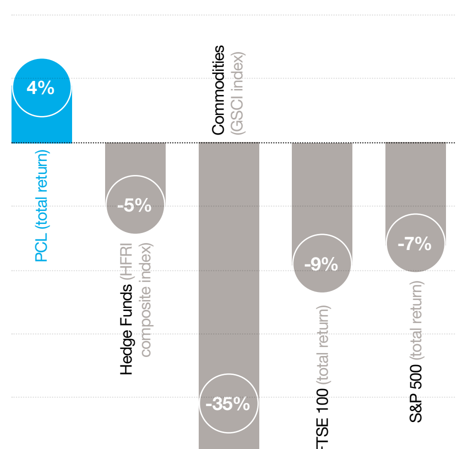
As a result, Knight Frank forecasts annual rental growth of 1% in western areas of prime central London and 2.5% in markets east of Mayfair and south of the River Thames in 2016.

FIGURE 1
Rental value growth in prime central London
Period to March 2016



Source: Knight Frank Research

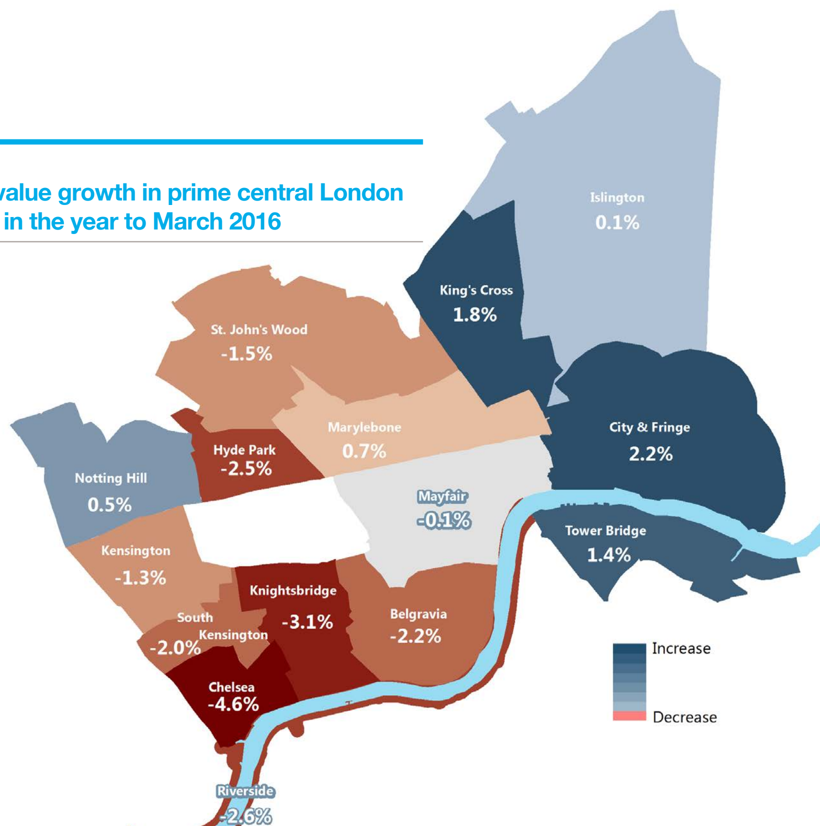
FIGURE 2
Prime central London outperforms other assets
Year to February 2016



Source: Knight Frank Research

PRIME CENTRAL LONDON RENTAL INDEX

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



DATA DIGEST

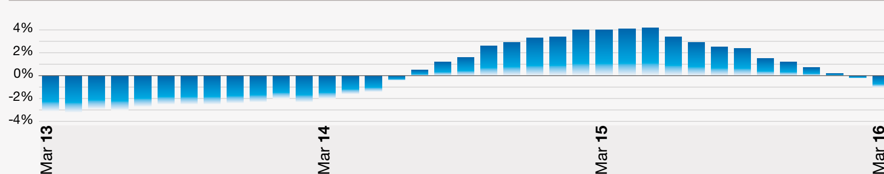
The Knight Frank Prime Central London Index, established in 1995 is the most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks rental values of prime central London residential property. 'Prime central London' 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.

THE MACRO VIEW MARCH 2016

Prime Central London Index | **173.4**

Annual rental value growth in prime central London over the last three years



BONUS SEASON IN PRIME CENTRAL LONDON

In similar fashion to most UK residential markets, demand in prime central London rises in the spring.

The effect was more pronounced before the global financial crisis, when bonus payments were more prevalent, particularly from the financial services industry.

The banking industry continued its recovery in 2015 following the collapse of Lehman Brothers in 2008, key data shows.

Global mergers and acquisitions (M&A) activity reached $3.8 trillion in 2015 according to Bloomberg, beating a previous 2007 record. There was also a 16% increase in the value of European stock market flotations according to accountant PWC. This was despite a 16% decline in London.

However, while the flow of deals is rising, there are no indications bonuses will start to materially drive property demand. This is due to a pervading mood of market uncertainty as well as fundamental changes in the banking sector.

"The banking industry is finding a new normal and the heady days of old are, in most cases, a distant memory," said Nick Miller, head of corporate and institutional banking at executive recruitment company Odgers Berndtson.

"Bonuses are down 10% to 15% across the board and the criteria for getting them have become tougher. Furthermore, promotions to managing director level are happening significantly later in people's career."

While he acknowledges M&A activity is rising, he says a number of "large bumper deals" are skewing the figures.

The slowdown has also been magnified by banks reducing headcount and winding down fixed income, currencies and commodities operations, Miller added.

The sentiment is echoed by James Pace, head of Knight Frank's Chelsea office, "In the old days we would see a pick-up in activity in the first two months of the year from bankers who had an idea what their bonus would be. That has now completely disappeared and the market kicks into life later."

GLOBAL BRIEFING
For the latest news, views and analysis on the world of prime property, visit KnightFrankblog.com/global-briefing

RESIDENTIAL RESEARCH

Tom Bill
Head of London Residential Research
+44 20 7861 1492
tom.bill@knightfrank.com

PRESS OFFICE

Jamie Obertelli
+44 20 7861 1104
jamie.obertelli@knightfrank.com

Daisy Ziegler
+44 20 7861 1031
daisy.ziegler@knightfrank.com

Important Notice
© Knight Frank LLP 2016 - This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank LLP for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank LLP to the form and content within which it appears. Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members' names.