

RECOVERY IN RENTS AND YIELDS REMAINS HESITANT IN PRIME CENTRAL LONDON

Rental values climbed in October as the UK economic recovery strengthened and yields saw the strongest improvement in three years, as Tom Bill explains.

OCTOBER 2014

Rental values rose 0.5% in October, the eighth successive rise

Annual growth was 2.6%, the highest rate since December 2011

In the third quarter of 2014, **tenancies agreed rose by a quarter and tenancies started increased by a third**

Rental yields rose to 2.9%, recording the biggest monthly gain in more than three years

The spread between **prime central London yields and UK government bonds has widened**



TOM BILL
Head of London Residential Research

"The prime central London rentals market is not in full-blown recovery mode despite the broad upwards trend"

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Rental values in prime central London rose for the eighth successive month in October, recovering to a level last seen two years ago.

In October 2012, rental values were at the early stage of a shallow decline that took place against the background of a tepid economy and a strong sales market.

Two years later, the International Monetary Fund forecasts that UK economic growth will outpace other developed countries in 2014, at the same time demand in the sales market has shown signs of cooling ahead of next May's general election and uncertainty surrounding the possibility of a mansion tax.

Monthly growth of 0.5% in October took the annual increase in rents to 2.6%, which was the highest rate since December 2011.

Furthermore, demand in the third quarter of 2014 exceeded the same period last year, with tenancies agreed up by a quarter and tenancies started rising by a third, as figure 1 shows.

With UK economic data remaining mixed, the prime central London rental market is still not in full-blown recovery mode.

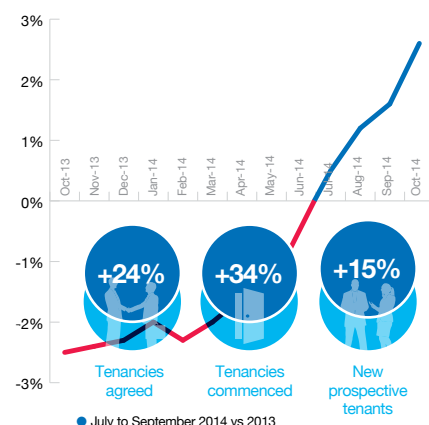
Though the number of new prospective tenants and viewings rose in October compared to the same month last year, the number of tenancies started is likely to end the month down, which reflects the hesitant nature of the recovery.

The positive IMF forecast should be balanced against data from accountant E&Y that showed the number of profit warnings issued by UK companies between July and September was the highest in the period for six years.

In a further move that may dampen demand in the short term, mortgage lenders have cut rates as the likelihood of an imminent interest rate rise recedes. Lenders are also attempting to bolster their loan books after a slower period that followed the introduction of stricter lending criteria earlier this year.

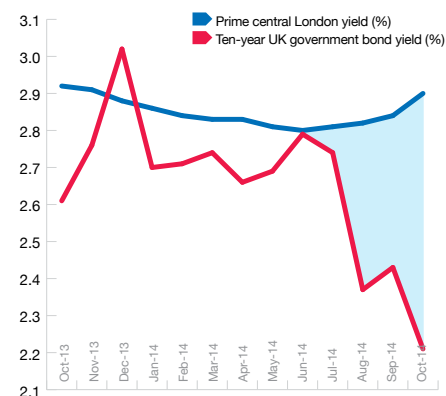
In positive news for investors, rental yields recorded their biggest monthly increase in more than three years, rising to 2.9% in October. As figure 2 shows, the spread between prime central London yields and the so-called risk-free rate of a ten-year government bond has widened notably in recent months.

FIGURE 1
Rising demand and rental values
Annual growth



Source: Knight Frank Residential Research

FIGURE 2
The strengthening investment case

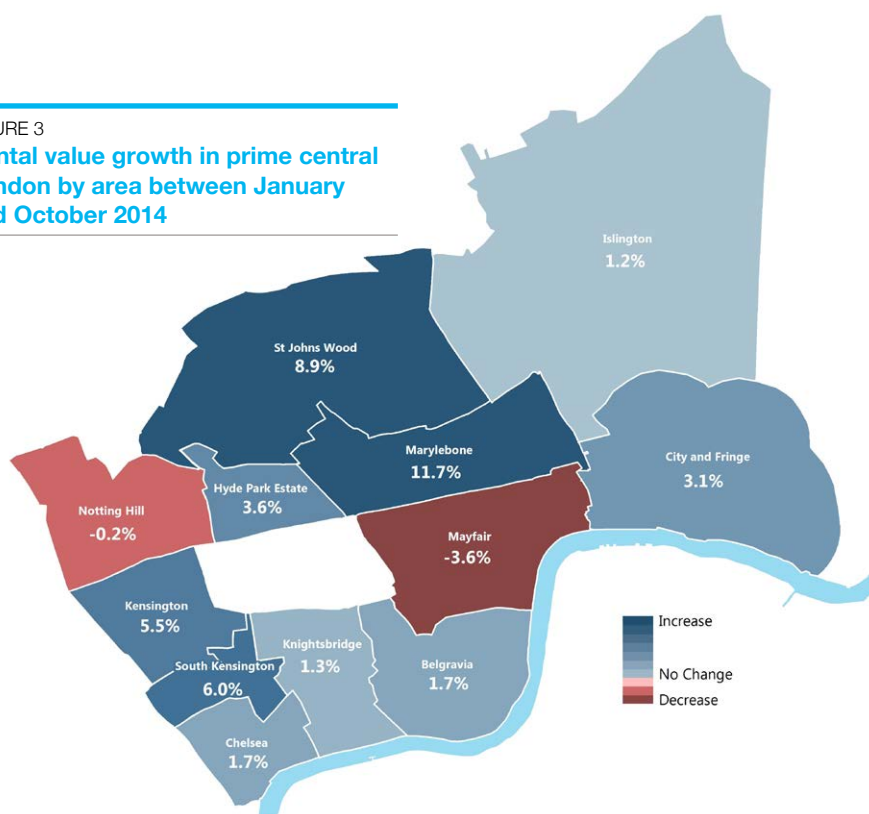


Source: Knight Frank Residential Research

PRIME CENTRAL LONDON RENTAL INDEX

FIGURE 3

Rental value growth in prime central London by area between January and October 2014



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.

Knight Frank Prime Central London Index

	KF Prime Central London Index	12-month % change	6-month % change	3-month % change	Monthly % change
Oct-13	169.4	-2.5%	-1.4%	-0.8%	-0.5%
Nov-13	168.9	-2.4%	-1.6%	-0.9%	-0.3%
Dec-13	168.3	-2.3%	-1.9%	-1.2%	-0.4%
Jan-14	168.6	-2.0%	-1.3%	-0.5%	0.2%
Feb-14	168.0	-2.3%	-1.5%	-0.6%	-0.4%
Mar-14	168.4	-2.0%	-1.1%	0.1%	0.2%
Apr-14	169.0	-1.6%	-0.2%	0.2%	0.3%
May-14	169.4	-1.4%	0.3%	0.8%	0.2%
Jun-14	170.9	-0.4%	1.6%	1.5%	0.9%
Jul-14	171.7	0.5%	1.8%	1.6%	0.4%
Aug-14	172.5	1.2%	2.7%	1.9%	0.5%
Sep-14	173.0	1.6%	2.7%	1.2%	0.2%
Oct-14	173.8	2.6%	2.9%	1.2%	0.5%

Source: Knight Frank Residential Research

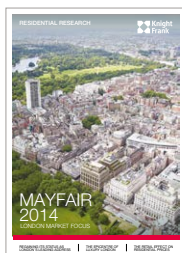
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