RESIDENTIAL RESEARCH

INTERNATIONAL PROJECT MARKETING 2010

Global investment flows into the UK new-build residential market

Knight Frank

INTERNATIONAL PROJECT MARKETING 2010

International investment revival

The recovery of global investment demand for UK new-build property has been one of the most remarkable features of the residential market over the past 18 months. *Liam Bailey, head of Knight Frank residential research,* investigates the dramatic international response to the weak pound, record low interest rates and the UK's dramatic undersupply of housing.

We have been here before. During the peak period of the recent UK residential property boom, between 2005 to 2007, there was rapid growth in international investor demand for new-build residential property from Ireland, South Africa, Europe and Asia. At that time while demand was concentrated on London, there were also significant requirements for property in the larger UK cities, in particular in Leeds, Manchester and Birmingham.

How things have changed. While the market has returned to life, after its almost total closure in 2008, current demand is almost totally concentrated on London and, as we discuss later, demand is primarily coming from Asia. Investors from Ireland and other countries have been chastened by the recent economic turmoil.

So how significant has the Asian investor been in the market over the past year? If we consider the central London market as a whole, there were 7,579 new-build completions in the 12 months to March 2010 in the 11 boroughs making up the central London market. Of these, our research confirms that 41% were bought by investors rather than by owner-occupiers. This proportion is significantly lower than that in 2007 when 72% were bought by investors.

Asian investors comprised more than 49% of all investors in the 12 months to the end of March this year. The dominant Asian nationalities have been Chinese and Hong Kong (11% of the market), followed by Singaporeans (10%) and Malaysians (7%).

We estimate that over the past 12 months the total volume of Asian investment in the central London housing market has totalled £761m. While the Asian investors' share of all new-build sales is only 21% they have undoubtedly impacted on market performance and have helped developers to push prices higher since the beginning of 2010 – a welcome change following almost two years of flat or falling prices.

Future Prospects

Current sales evidence, in addition from feedback from our teams in Asia, is that demand for London property is still strong and this demand is likely to be maintained over the course of 2010 and into 2011. In forecasting likely future demand we need to be mindful of the conditions in the local housing markets and the wider economies in Asia.

China and India amongst other countries did not even experience a significant economic slowdown, let alone an actual recession, and wealth creation is continuing apace throughout the main Asian markets. As a result, significant new funds have been generated for future investment, with profits from local Asian property markets a key contributory factor towards this new wealth creation.

The rapid pace of price growth in their home markets has caused problems for Asian investors. With prices pushed higher by 50% in the year to April 2010 in Hong Kong, for example, the impact on affordability and the ability to secure attractive income returns means that investors have been pushed to look for more international opportunities.

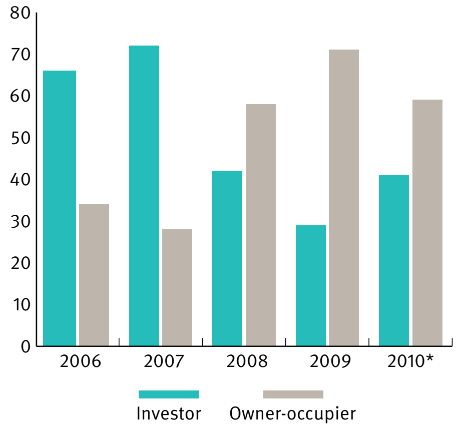
There are now clear signs that price bubbles in many of the big Asian centres are beginning to deflate. The Chinese, Hong Kong and Singaporean governments amongst others have taken a much more activist stance in trying to manage this process. Their success or otherwise will have important repercussions for the central London market.

Initial feedback from our Asian teams suggests that there is a strong potential for the negative impact of lower housing wealth in Asia to be at least partially offset by a desire for investors to target safe haven locations such as London.

Figure 1

Investment versus owner-occupation

Central London new-build sales, split by buyer type (%)

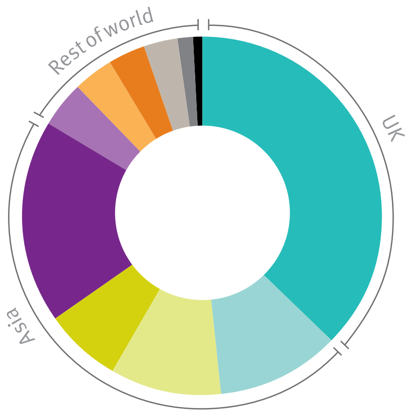


Source: Knight Frank Residential Research
*January to May only

Figure 2

Who is investing?

Central London new-build residential puchasers by nationality, 12 months to May 2010



UK	36.9%
China / Hong Kong	10.8%
Singapore	9.9%
Malaysia	6.8%
Rest of Asia	18.1%
Europe	4.2%
Middle East	3.5%
India	3.3%
Russia	3.1%
Rest of the World	1.3%
Australia	0.7%

Source: Knight Frank Residential Research
Note: The percentages may not add up to 100% due to rounding

International investment economics

Overseas purchasers buy property in the UK for a wide variety of reasons, but in almost all cases the central objective is to secure a return on their investment. The interaction of currency movements, strong capital price growth and, more recently, rising rents, have created an attractive investment case for many investors considering central London property.

The weaker pound alone has created a compelling buying opportunity for Asian investors. Despite prices rising by 22% in the 14 months up to the end of May 2010, effective prices in central London were still 32% lower compared to their peak March 2008 level for a purchaser looking to buy in Hong Kong dollars.

Similar savings have been delivered to buyers whose wealth is held in Singaporean dollars, Malaysian ringgit, Euros or US dollars. The future outlook for the pound is therefore critically important to these investors.

The recent European financial crisis points to two potential outcomes for Sterling. The first seems more plausible following recent market movements; this is that the UK, with its huge and still rising public debt, is at risk of being associated with the weakness observed in the Eurozone. This would suggest further falls in the pound and a slower recovery. The alternative scenario, that the UK could impress the markets with strong fiscal controls and healthier medium term economic growth, could see the pound attracting investors looking for a safe haven from the Euro.

It is unclear which of the above outcomes is most likely, but it does not seem credible to expect the pound to stage a rapid recovery in 2010. The Sterling exchange rate is still likely to provide a key driver for international purchasers into 2011.

Investors are also considering the outlook for prices. The strength of the recent recovery in values is related directly to the weak pound and the low cost of mortgage finance, in addition the recovery in the central London service sector economy has also helped. If we assume that the weakness of Sterling continues and that the service sector economy maintains its steady but unspectacular rate of growth, it is the cost of mortgages and their availability which will be the key factor influencing future price growth.

With inflation remaining stubbornly high in the UK, there have been growing expectations that interest rates would begin to rise over the course of 2010. However the size of the recent recession, the scale of the fiscal squeeze and the spare capacity which has been created in the UK economy suggests that there are good reasons why the UK could avoid a surge in inflation. The likelihood is that rates will begin to rise at some point in late 2010 and possibly in early 2011. However, these rises will hopefully be mitigated for mortgage borrowers by reductions in lender margins.

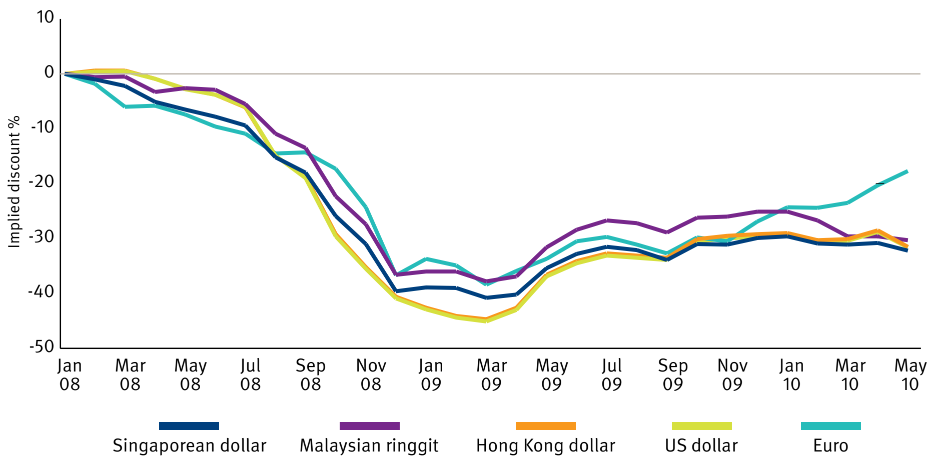
The prospects for capital growth over the next 12 months would seem to be far less auspicious than over the last 12 months. The main reason being that prices have already rebounded substantially from their low point, and the benefits from the late 2008 market stimulus measures have already taken place. Our view is that central London will escape price falls in 2010 and will see steady growth from 2011, however the rest of the UK offers a much less positive prospect.

Rents in London have been rising since June last year, after falling dramatically by 20% in the previous 12-month period. The oversupply which characterised the market up to mid-2009 has been replaced in 2010 with the emergence of a landlord's market, with rising rents and lower void periods, a change which has obviously been welcomed by investors.

The problem for buyers looking to secure stronger investment yields has been that capital price growth has far outstripped rental growth over the past year, and that yields have been squeezed still further. For new-build properties in good locations a gross yield of above 5% is a rarity.

The drivers for international demand are likely to remain in place through 2010 and into 2011. We believe that investors will become aware of the limitations to capital growth through 2010 and will begin to focus on income potential. The hope for developers is that the recovery of the London economy, and therefore domestic demand, will become much more firmly established before there is a significant slowing in international requirements.

Figure 3
Global savings
Implied discount on prime central London prices, from January 2008, allowing for market and currency movements



Source: Knight Frank Residential Research, Bank of England

The international market for UK investment property

49%

The proportion of London residential property investors that are of Asian domicile

Throughout the recent residential market revival UK investors have been increasingly active in their attempt to take advantage of lower prices and also low financing rates. Over the past 12 months they have been joined, especially in London, by a growing range of international buyers looking to secure investment opportunities.

The weaker pound has driven demand for prime London properties from an ever widening range of nationalities. Our own figures confirm that 49 nationalities bought across central London in the 12 months to May 2010. These buyers are driven by a range of drivers – from the need to secure primary residences, second homes or investment properties.

At the top of the market Russians have been joined by Indians, Middle Eastern buyers – who are back in force in 2010 – and European buyers. As the Euro crisis developed in April and May 2010 there was a noticeable growth in European buyers looking to place money outside the Eurozone.

Across central London as a whole there is considerable demand for residential property from a wide diversity of nationalities. However, when we look at the new-build market, and specifically the apartment market which suits the requirements of investors, it is Asian buyers who have been increasingly dominant.

Understanding Asian Investors
Most of the current crop of new-build sales exhibitions in Asia being undertaken by UK developers tend to be concentrated on the main hub cities, especially Hong Kong, Singapore and Kuala Lumpur. As regional financial centres these cities attract business from wide catchment areas and act as conduits for wealth.

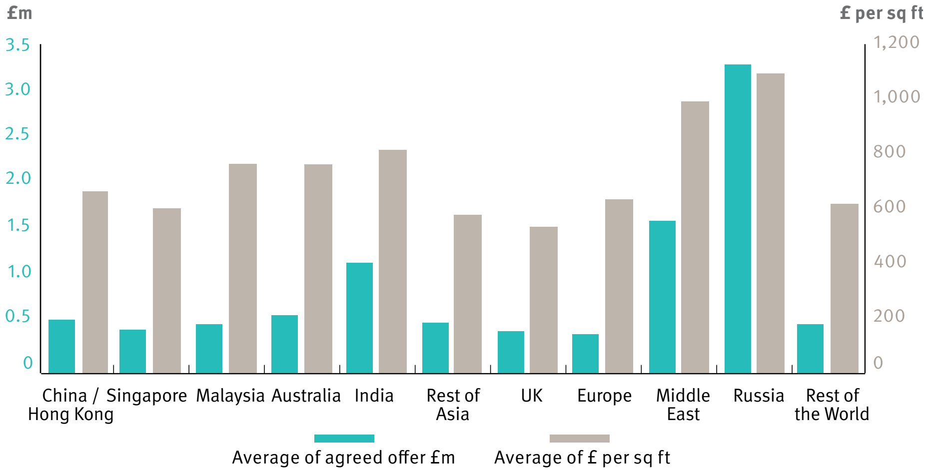
Examples of wealth flows include wealthy Malaysians from the prosperous Klang Valley and Penang who commonly invest through intermediaries in Kuala Lumpur. Investors from Indonesia and Brunei tend to rely on Singapore as their main point of access to international investment opportunities.

Hong Kong is particularly important to UK exhibitors because of its special status within the People's Republic of China, negotiated when the former colony was handed back in 1997. The 'one country, two systems' philosophy means that Hong Kong has a much freer economic regime than the mainland and even retains its own currency, the HK dollar, which is the tenth most traded currency in the world. Wealthy Chinese living in the People's Republic, notably Shanghai, are not permitted to export significant funds in the Chinese renminbi so use Hong Kong as an intermediary location.

Figure 4

What are they spending?

Central London residential investor average spend by broad nationality, 12 months to May 2010



Source: Knight Frank Residential Research

Knight Frank's experience over the past 12 months has been that with the weak pound leading to improved buying power, behaviour has changed. Asian investors have been tempted to shift upmarket. In 2007 exhibitions were focussed on smaller more affordable units, but now demand is as much about two-or three-bedroom apartments with a noticeable move up to the £400,000 to £800,000 price bracket.

Feedback on investor sentiment in the first five months of 2010 confirms a belief that this is a good time to move into the London market. Not only is there a belief that prices have further to rise, but also that the city is in a strong position to benefit from the global economic recovery.

Fears that the property market might be on the verge of bursting in mainland China are also fuelling demand for overseas property from Chinese buyers who want to spread their exposure. Local investors have become markedly more nervous after outstanding bank credit rose by 30% and at least seven key cities saw their new home prices surge by more than 50% over the 12 months to March 2010.

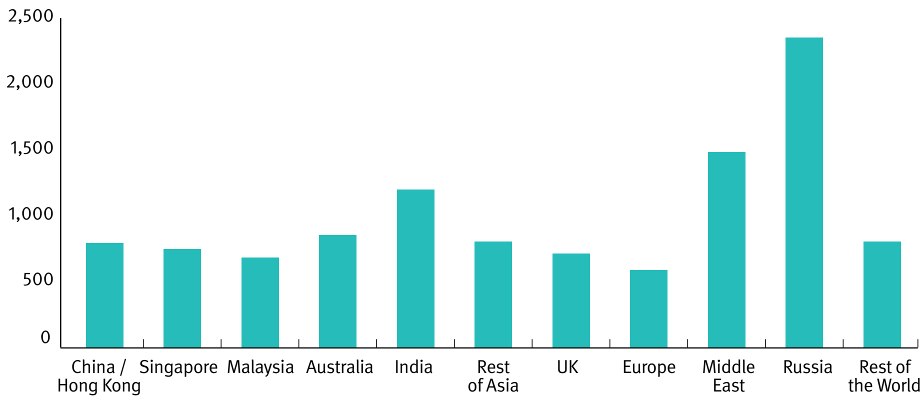
The Chinese have built a reputation as very strong savers and investors, the relentless rise in domestic property prices since house ownership was legalised in 1998 has encouraged a strong belief in bricks-and-mortar investments. Many Chinese investors have difficulty finding low-risk investment vehicles, especially as the Chinese stock market is notoriously volatile and the government has effectively banned third home ownership. Foreign property is therefore very attractive for mainland Chinese if they can get through the regulatory minefield and release the funds.

A significant driver for investment comes from educational requirements. Over the past decade the number of Asian students studying at UK universities has risen by 175%. The strongest growth comes from Chinese, Indian and Pakistani nationals. In the case of China, the number choosing to study in the UK rose from 4,017 in 1998/99 to 47,035 in 2008/09. In many cases Asian investors look to buy to cover the period of their son or daughter's stay at university, the properties are then retained for investment.

Figure 5

What do they buy?

Average unit size by investor nationality in central London, 12 months to May 2010 (sq ft)



Source: Knight Frank Residential Research

This requirement has been a significant driver for the strong emphasis placed on accessibility to public transport. Asian investors focus intently on the London underground network, and generally demand that properties need to be located within a few minutes' walk of a tube station. In fact they go further by insisting that developments really need to be located inside Zones 1 and 2.

The prospect of a new underground station can attract investors to previously unfashionable postcodes. The Jubilee Line extension south of the river brought intense interest to Bankside, and many foreign investors have bought into the regeneration of Dalston, around the East London Line extension.

In terms of investment returns, overseas property investors in London are ultimately looking for capital growth. An increasing number of investors are looking very keenly at income returns, especially after the 2008 reversal in capital values, which focussed attention on the need for secure income streams.

Asian investors are also very concerned with obtaining detailed insight on the market and locality in which their target development is located. High-quality security, facilities such as gyms and restaurants, and services including full-time concierges are increasingly in demand. Secure car parking is very desirable for most purchasers, especially if spaces can be let separately. Investors need to be assured that the area round the development is relatively secure.

Overseas investors are much more sophisticated in the research and due diligence they undertake compared to only five years ago. As a result, they have shown a greater willingness to consider new neighbourhoods. Nonetheless, developments located close to major London landmarks are still far easier to market.

International investment in action – Pan Peninsula

As well as forming part of the world's leading financial centre, Canary Wharf is now established as one of London's main locations for residential investment. The neighbouring Pan Peninsula, one of the tallest residential developments in Europe, has emerged as one of London's most successful investment schemes, selling extremely well in the Far East.

"It went down incredibly well," says Sebastian Warner of Knight Frank, speaking after exhibitions in South East Asia in the first quarter of 2010. "It has been one of the most successful sales campaigns ever in Hong Kong and Singapore, selling 110 units at prices from £250,000 to £4 million." Sales were at an average of £800 per sq ft.

Pan Peninsula is arguably one of the best developments in London at the current time. It enjoys an excellent position, is surrounded by water and commands views of many of London's iconic buildings. The development is situated in close proximity to Canary Wharf and the Tube and its high build quality has created huge appeal for foreign investors.

The twin-tower scheme designed by internationally-renowned architectural practice Skidmore Owings Merrill was an immediate hit with buyers when it was launched prior to the recent recession.

With sales on hold for several months during the downturn, Knight Frank advised Ballymore to start a new marketing initiative which included the international markets. So when the market stabilised in 2009 the message was sent out that the apartments in this prestige development were once again available.

Chinese buyers were attracted by its waterside location, which has very good connotations for believers in feng shui, and the height which makes Pan Peninsula one of the instantly recognisable landmarks of Canary Wharf. The development's iconic architecture has proved very important in the current investment market.

Pan Peninsula's position close to the financial centre and the Jubilee Line makes apartments very lettable, and the development has a number of on-site amenities including a spa offering holistic and Asian-influenced therapies; a residents-only gym and swimming pool, a private cinema and one of the highest cocktail bars in Europe, accessible only to residents and diners at Tompkins, the New York-style steak house on the waterside. Pan Peninsula also has 24 hour concierges to help residents with anything from getting a taxi to having a suit dry cleaned. This attention to detail has proved very attractive with overseas investors.

Pan Peninsula, Canary Wharf

Kuala Lumpur

Eric Ooi

Managing Director, Malaysia

Malaysian investors have been drawn to the London market by the better value offered by the weak pound and the belief that prices are offering good value. They are looking to buy in London to achieve capital appreciation, but they are also looking for a reasonable income return from the start.

Malaysian property investors are generally business people or entrepreneurs. CEOs of multinational companies and major corporations in the region are also big players due to their more global outlook and contacts. Over the past 12 months in particular we have noticed that a high proportion of investors are relatively new to the London market.

Affluent Malaysians have traditionally bought in Australia, where they often send their children to university. With Australia being that much closer and to be fair a much cheaper option for investors – London has been a more realistic option for the wealthiest segment of buyers.

Apartments are purchased for investment, as second homes or for children to use while they are at university.

Malaysians are cautious investors, looking for security rather than high returns. As they have come later to the market than Singaporeans, they are generally less confident about the market, and they are looking to secure a solid income stream with proven rental demand.

One upshot of this cautious approach is that Malaysians are often more prepared than other Asian investors to look at locations outside Zone 1 or 2 if the product is affordable and is in a good position for letting.

Hong Kong

Colin Fitzgerald
Managing Director,
Greater China

Hong Kong is one of Asia's richest cities, but importantly its relaxed financial regime means that it acts as a conduit for sales and investments for the emerging wealthy across China.

The city is bouncing out of recession and investors are looking at overseas property opportunities in huge numbers. An estimated £350m of London property have been sold through Hong Kong in the last 18 months.

For local investors there is a belief that while income yields are not hugely attractive – there is a strong potential for good capital growth.

The concentration on London is partly a legacy of the colonial period, as many Hong Kong citizens know the city well and have relatives in the UK. In addition, the UK is still a major destination for education or for business or leisure visits.

Despite the general familiarity with the UK, almost all investors buy only in the capital, and in particular in central locations. Critically, apartments must be close to the Tube, if they are close to major educational facilities even better and well recognised locations are also in strong demand.

The combination of increasing prosperity, lower London prices and the favourable exchange rate means that Hong Kong investors are moving upmarket, but they are also demanding a lot more for their money.

Eighteen months ago the average investment purchase in London was between £250,000 and £500,000, but the market has shown an appetite for better quality apartments in the over £500,000 market.

In the past 18 months a large number of new London developments has been marketed in Hong Kong and investors are becoming increasingly choosy.

There is a final consideration for London developers to bear in mind – the demands of feng shui, the Chinese belief in energy flowing through buildings to affect wellbeing. Hong Kong is the home of feng shui and it does play a part in investors decision making, although only a few are real believers. True investors who expect to let the property on the local market do not worry about feng shui, but it can be a real problem for some second home owners.

Singapore

Peter Ow
Managing Director,
Singapore

Singapore's rapid emergence from recession over the past 12 months has boosted property prices, which are now close to peak levels. Local investors are increasingly looking overseas for opportunities and London is a major target.

The strong Singapore dollar and low interest rates have given Singaporeans strong buying power across the market, although demand is concentrated on new one- and two-bedroom flats under £1m.

One of the most common motives for purchase is initially to provide a secure place for children to live when attending university in London, so a location close to college is more important than a high-profile address.

But an investment motive is a clear driver. While most investments begin when children are at university, properties will often then be retained to create a longer income stream.

There is a significant advantage for high-profile developers when selling to Singaporeans. They are generally attracted to product from reputable developers with a track record, and buyers prefer to secure property purchases from well-known names. For new entrants to the development market, the most valuable step to take is to tie up with a well know sales agent to provide a degree of confidence to purchasers.

Public transport, particularly the Tube, is very important to Singaporeans who benefit from one of the world's best transport networks. UK developers need to understand that Singaporeans are very pampered, and enjoy a very good public transport system, so proximity to tube stations is critical.

The basics of a well-run block are important for Singaporean buyers, so security and management should be first class, but luxuries such as gyms, concierge services or business suites are less important, especially if they push up service charges.

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