RESIDENTIAL
RESEARCH

THE WORLD'S MOST DESIRABLE RESIDENTIAL MARKET

The Super-Prime London Report 2011

Knight Frank

SPRING 2011

INTRODUCTION

IT WASN'T VERY LONG AGO THAT LONDON'S STATUS AS THE WORLD'S ONLY TRUE GLOBAL CAPITAL WAS RECEIVED WISDOM BY JUST ABOUT EVERY ECONOMIST AND WEALTH ANALYST THE WORLD OVER.

When does Prime become Super-Prime?

There is no hard and fast definition to the prime London market, although £1m has generally been accepted as the entry point. Similarly the super-prime market lacks a formal definition. Our view is that £10m is the appropriate starting point, which effectively means this segment encompasses the top 1% of the whole of the central London marketplace.

Back in 2007, at the top of the bull market, it was generally accepted, especially by those in London's business world, that while Asia's economies would no doubt do great things over the next few years – and that Brazil and Russia were looking very interesting – it was London that would be the real beneficiary of this surge in global wealth creation.

At that time it seemed that every emerging market oligarch was heading into central London to confirm their arrival on the global rich list, by securing the only real 'must have' item; a super-prime London residential property, ideally within a five minute drive of Hyde Park.

For anyone in the central London property market at the time, there was a wonderful sense of being at the centre of world trends. Rather guiltily, I remember delivering a presentation close to Wall Street, in the summer of 2007, to a room of rather disgruntled US wealth managers as I breezily explained the difference between London's 'global residential market' and Manhattan's rather more 'domestic appeal'.

Of course everyone knows what happened next, with the market crash in 2008 puncturing any sense of prime market immunity.

Despite the recent resilience of London's housing market, there has been a growing question mark over London's ability to retain its top city status. The Y/Zen Global Financial Centres Index confirmed in late 2010 that while London remained the world's top financial centre, closely followed by New York it's lead over Hong Kong and Singapore is rapidly being eroded.

More concerning for London has been the broader popular backlash against wealth.

While not limited to the UK, a fusion of resentments against mega-bonuses, bank bailouts, MP's expenses and of course the recession, has certainly given this trend a particular resonance in London.

The combination of the new 50% income tax, the bonus tax, tighter non-dom rules and the ongoing sniping at the City and bankers from politicians has created questions not only over the ability of London to remain as a global wealth centre, but even the desirability, in the eyes of politicians, for this status to continue.

The outcome of this debate is critical for the future health of London's super-prime market.

In this report we have attempted to provide a robust analysis of the current health of the sector, but also an informed view on the outlook for the market.

During January 2011 we interviewed 30 of London's leading wealth advisors, tax lawyers and tax accountants to gather their insight into their clients' views on London as a residential location. We have supplemented this survey with feedback direct from the market, from a dozen of Knight Frank's agents who deal almost exclusively in the super-prime £10m+ marketplace.

Even if you don't concur with all of our findings, I hope that you will agree that we have at least provided a starting point for the debate.

Liam Bailey
Head of Residential Research

IS THE SUPER-PRIME LONDON MARKET SECURE?

Our super-prime London survey addresses the current and future risks and opportunities for the market.

The first issue we asked our wealth, legal and accountancy experts to consider was the influence of key issues on their clients' decision to buy in London's super-prime residential market. In figure 1 we have summarised the results.

At the top of the list of reasons for purchase are the intangible elements, led by the fact that these buyers often have an existing network of friends, family and business associates in London.

London's reputation as a 'safe-haven' investment location, combined with geo-political concerns elsewhere around the world, most recently for example in Egypt and Tunisia, have helped draw buyers into the market.

Also revealed in figure 1 is the fact that with global economic growth now running at pre-recession levels, this factor is contributing to wealth creation around the world which is now pouring into London once again.

With inflation rising in Asia, the desire to add tangible assets to wealth portfolios is proving itself to be a key driver of demand. It is only the UK government's intervention in the housing market (higher stamp duty for £1m+ properties for example) and the UK's changing tax environment which are perceived as serious negatives; the latter point we expand on next.

The second issue we asked our expert panel to consider was the impact of recent tax and financial sector changes on London's future attraction as a wealth hub (figure 2). By some margin the most damaging issue was felt to be higher rates of taxation – especially the 50% income tax rate.

Non-dom tax changes came second, and with the most recent official data for the 2008-09 year suggesting that the number of residents in the UK claiming non-dom status fell by 14,000 that year, there does seem to be a reasonable basis for this concern.

With the exception of one-off wealth taxes, which tend to undermine the UK's reputation as a stable tax location, all of the other issues put to our panel were viewed as issues for the future which could potentially be averted by policy intervention.

Other comments provided by our panel referred to concerns over the increasingly punitive tax treatment of trusts. In addition, while the new Government's stated desire to simplify the UK tax system was accepted as a positive step, there were several concerns over the fact that there is a growing tendency for HMRC guidelines to be overturned retrospectively by parliament or the courts, and that the most beneficial development would be if a degree of certainty could be reintroduced to the system.

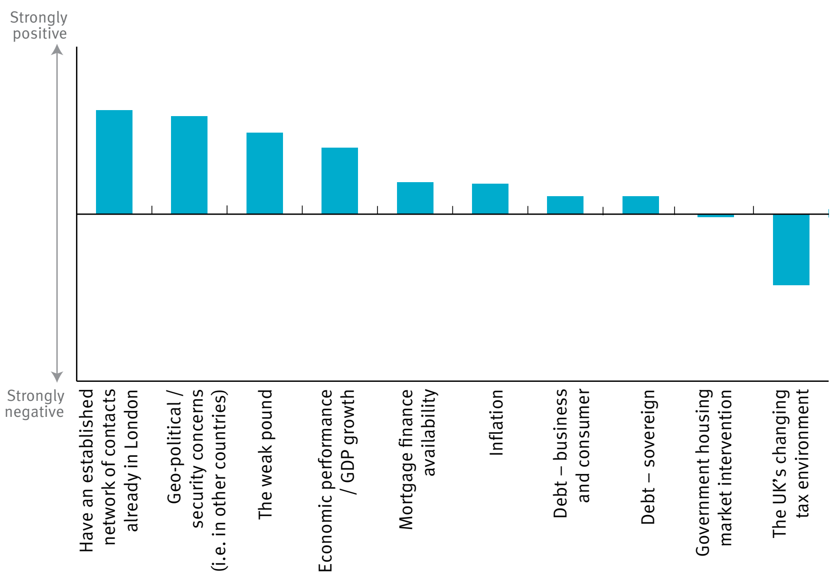
Our agents active in the super-prime market have given us an insight into the attitudes expressed by vendors when they are looking to sell, and we have compared these over time. In figure 3 we have compressed this feedback by considering the changing importance of different reasons given for deciding to sell a property.

Global economic growth is now running at pre-recession levels contributing to wealth creation around the world which is pouring into London again.

Figure 1

Why are they buying?

How important are the following factors in influencing wealthy people when buying property in London?



Source: Knight Frank Residential Research

If there was a surge of negative reasons for sale – the tax burden or London's perceived demise in 2008 and 2009 – it appears that over the past 12 months this has dissipated. While there does seem to be a growth of downsizing requirements from existing owners and some surplus property disposal, our experience is that there will be no lack of demand from buyers for these properties, as we explain below.

Future outlook

In terms of the elements which bode well for London's ongoing success in attracting wealthy residents (figure 4), our contributors pointed to the continued benefit provided by London's financial and business cluster.

The underlying story from the results in figure 4, are that it is the lifestyle and business offering which largely explain London's attraction, followed by education and political (if not tax) stability.

This high regard for London's business and lifestyle cluster is important. Several contributors noted that they had clients who had considered moving to Switzerland, primarily pushed by London's changing tax environment.

The client's determination to pursue such a move were stymied by the need to weigh up the availability of the right infrastructure, employment prospects, family and friends, schooling etc. For most people the conclusion is that Geneva can not replace London's cluster of contacts and lifestyle opportunities.

The other issue revealed in comments made during our survey, relates to housing and even office shortages. There appears to be a general agreement from those with clients who have looked to make the move to Switzerland, and even other centres, that these smaller, and admittedly more tax efficient locations, are simply unable to match the attraction and integration of international melting pots like New York or London.

By way of an example of the ongoing attraction of London, our research uncovered the estimate that despite some relocations, London still retains over 800 hedge funds managing £300 billion of assets, compared to 140 or so in Switzerland managing an estimated £15 billion.

The biggest single trend in demand for property in central London is the seemingly inexorable rise in international demand and the breadth of this demand, with over 50 different nationalities buying property through Knight Frank in 2010, compared to only 30 or so two years previously.

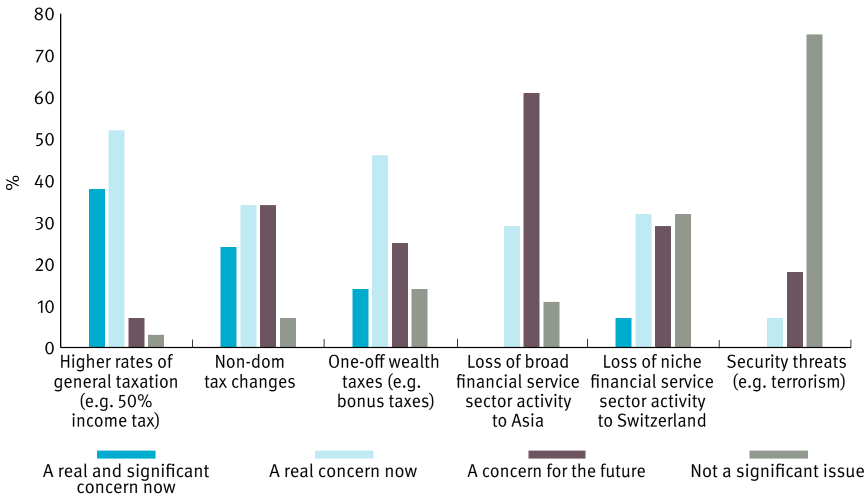
This widening of international demand points to prescience of the view noted in the introduction of this report, that the impact of global wealth creation is felt very keenly in central London, and in the super-prime market in particular.

Looking to the future, we asked our panel and our own sales agents to identify the nationalities they believed would begin to grow in market share in the future.

Despite an already significant share of the super-prime market, at 14% in 2010, there was a consensus that buyers from Russia and the former CIS states would become even more important to the London marketplace. Demand from Chinese nationals, which was negligible until 2010 was expected to continue its recent rapid growth, followed by Indian and Middle Eastern demand.

Of the newer nationalities tipped for growth, anticipated demand from Turkey, Egypt and Lebanon ranked highly, pointing to the combination of growing wealth here and also, unfortunately, to growing political tensions which have been such a regular precursor to property demand in London.

Figure 2
Status anxiety
Which of these statements most closely fits your views regarding the following potential risks to London's attraction as a future wealth hub?



Source: Knight Frank Residential Research

Despite some relocations, London still retains over 800 hedge funds managing £300 billion of assets, compared to 140 or so in Switzerland managing an estimated £15 billion.

We asked our agents to define new locations or at least locations where demand was growing rapidly from prospective buyers. The response from our agents was clear, demand for super-prime property is still led by locations in close proximity to Hyde Park, but also extends north through St John's Wood to Hampstead, west to Chelsea and with some demand extending to locations like the South Bank.

The potential for growing demand in the super-prime market along the northern edge of Hyde Park, Bayswater through to Marylebone, was noted by several agents, as was the ongoing expansion of interest in Mayfair and St James's following the ongoing process of office to residential conversions being undertaken.

In figure 6 we asked our agents to create a top 10 list of property requirements, based on their work in the super-prime sector. The importance, and value, attached to privacy in an urban environment comes out very strongly. It also reflects the opportunity offered to super-prime buyers, allowing them to benefit from the clustering and networking offered by a big world city whilst retaining a private retreat at its heart.

Conclusion – secure demand

Focusing on the long-term, our survey work confirmed that there are question marks over the impact of some high level tax changes on London's enduring appeal. These should not be overstated, demand for accommodation in London bounced back after the 2008 crisis fairly quickly and the market has re-established itself.

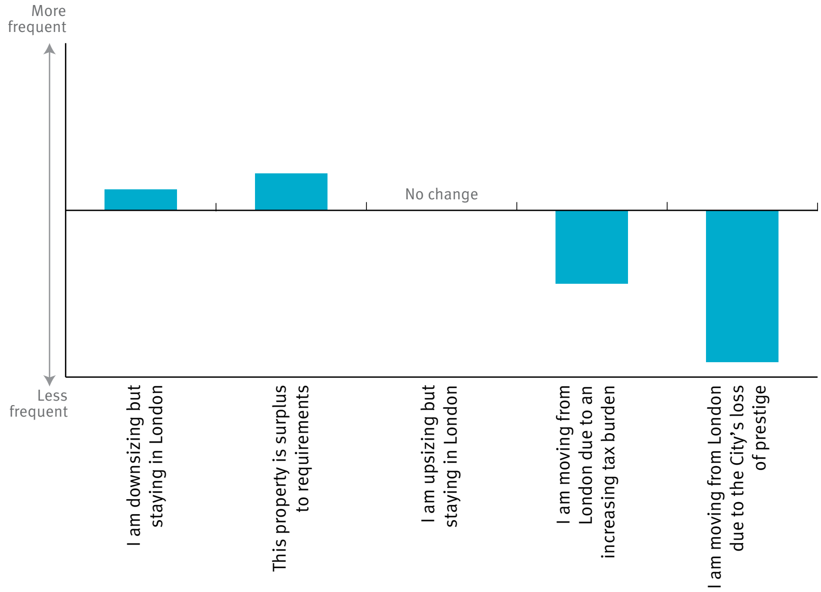
The one issue which does seem worth highlighting is the number of times the word "uncertainty" was mentioned by our panel. One of the UK's real attractions for international investors and residents has always been its reputation for stability in legal, political and tax affairs. This is one issue worth watching over time.

Despite that proviso, as we confirm next in our market outlook, the positive sentiment regarding the future demand for London's super-prime properties is reinforced by activity in the market.

Figure 3

"I am selling because..."

Considering the various reasons for sale given by super-prime vendors, have any changed in importance over the past year?

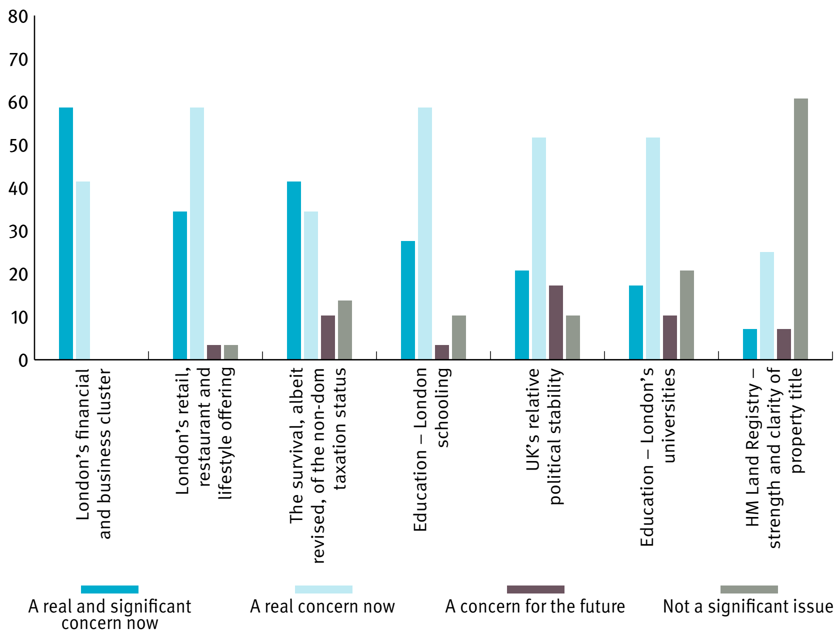


Source: Knight Frank Residential Research

Figure 4

A healthy future?

Which of these statements most closely fits your views regarding the following potential opportunities to London as a future wealth hub?



Source: Knight Frank Residential Research

SUPER-PRIME MARKET PERFORMANCE

The central London residential market recovery over the past 18 months has far outpaced the performance seen in the wider UK, and the super-prime market has been at the head of this recovery.

After falling sharply in 2008, super-prime London prices began to rise from early 2009, and the market momentum drove them higher up until the middle of 2010. The post-UK election period saw a weakening in the UK housing market, which was reflected in London with small price falls across the market.

By the end of last year prices began to rise again, with low supply helping to maintain strong price performance.

The drivers for this strength in performance in the central London market are firstly strong demand (buyer registrations in the final three months of 2010 were 18% higher than the same period in 2009) set against weak supply, with the volume of available properties only 5% higher in December 2010 compared to a year earlier.

This strong demand has been underpinned by the ongoing weak pound still delivering discounts for dollar-based buyers of 25% compared to London property pricing at the peak of the market in September 2008.

Added to this the Eurozone crisis has driven new demand from European buyers, looking for a perceived "safe-haven" investment in the central London property market – with European purchaser registrations rising 25% in the final three months of last year on a year-on-year basis.

In short, the central London market is continuing to buck the wider UK trend of weaker sales volumes and prices. The ability for this trend to continue depends very much on the unique factors in London continuing to play out during 2011.

In the super-prime market, the really significant indicator of robust performance, has not been price growth, but rather healthy sales rates. After a dearth of £10m+ sales last summer, volumes were down 80% in July and August compared with the levels seen in both 2008 and 2009, there was a sharp rise in activity in the final quarter of the year. Volumes were on a par with the very strong final quarter results in 2009, with over 20 £10m+ sales each month across the whole central London market.

How to explain the recovery in high-end sales? In a word – confidence. An example is the Knight Frank Kensington and Notting Hill offices, who alone completed five sales over £10m in a single six week period towards the end of 2010.

Although a significant proportion of sales in 2010 were made to new, international buyers, a large number also went to existing London residents who were looking to improve on their existing accommodation.

Over the course of 2010 prices in the super-prime sector rose by around 8%, but examples of individual properties seeing growth of 15%, or even 20%, were not uncommon.

One of the key reasons for the strength in performance was the low volume of available properties, and in the super-prime market

Table 1
National Champions

Which foreign nationals do you expect to expand their share of super-prime London?

1	Russian
2	Chinese
3	Indian
4	UAE
5	Other Middle East
6	Egypt
7	Italian
8	Lebanese
9	Turkish
10	Brazilian

Source: Knight Frank Residential Research

particularly, a lack of 'turn-key', newly refurbished properties for sale in the better markets. The ongoing difficulties for developers to secure bank funding for larger single-unit schemes partially explains the low level of available stock.

Outlook for 2011

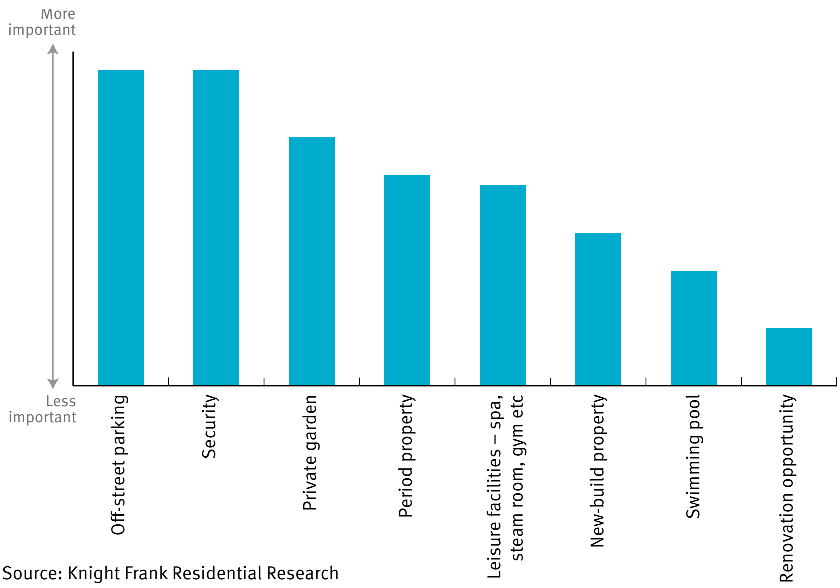
The performance of the market in 2011 will be partially driven by ongoing tight supply and as January has progressed evidence suggests that this factor will not reverse. We asked our sales agents to comment on the contributory impact of key macro factors (figure 7) on price performance last year and their expectation for this year.

The expectation is that the super-prime market will see an additional boost this year from London's 'safe-haven' role as political difficulties play out in more locations around the world over the next 12 months. In addition, rising inflation should begin to create higher demand for tangible assets, benefiting the market.

On the negative side, the gathering concerns over the UK's economic recovery and the ongoing problems in the Eurozone, together with ongoing debt problems, point to potential difficulties in the year ahead from some areas.

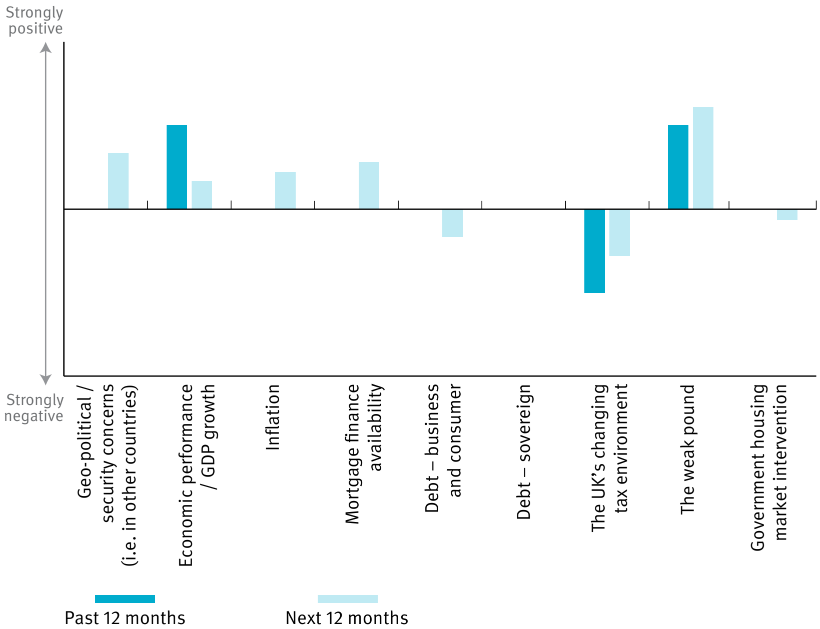
While our central view is that the prime London market will see prices unchanged in 2011, we believe that there is real potential for price growth of between 5% and 10% in the super-prime sector this year. There have been a number of very significant sales in the first few weeks of the year, which point to the depth of wealth which is looking to buy into the top end of the London market. This fact taken together with the ongoing lack of supply could help to push prices higher.

Figure 6
Main requirements
How important to buyers are the following features in the super-prime market?



Source: Knight Frank Residential Research

Figure 7
Market drivers
How important are the following in influencing super-prime price performance?



Source: Knight Frank Residential Research

RESIDENTIAL RESEARCH

Residential Research

Liam Bailey
Head of Residential Research
T 020 7861 5133
liam.bailey@knightfrank.com

Global Property Wealth

Philip Selway
T 0207 861 1112
philip.selway@knightfrank.com

London Sales

Noel Flint
T 020 7591 8600
noel.flint@knightfrank.com

Tim Wright
T 020 7361 0181
tim.wright@knightfrank.com

Eliza Leigh
T 020 7861 1778
eliza.leigh@knightfrank.com

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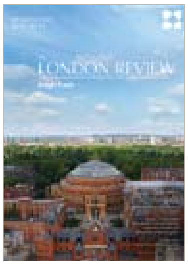
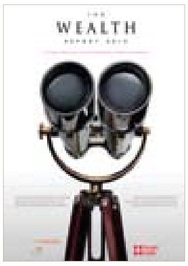


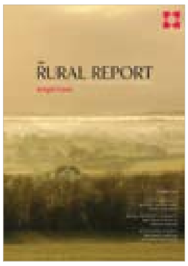
The London Review Autumn 2010


Global Residential Market Forecast 2010-11

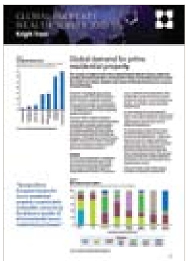


The Wealth Report 2010


Private View 2010



The Rural Report 2010


Global Property Wealth Survey 2010

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