RESIDENTIAL RESEARCH

LONDON RESIDENTIAL REVIEW

ASSESSING THE IMPACT OF STRONGER PRICE GROWTH ACROSS LONDON'S RESIDENTIAL MARKETS **AUTUMN 2013**

LOCAL SALES AND LETTINGS MARKET PERFORMANCE

PRIME LONDON V GREATER LONDON

THE INVESTMENT CASE FOR LONDON

LONDON LEADING

Average prices for prime central London property are over 60% higher than in March 2009 and have risen by 7% in the last 12 months. Liam Bailey examines the key factors driving the market.

KEY FINDINGS

As economic growth in London strengthens **the 'ripple effect' has returned with price growth moving out from central London**

Prime central London property prices are **7% higher on an annual basis...**

...but, property prices in Greater London have risen **by 9.7% over the same period**

The vast majority of home movers who leave Kensington & Chelsea and the City of Westminster **migrate to inner London boroughs**

...which makes it difficult to equate price rises in outer boroughs to the **performance of prime central London**

We forecast that property prices in prime central London **will increase by 6% in 2013, but stronger growth will be found outside central London**

LIAM BAILEY
Global Head of Residential Research

"...price growth in 2014 will continue to migrate beyond central London, into the wider Greater London market and beyond."

Last year we forecast that 2013 would see a change in London's prime property market; with price growth expected to slow in response to an increase in Stamp Duty for £2m+ homes in addition to broader affordability constraints.

There is no doubt that the rate of price growth has slowed, with 7% annual growth in September this year, compared to 10% growth in the same month last year. However, the combination of ongoing low interest rates, an advantageous pound/dollar exchange rate and London's "safe haven" investment status, have ensured that demand for the city's best homes remains strong.

Between January and September this year, the rate of price growth for prime central London property stood at 5.5%. Behind this headline figure we can discern varying trends in price growth by value band.

7%

Annual growth in prime central London property prices

In the £5m-£10m and the £10m+ price brackets, homes have increased in value by 3.1% and 1.6% respectively in 2013 to date. The real outperformance has been in the sub-£1m and £1m-£2m price brackets, where growth in the same period has been 10% and 8.2% respectively.

Despite higher prices, demand for homes in prime London remains strong, and there has been a sharp increase in both demand and sales volumes across London's prime markets. Applicant numbers are higher by 52% so far in 2013, compared to the same period of 2012, while the number of sales agreed is up by 48% year-on-year.

Since 2009 price growth for prime central London property has far outperformed that of Greater London. However, as we examine on pages 6 and 7 this growth is beginning to spread to the wider boroughs and the traditional 'ripple effect' appears to be re-establishing itself.

Policy change

This time last year we were discussing the long-term impact of the increase in stamp duty for £2m+ homes. This, together with the introduction of the Annual Tax on Enveloped Properties, created an air of uncertainty among potential buyers.

The main policy innovation from this year's Budget was the introduction of Help to Buy, which provides a taxpayer backed subsidy for first-time buyers trying to access the housing market with low deposits.

Following its introduction in April this year, 12,500 homes were reserved under the aegis of the scheme, in its first four months of operation.

While Help to Buy, with its £600,000 valuation cap, is a more significant factor in the UK mainstream market, rising housing market sentiment is infectious across markets and is likely to act as a positive influence in terms of future pricing, even in London's prime market segments.

Knight Frank/Markit Economics housing sentiment survey, for example, confirms a surge in optimism regarding future house prices.

It is our view that prime central London property prices will increase by around 6% in 2013. However, as we examine in this report, price growth in 2014 will continue to migrate beyond central London, into the wider Greater London market and beyond.

THE INVESTMENT CASE FOR PRIME LONDON PROPERTY

Demand in the prime London sales sector has remained high through 2013 while rents have struggled. Falling yields point to the need for a timely review of investor strategies.

Despite rents having fallen by 1.2% so far in 2013, activity in the prime lettings market remains high. The number of tenancies commenced over the past two months, for example, has hit record levels.

The Knight Frank Prime Central London Rental Index recorded a drop of 0.1% in September, a contrast to the wider UK lettings market where rents have been increasing. The legacy of restructuring in the financial and business services sector is continuing to weigh on prime London rents.

While recent falls in prime London rents are unlikely to be welcomed by the city's landlords and investors, the rise in capital values has ensured that total investment returns have remained at double digit levels for each of the past three years. In 2012 for example, total returns stood at 10.6% (figure 1).

Gross rental yields for let residential property in prime London remain below the UK average, where 5% is a realistic target for many investors. In comparison gross rental yields in prime London are 3.34%, reflecting the rise in capital values since 2009.

Within the city's prime markets there are areas of local outperformance. Gross rental yields in Canary Wharf for example sit at 4.9%, followed by Wimbledon and St John's Wood at 4.6% and 3.6% respectively.

Catalysts for growth

For property investors a key advantage over alternative assets is the ability to influence returns through area and stock selection. Major infrastructure projects, such as Crossrail, are expected to increase the demand for rental property, following significant improvements to connectivity and accessibility, which ought to feed into enhanced investment returns over time.

Our forward indicators for the market (shown on page 8) suggest that the long-term outlook for the rental sector is positive. Office space take-up was 19% higher year-on-year in the second quarter of 2013, pointing to increased future employment levels, and therefore tenant demand which remains strong, with the number of new applicants and tenancies agreed both higher year-on-year.

The financial sector employment situation in London is less clear cut, with our key indicator showing a 37% year-on-year decline in the number of available jobs in July. However, while financial sector workers have been a mainstay of tenant demand in the past, the growth of the technology, media and telecoms sectors is boosting demand from corporate tenants from within these industries.

According to Knight Frank Research, London's technology media and telecoms (TMT) firms, which have been transforming the City office district, are expected to acquire 1.6 m sq ft of office space in 2013, a 23% increase on 2012.

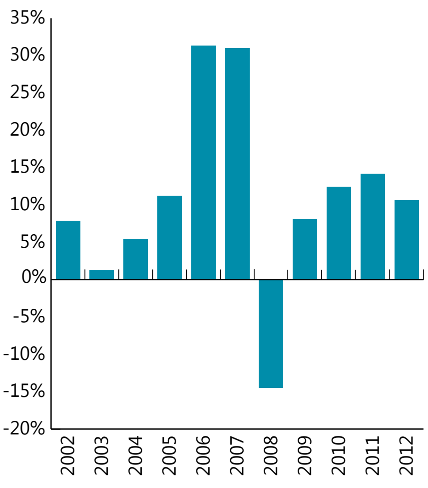
Although prime residential rents have continued to fall so far this year, they are still almost 22% higher than they were during the market trough in the second half of 2009.

The improving economic and employment picture in London, with sharply rising economic sentiment, as evidenced by our House Price Sentiment Index informs our positive outlook for rental growth of 3% in 2014 and 5% in 2015.

10.6%

Total returns for prime London property in 2012

FIGURE 1
Total investment returns
Annual total returns on prime central London property, capital growth and net income return



Source: Knight Frank Residential Research

LONDON RESIDENTIAL REVIEW AUTUMN 2013

PRIME LONDON LOCAL MARKET ANALYSIS

Our map of prime London sales and rental market performance provides a snapshot of conditions at the beginning of October 2013, and reveals a divergence in performance between central and outer London hotspots.

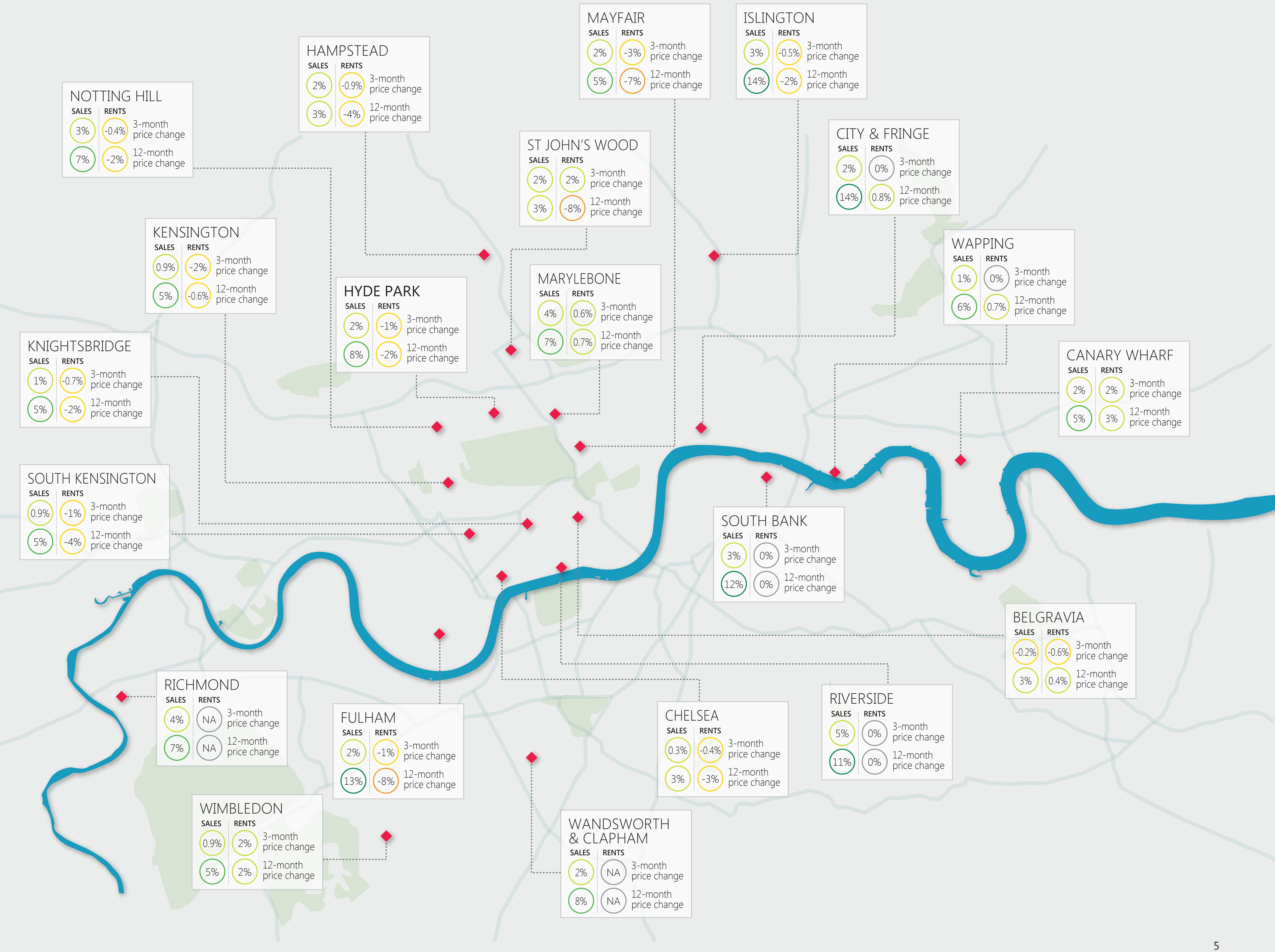
The strongest locations for price growth are clustered around the fringes of prime central London, with The City and City Fringe, Islington, South Bank, Fulham and the Riverside markets leading – with double digit growth over the past 12 months, and between 2.3% and 5.4% growth over the past three months alone.

The more centrally located locations, like Belgravia, Chelsea, Kensington and St John's Wood have seen more subdued growth recently, following very strong performance over recent years.

In the rental market, while most prime locations have seen rents slip back over recent months, once again it is areas away from the centre of London which have bucked the trend, with positive growth in Canary Wharf and Wimbledon over the past three and 12 months.

The underlying strength of demand in both sectors is highlighted by the generally positive growth in prospective purchaser and tenant volumes, against a fall in the availability of stock to both buy and to rent.

- 10% OR MORE
- 5% TO 10%
- 0% TO 5%
- 0% TO -5%
- -5% TO -10%
- -10% OR MORE



CLOSING THE GAP

Over the past four years, while prime central London prices surged, the wider London market, and the UK as a whole, was decidedly subdued. Oliver Knight explains how the pattern is changing.

"House prices in Greater London have risen by 9.7% over the last 12 months. In prime central London annual price growth stands at 7%, down from 10% in September 2012."

OLIVER KNIGHT
Residential Research

An analysis of the latest data confirms that price growth is now spreading to London's outer boroughs, buoyed by a widening economic recovery and aided by government policy.

Figures released by the Office for National Statistics (ONS) in September help to illustrate this ripple effect, with price growth in Greater London now outstripping prime central London. House prices in Greater London have risen by 9.7% over the last 12 months. In prime central London annual price growth stands at 7%, down from 10% in September 2012.

The turnaround in performance has been startling. Over the past five years, property prices have fallen in 12 London boroughs. Over the past 12 months that figure has declined to just one (figure 3).

Prices have grown by over 11% in Wandsworth on an annual basis, the strongest growth of all London boroughs, far outperforming prime central London. Elsewhere, property prices in Camden and Hackney have risen by 11% over the same period, while in Merton residential property prices are up by 10% on an annual basis.

Some commentators have suggested that higher prices in prime central London have pushed buyers out into adjacent boroughs in an effort to find more affordable properties. This argument suggests that these buyers are therefore dragging price inflation with them. We decided to investigate migration trends in and around London, to assess this claim.

On the page opposite we have looked at the movement of property buyers out of prime central London (figure 4).

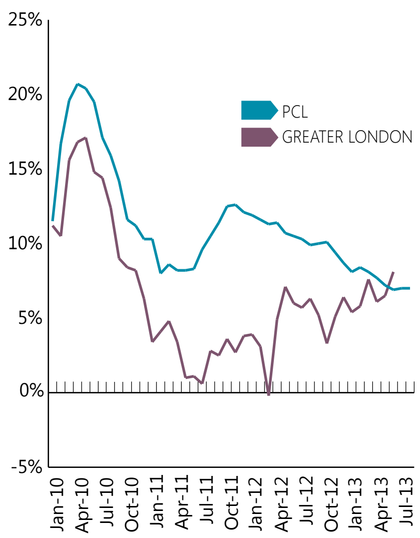
Discounting the large percentage of buyers who move within prime central London boundaries, the majority of home movers who leave the central boroughs migrate to the surrounding inner London boroughs of Camden, Wandsworth and Hammersmith & Fulham.

This pattern of migration makes it difficult to equate price rises in outer boroughs, such as Merton or Barking and Dagenham, to the performance of prime central London prices.

As we discussed earlier, the performance of London's economy, employment creation and government initiatives, such as Help to Buy and Funding for Lending, have helped to boost sentiment and acted as a spur for the property market.

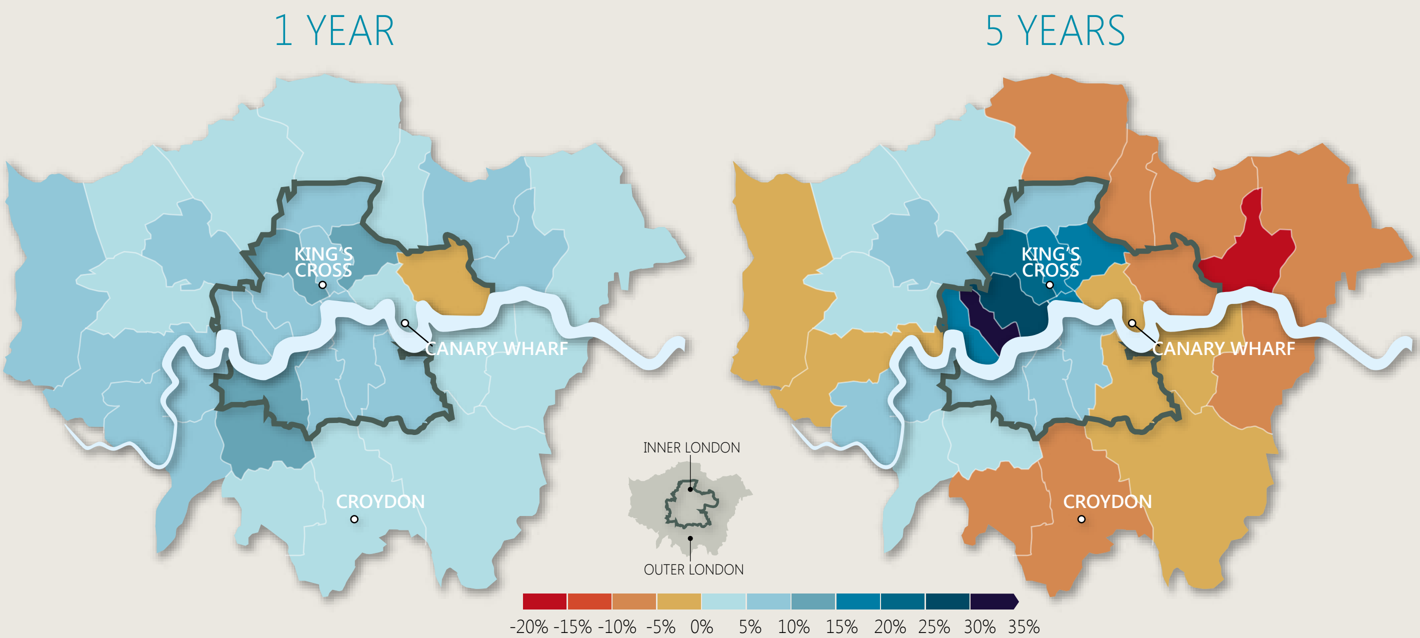
As the economy improves we expect the ripples of price growth to widen out from London.

FIGURE 2
Annual growth PCL v Greater London
January 2010 to date



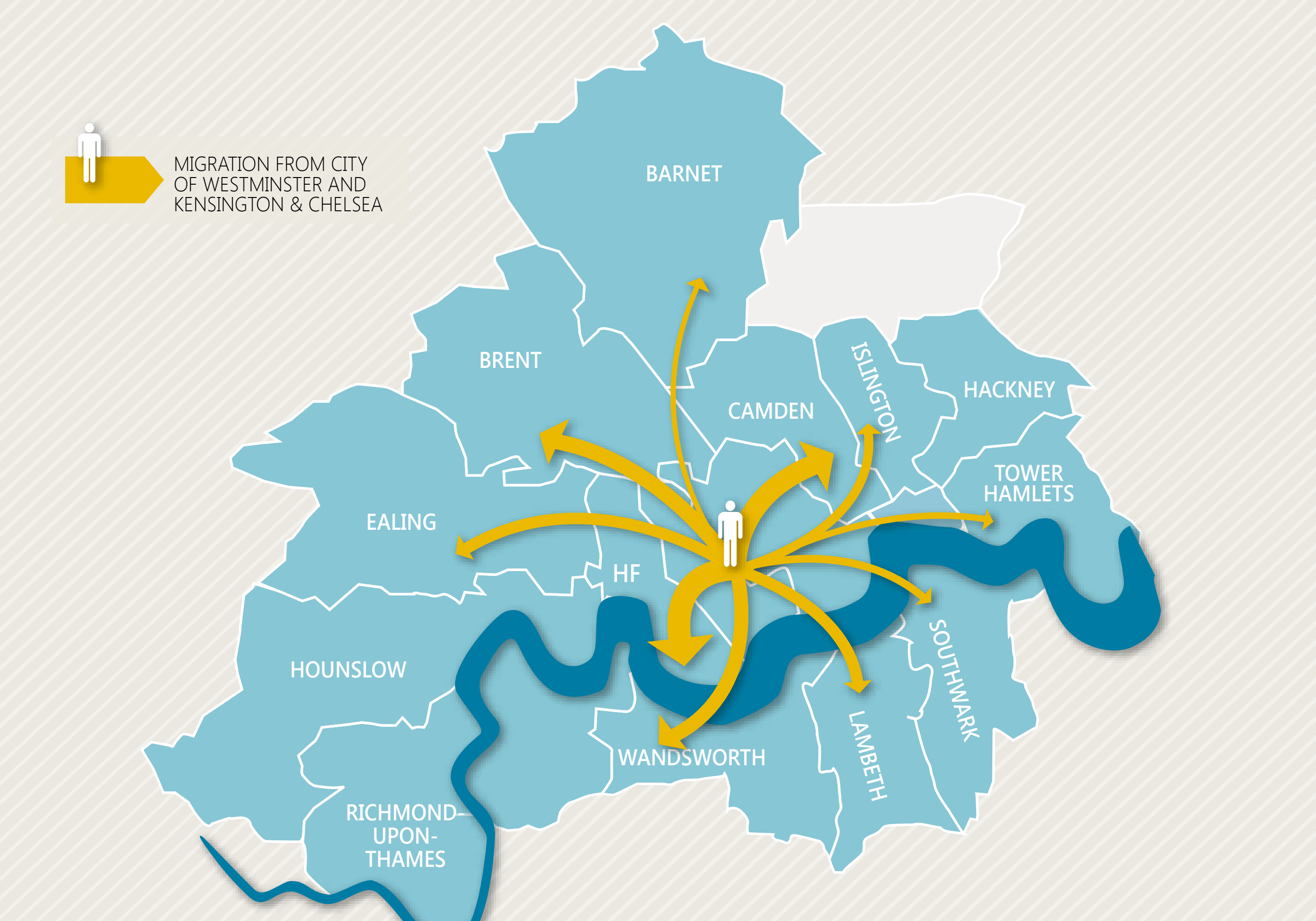
Source: Knight Frank Residential Research / ONS

FIGURE 3 **House price growth in London, over one year and five years**



Source: Knight Frank Residential Research, ONS

FIGURE 4 **London migration trends** Movements of property buyers out of the City of Westminster and Kensington and Chelsea



Source: Knight Frank Residential Research

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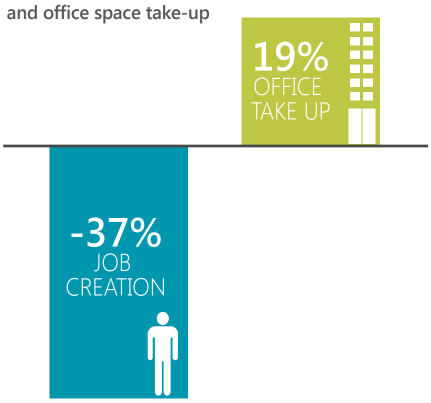
LONDON DATA SNAPSHOT

ECONOMIC

Central London new job vacancies and office space take-up

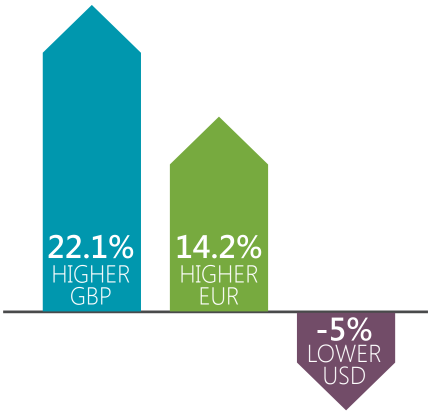


Job creation figures are a year-on-year comparison for July 2013
Office take up is a year-on-year comparison for Q2 2013

Source: Source: Knight Frank Residential Research/Morgan McKinley

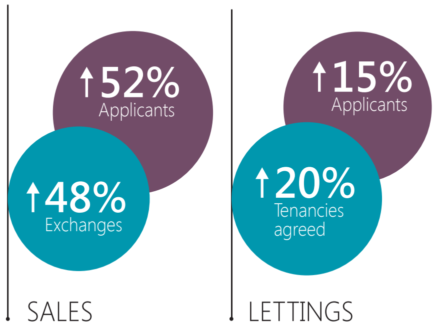
CURRENCY

Prime central London property prices compared to Jan 2008 in sterling, euro and US dollar terms...



MARKET

Prime London sales and lettings market demand and supply



All figures are for the year to September 2013 compared to the same period in 2012

Our key property market metrics paint a positive picture for both the prime London sales and rental sectors. Demand and activity has increased over the year to date compared to the same period of 2012.

In the sales market, the fall in the value of the pound against rival currencies over the past five years has only served to make the prospect of owning prime property in the capital more appealing.

Prime central London homes have risen in value by just over 22% since January 2008, but, as our calculations confirm, currency fluctuations mean that this rise has not been as steep for euro and dollar-denominated buyers. In euro terms, prime central London property is 14.2% higher than in January 2008, while for US dollar-denominated investors prices are still 5% below this level.

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