

## Prime Central London residential update



### Executive summary

- The slowdown that had been evident nationally has spread to the Central London market in recent months.
- Prime Central London (PCL) pricing fell by 1% in the year to June. Super-prime stock (£5m or more) saw price growth of 13%, compared to a 4% fall in the rest of the market.
- We now anticipate that the PCL market will perform roughly in line with the national market in price change terms this year.
- With no improvement in financing conditions, a PCL price fall of 9% is forecast in 2008. A further fall of at least 5% is anticipated in 2009.
- More rental stock is entering the market as those who had considered selling opt instead to let their property.
- Annual rental growth was 10% by mid-2008. We forecast the rate will fall to 7-8% by the year end.

## Market risks

Changes to non domicile taxation rules in April had an adverse effect upon some purchasers but the effect has not been as radical as had been feared in late 2007 when initial proposals were released. The Chancellor's implemented amendments were modest enough to prevent any large-scale withdrawal of the 'non-doms'. This largely removed one major risk from the higher priced end of the market.

The effects of the credit squeeze are evident as up to 11,000 jobs in the City's financial services sector were lost in the second quarter according to a CBI/PriceWaterhouse Coopers survey. Forecasts to the end of 2009 suggest that thirty to forty thousand jobs could be lost. This is already adversely affecting many parts of the PCL market, particularly in the £1-5 million range.

## Supply and demand

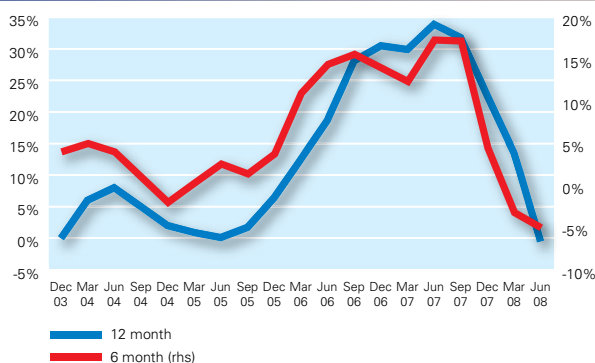
Stock on the market has been accumulating, especially in the sub-£1.5m price range, as many prospective vendors maintain unrealistic asking prices. The inevitable result is that turnover levels decline. Central London sales in the first 5 months of 2008 were 47% lower than in the equivalent period last year, according to Lonres, the Central London sales database. Constraints on access to mortgage finance show no sign of easing with May approval levels nationally 64% lower than 12 months earlier. In addition, widening anticipation of further price falls perpetuate increasing purchaser caution.

## Pricing

By the second quarter of 2008, PCL pricing was 1% lower than in the equivalent period in 2007, whilst a downward trend in the 6-month rate was evident (Chart 1). The 3-month rate fell to -4% in June, from -1% in March.



Chart 1: Prime Central London price growth

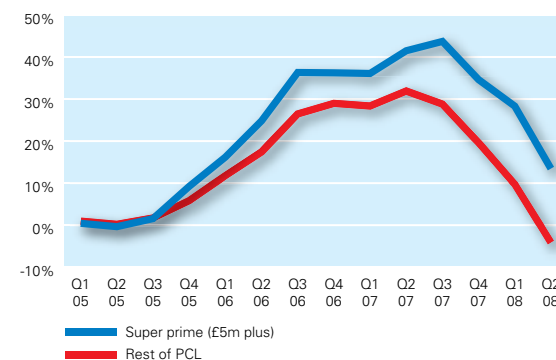


Source: King Sturge

## Super-prime strength

For stock priced £5m or more, sales volumes were higher year-on-year, in stark contrast to the rest of the market. Annual super-prime price growth was 13% in mid-2008, noticeably exceeding the rest of the PCL market (Chart 2), though there is a downward trend. Pricing in the second quarter of 2008 was unchanged in this sub-market.

Chart 2: Annual price growth



Source: King Sturge

Competitive bidding has been evident but is diminishing as the focus for such activity is centred on family homes and apartments offering generous lateral space. At the One Hyde Park scheme, SW1, where prices range from £6m upwards, half of the 80 apartments available were sold in the 15 months to June, with completion scheduled for 2010. In the market for lower-priced development stock, cash-rich long term investors are exploiting the lack of competition from debt-dependent purchasers, to undertake bulk acquisition deals at double-digit price discounts.

Developers have been reining back activity as a result of the weakening end-sale values and rising cost



pressures, with the number of starts in Westminster and Kensington & Chelsea 36% lower in the first half of 2008 than the equivalent period in 2007, according to EGi. Into the medium term, this will underpin values as it will inevitably inhibit the amount of stock coming on to the market.

### **Purchaser profile**

UK purchasers continue to constitute a large minority (45%) of the total in the prime central London market in the past year. Facilitated by sterling's recent weakness, there has been more activity from European purchasers who constituted 35% of the total. Oil price movements are providing an impetus to demand from Middle Eastern purchasers who look set to make up the largest proportion of the remainder of the market throughout 2008. The strength of pricing in a range of commodity markets should ensure that the PCL purchaser profile is increasingly diverse in 2008.

### **Price forecast**

We forecast that PCL prices will fall by 9% in 2008 and at least a further 5% in 2009, as the effects of finance sector employment weakness continue to be felt. As such, we no longer expect the PCL market to noticeably out-perform the UK in price growth terms.

### **Lettings market**

More rental stock is entering the market as prospective vendors opt to rent out their property rather than release it to the sales market in a period

of weakening capital values. The trend appears to be most evident in the smaller 2-bedroom flat sub-market with asking rents of £700-£1,000 per week. As in the sales market, higher value stock (rented out at over £3,000 per week) is attracting the highest level of demand.

The credit squeeze, however, is slowly exerting pressure on corporate sector demand. Tenants from this sector have been negotiating more favourable lease length terms and rents upon expiry. It appears that landlords are increasingly conscious that the supply of such high quality, reliable tenants may fall in the coming months. More tenant choice, combined with increasing pressure from rising mortgage servicing costs may mean many landlords' asking rents are being set at unrealistic levels.

Rents rose by 10% in the year to June. In the first half of 2008, rental yields have reversed the downward trend that had been evident throughout the previous 3 years. By mid-2008, rental yields of 4.2% were achievable, up from 4% at the start of the year. The upward trend is expected to remain evident into next year.

The tenant profile is international in character, with the UK only accounting for 19% of the total in the first half of 2008. Western Europe accounted for the largest proportion (34%) and North America (16%).

We believe the weakening corporate sector will result in lower rental growth rates by the year-end. Our growth forecast in 2008 of 7-8% remains unchanged.

## Area definition

King Sturge Prime Central London - Belgravia, Knightsbridge, Chelsea, South Kensington and Mayfair.



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