



PRIME CENTRAL LONDON: A TALE OF TWO CITIES?

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OVERVIEW

On the 10th August, the national papers ran with headlines of further gloom in the housing market as prices decline again. On the same day, the afternoon London press exploded with news that the penthouse of One Hyde Park had sold for a whopping £140m. While the bulk of the London market is expected to behave akin to the wider national market, nervously trying to dodge the 'double dip', the prime market continues to run away with record prices in what is truly emerging as a tale of two cities. Foreign investors have been fundamental to this recovery, while potential domestic purchasers remain quiet in comparison. As one of the most important cultural and financial hubs in the world, London will always be one of the most sought-after destinations for buying property, particularly trophy apartments and houses. Prime property in Central London is like art, coins and antiques; it is viewed as a good long term investment. The exchange rate has made investing now particularly popular with overseas buyers, while the lack of properties on the market has put additional upward pressure on prices.

PRIME IS LEADING THE RECOVERY

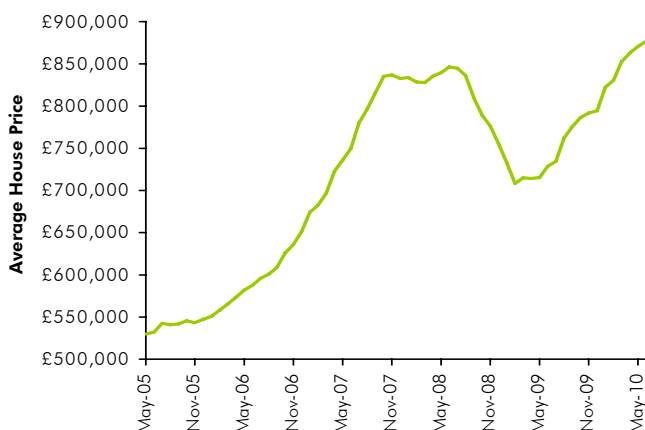
According to Land Registry monthly data, average house prices in most parts of the UK, including prime central London, fell to their lowest point in early 2009. The subsequent pick up has been particularly sharp in the prime markets; average prices have risen by nearly 20% in the City of Westminster and 23% in Kensington and Chelsea. They now stand at £625,392 and £876,721 respectively, representing a 1% and 3.5% margin from their pre-crunch levels. Growth across the rest of London has been slower, at closer to 14% since April last year. They are still 4% lower than they were at their peak. Transaction levels have also picked up, again much more dramatically in the prime markets. However, these remain historically low.

DRIVEN BY INTERNATIONAL INVESTORS

International investors have been fundamental to the performance of the prime market over the last year and now considerably out-number domestic buyers. Although a trophy property in central London will always be highly sought after, interest from overseas has escalated since re-pricing began in May 2008.

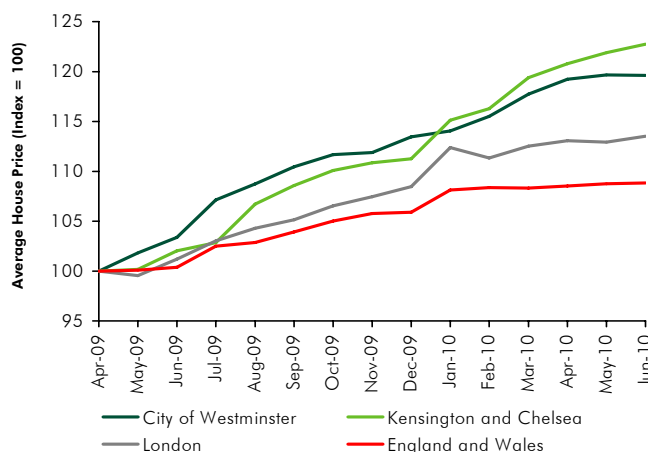
Despite the recovery in underlying prices, sterling remains weak and considerable discounts are still available. Average house prices in Westminster are now broadly in line with their peak levels. However, to those buying with Japanese Yen, they are 36% cheaper. For those buying with the Hong Kong Dollar, American Dollar, Saudi Riyal and the United Arab Emirates dirham, the discount is around 25%.

House Price Recovery, Kensington and Chelsea



Source: Land Registry

Average House Price Change (Index = 100)



Source: Land Registry

Russian buyers have been prominent recently, particularly those buying with US Dollars. Despite a contracting economy, Russia saw its stock market rise by 104% and number of millionaires rise by 21.3%. Western Europeans have also played a key role but due to the currency fluctuations, they benefit less from a price reduction than those in the Middle East or Asia.

The international appeal of Central London property is buoyed by the popularity of its universities. Many wealthy parents look to combine an apartment for their off-spring with a good long-term asset. This trend could become even more pronounced as UK universities work harder to recruit from overseas against the backdrop of government cuts. East Asian countries are targeted for recruitment in particular and this could have a knock-on affect on this residential market.

Furthermore, the attitude towards property ownership in the Far East also adds to the appeal of a Central London Property. For example, in Hong Kong, it is not so much about owning a second home, as it is about owning a collection.

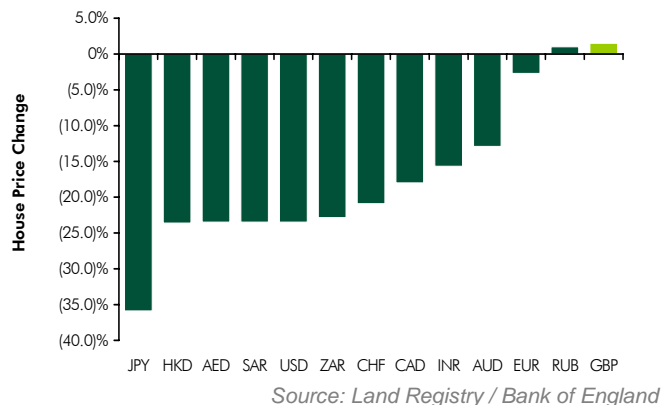
In the current environment, continued interest from overseas will depend partly on Sterling. Although there is some debate, most commentators anticipate that it will remain weak for the rest of the year and into next, on the back of the need to keep interest rates low and generally poor economic conditions. This could encourage further investment if there is the right stock.

Looking to who has the capacity to buy at the very top end of the market, 40% of the world's billionaires live in the US, up to 403 from 359 last year. But according to Forbes, the number of super-wealthy individuals in China and India is also growing particularly fast. Among this year's 97 newcomers, 62 made their debut from Asia, "a region that saw swelling stock markets and several large public offerings during the past year," Forbes Magazine said. There are now 64 billionaires in China, compared with 28 the previous year. Many anticipate that they the Chinese will become 'the new Russians' as major players in the Prime London property market.

CONFIDENCE AT HOME IS GROWING

While UK-based demand for prime property has largely been overshadowed by foreign investors, there are encouraging signs that domestic high net worth individuals are returning to the market, as prospects in the City start to look up. The FTSE 100 has behaved nervously since the general election but there are now signs of improvement. Optimism towards levels of business activity is improving and it is widely viewed that FBS employment will continue to pick up, as more major financial institutions have upped recruitment.

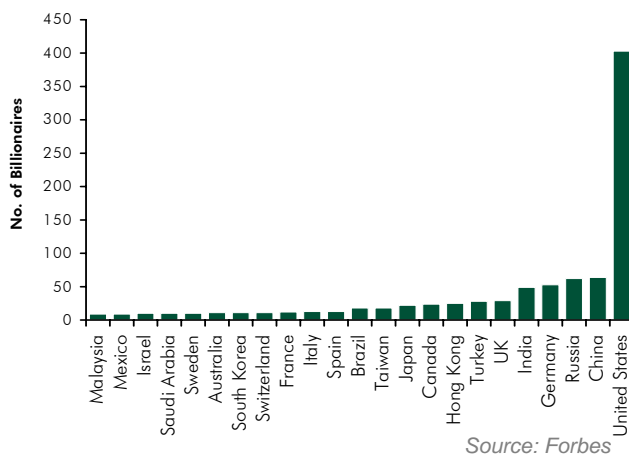
Currency Impact on House Price Change, May 2008 – June 2010



HNWI Population by Country



No. of Billionaires by Country

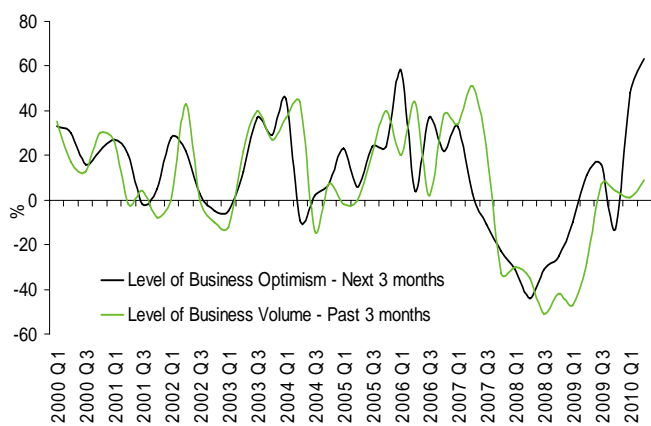


The City was also relieved to escape big bonus taxes in the emergency budget. The Centre for Economics and Business Research has revised its bonus pool expectations for 2010/11, up to £6.8bn. They anticipate this figure will rise to about £7.2bn in 2011-12, and £7.7bn in 2012-13. While this is still lower than the 2007 peak (thought to be around £10.2bn) and the fear that policy-makers could still try to end to the bonus culture hasn't fully disappeared, this is unequivocally an improvement beyond expectations.

Despite a shrinking economy in 2009, the number of millionaires in British grew to 448,100, up 24% from 2008. Furthermore the 155 UK-based individuals in the Sunday Times Rich List 2010 saw their total fortunes rise by 20% in 2009, to more than £29bn. This compares with a fall of 27% in their wealth a year before.

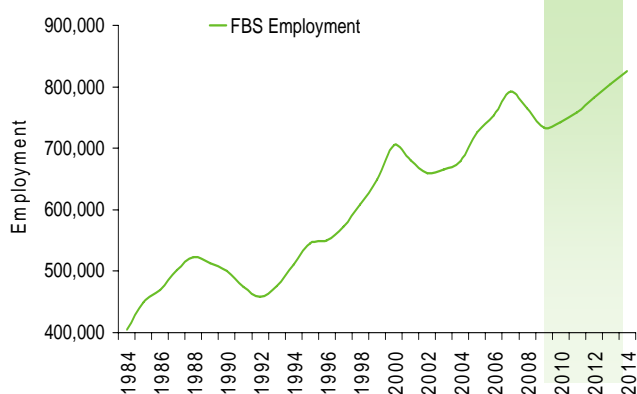
The return of confidence in the City should translate into buying ability and a revival of interest in prime property. There are now a broader number of individuals looking at mid-sized properties in the capital. This might be in the form of personal investment or via a specialist fund that can, say, capitalise on short-term lease opportunities.

Volume Vs Optimism in the UK Financial Sector



Source: CB Richard Ellis / Experian Business Strategies

Central London FBS Employment



Source: CBI/PwC (EcoWin)

PRICING CONTINUES TO REFLECT SUPPLY

Supply constraints continue to have a critical impact on the pricing of prime property. In some respects, this is not a new story. Indeed, the term prime or super prime is relative and the properties must be exclusive by definition. However, the economic climate and lack of development over the last two years have exacerbated the shortage of stock, hence the upward pressure on pricing over the last six months.

Due to these market conditions, some new developments that have been market-ready have held off; for example, One Hyde Park delayed the release of some of its units until conditions stabilised; the development was not in a hurry to sell and it was considered worth the extra wait in order to ensure the highest values. The delay also applies to home-owners, indeed, a key characteristic of the prime market is individuals are usually driven by choice over necessity. As a result, potential sellers are able to wait for values to recover before selling and this is no doubt why there have been considerably fewer properties coming onto the market.

Just as extensions and home improvements enable most home-owners to enjoy their current property and avoid selling, the top end of the market is playing the same game. Expensive refurbishments and combining smaller properties into one has, for some, become an alternative. At the extreme end, Roman Abramovich has reportedly bought nine adjoining apartments in Lowndes Square and is turning them into a 'mega mansion'. Planning consent is not required to turn four flats into one dwelling, so it is difficult to ascertain the extend of 'de-conversions' elsewhere in the market, though anecdotally we would suggest this is becoming more common. The lack of sizable properties on the market, together with the desire for totally bespoke interiors, is driving the 'don't move: improve' mantra across the market.

There are also indications that the lack of stock is encouraging potential purchasers to cast a wider net than they have traditionally, rather than just focusing on the 'golden postcodes'. Hampstead, St John's Wood, Notting Hill, the Southbank and even areas hoping to fall under the Olympic halo will attract more attention.

However, there are now signs that supply constraints could be relaxing very slightly; the recent pick up in pricing has encouraged more sellers back into the marketplace. This will, in turn, cause prices to soften.

'While the economic events of the last two years have shaken the foundations of all investment decisions, what has emerged is a desire for more security in the long term. Although prime property will remain volatile in the short-to-medium term, most likely with falls towards the end of the year, it is still considered a prime asset in the long-term.'

In terms of current and future new-build supply, Molior note there are 16 schemes in the pipeline across Kensington and Chelsea, and 49 in Westminster. Only 1 is currently under construction in K&C and 10 in Westminster; combined, there are only around 900 units under construction in both boroughs. Such thin supply means that each release can have a disproportionate impact on overall pricing in these boroughs.

Schemes that have launched over 12 months have sold particularly well, due to their rarity. For example, Ink in Kensington and Chelsea is slightly off the traditional prime pool in North Kensington, but has sold fast; all 57 units sold in 8 months.

While there are other schemes further a field, these are still few and far between. Due to their rarity, they tend to sell well; for example, Neo Bankside on the Southbank is enjoying interest from both domestic and international purchasers and selling at an average of £1,150 psf. This is twice the average for this area and some units are even selling for £1,700 psf. This underlines the potential for prime pricing for a prime product in areas that are not traditionally considered a prime.

City of Westminster Planning Pipeline

	Schemes	Units
Applications Pending	5	391
Permission Granted*	38	1,419
Under Construction**	10	871

Kensington and Chelsea Planning Pipeline

	Schemes	Units
Applications Pending	1	251
Permission Granted*	14	2,017
Under Construction**	1	45

Source: Molior

* Incl. outline and detailed permission and those where construction may have started

** Incl. stalled schemes

CONCLUSION

The Prime Central London residential market has had a strong six months, with average prices climbing back up to their previous peak. We expect overseas purchasers to continue to take advantage of the weak sterling and remain heavily involved, while confidence is also now starting to return at home. Our mid year forecasts for the national market suggest that house prices will rise by 3% over 2010, with minor falls to follow. Although we anticipate that the prime markets will be more volatile, we think they will still outperform the wider market. Plus-20% growth is unlikely to carry on, but the ongoing interest from overseas investors will continue to create a more isolated market, freeing it somewhat from the economic conditions that anchor the wider residential market and give it a more troubled outlook.

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