PRIME CENTRAL LONDON RENTAL INDEX

Knight Frank

A THREE-SPEED LETTINGS MARKET EMERGES IN PRIME CENTRAL LONDON

Rental values declined in November as the year-end approached and financial services companies continued to cut budgets and staff, says Tom Bill

November 2015

Rental values fell -0.3% in November as part of a seasonal slowdown

Annual rental value growth dipped to 1.2%, against a background of a weak financial services sector

Rental yields were **flat at 2.95%**

Latest stamp duty changes **unlikely to materially alter London's tax status versus other global cities**

Macro View: The timing of a Bank of England rate rise

Rental values in prime central London declined for the second month in a row in November against the background of continued uncertainty in the financial services sector and a seasonal end-of-year decline in demand.

Values fell -0.3%, which meant annual rental value growth dipped to 1.2%, which is the lowest level since August 2014. Rental yields were flat at 2.95%.

It follows a peak of 4.2% in May this year as a degree of demand moved across from the sales market due to uncertainty over taxation and the general election.

Since then, nervousness surrounding global economic events including the slowdown in China means that many companies have reigned in relocation budgets and many banks continue to cut headcount as part of restructuring plans.

Furthermore, stock levels have risen as more owners adopt a wait-and-see approach to pricing trends in the sales market, which has tipped the balance in the favour of tenants and put downwards pressure on rents.

The result is that the number of tenancies started has dropped since 2014, though remains above the level two years ago. Demand, in the shape of new prospective tenants and viewings, is also down compared to what was a relatively strong 2014, though both remain above 2013 levels.

However, demand remains strong in lower price brackets and at the super-prime level of above £5,000 per week amid uncertainty around taxation including recent changes for buy-to-let investors and second home purchases.

The result is a three-speed market where demand is stronger in higher and lower price brackets than it is in the middle.

The changes announced by Chancellor George Osborne mean that buy-to-let investors and those purchasing second homes will be subject to an extra three percentage points on the rate of stamp duty from April 2016, which could lead to fewer rental properties, which would put upwards pressure on rental values.

November also saw the release of Knight Frank's global tax report, which showed London was in the middle of the pack compared to other major global cities in relation to prime property tax and holding costs. The latest changes appear unlikely to alter this position materially.

TOM BILL
Head of London Residential Research

"The result is a three-speed market where demand is stronger in higher and lower price brackets than it is in the middle."

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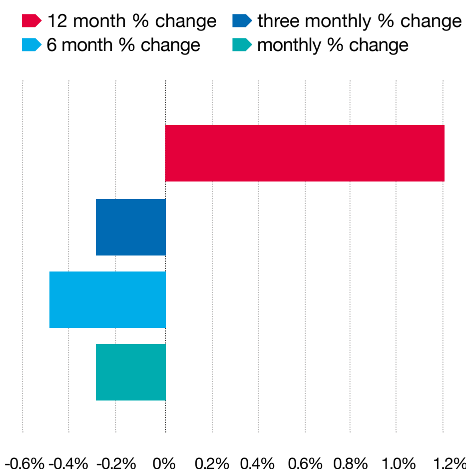
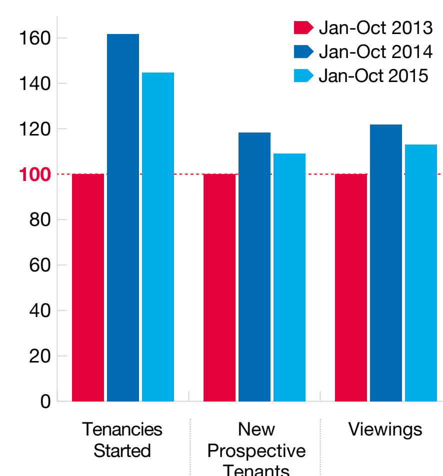
FIGURE 1
Rental value growth in prime central London



Source: Knight Frank Residential Research

FIGURE 2
Lettings demand moderates (rebased to 100)



Source: Knight Frank Residential Research

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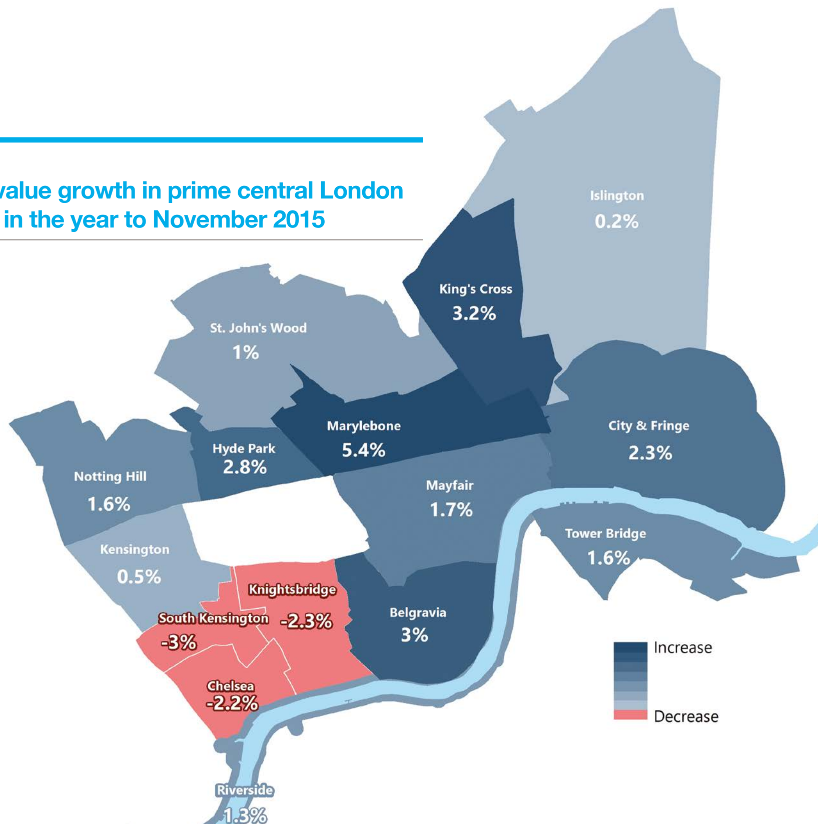
FIGURE 3

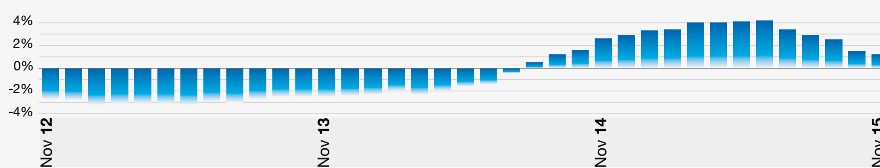
Rental value growth in prime central London by area in the year to November 2015



THE MACRO VIEW NOVEMBER 2015

Prime Central London Index | **175.9**

Annual rental value growth in prime central London over the last three years



THE TIMING OF A BANK OF ENGLAND RATE RISE

The US Federal Reserve has given increasingly strong indications that it will raise interest rates in December.

There have been similar indications before but after China recently cut rates and the European Central Bank signalled more quantitative easing in Europe, the risks to the global economy appear more actively managed if not brought under complete control.

Meanwhile, the Bank of England has been steering financial markets towards a rate rise late next year, meaning the UK and US are likely to be out of step in their approach to monetary policy for most of 2016.

One of the positive implications for the prime central London property market is that Sterling will become comparatively weaker versus the US dollar once the Federal Reserve raises rates, making property comparatively cheaper for buyers denominated in US dollars.

However, the fact the European Central Bank is likely to increase its quantitative easing programme in the same month clouds the picture because the euro would become relatively weaker versus Sterling.

Either way, it leaves the UK economy in a comfortable position between the US and Europe in terms of its approach, said Savvas Savouri, chief economist at asset manager Toscafund.

“By January, when US corporates begin to announce their earnings, the news could be unpleasant, not least the job cuts they reveal as a way of mitigating for lowering estimated earnings and more competitive prices to offset a stronger dollar,” he said.

“This exposes the Federal Reserve to claims that in acting early it acted unwisely in relation to its maximum employment and stable price mandates.”

“It could easily be that while the ECB sees criticism grow for being late in addressing deflation and the Fed too early in normalising, the Bank of England is seen as taking the most sensible timing course. It is an accolade hardly unfavourable to UK real estate and in particular London property. In that instance, headwinds quickly turn into following winds.”

DATA DIGEST

The Knight Frank Prime Central London Index, established in 1976, is the longest running and most comprehensive index covering the prime central London residential marketplace. The index is based on a repeat valuation methodology that tracks capital values of prime central London residential property. ‘Prime central London’ is defined in the index as covering: Belgravia, Chelsea, Hyde Park, Islington, Kensington, Knightsbridge, Marylebone, Mayfair, Notting Hill, South Kensington, St John’s Wood, Riverside* the City and the City Fringe. ‘Prime London’ comprises all areas in prime central London, as well as Barnes, Canary Wharf, Chiswick, Clapham, Fulham, Hampstead, Richmond, Wandsworth, Wapping and Wimbledon.

* Riverside in prime central London covers the Thames riverfront from Battersea Bridge in the west to Tower Bridge in the east, including London’s South Bank. The City Fringe encompasses the half-mile fringe surrounding most of the City including Clerkenwell and Farringdon in the west and Shoreditch and Whitechapel in the east.

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