Market in Minutes
Prime East of City

June 2012

SUMMARY

Demand from investors and overseas remains strong in first quarter of 2012

■ Limited levels of competing supply and a gradual increase in demand from owner occupiers employed in the financial sector will underpin prices and create opportunities in the prime East of City markets over the next five years.

■ There are variations between the East of City submarkets. Generally, the warehouse conversion market of Wapping has significantly outperformed the purpose built flat markets of Canary Wharf.

TABLE 1
Capital and Rental Value forecasts for Prime East of City

	Q1 2012	Year to Q1 2012	5 years to 2012	Forecast next 5 years
Capital Values	1.6%	3.8%	15.1%	22.7%
Rental Values	0.2%	1.8%	8.1%	27.6%

Table source: Savills Research

Prices and Transactions

Over the period since June 2005, price movements in the prime East of City market, comprising of Wapping and Canary Wharf, have more readily tracked the wider London market than the other established prime markets in the capital. Accordingly they have not seen the dramatic price growth of prime central London or indeed the more domestic markets of prime South West and North London.

While showing slightly lower price growth than the mainstream markets of London as a whole in the period 2006 and 2007, in aggregate these markets have seen stronger price growth since the market bottomed out in 2009 (see Graph 1).

Price growth of 26% since the middle of that year has contributed to the fact that prices are just under 4% over their levels at the previous peak of the market in March 2008.

However, there are variations between submarkets. Generally, the warehouse conversion market of Wapping has significantly outperformed the purpose built flat markets of Canary Wharf (see Graph 2).

Over the past five years price growth of 21% in the former compares to growth of just 7% in the latter.

This reflects the extent to which the Canary Wharf residential markets have had to absorb new build stock completed during this period. Land Registry figures suggest that over the last five years new build sales have accounted for 42% of all residential transactions in the market.

In 2009 and 2010 the contribution of six large schemes (Baltimore Wharf, The Icon, Phase 1 Canary Quarter, The Forge, Mastmaker Court and The Landmark) were completed with corresponding sales of 1,500 units.

These significantly distort the picture of the capacity of the market relative to the pre crunch period, which is perhaps better reflected by levels of second hand sales which were 56% of their 2006/2007 levels in these two years.

Initial Land Registry figures for 2011 suggest a more normal balance between new build and second hand

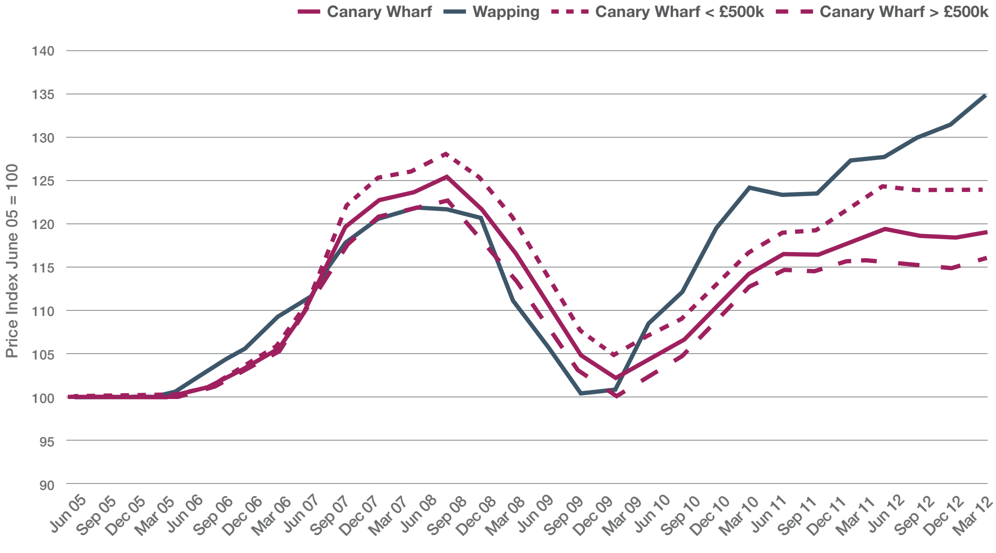
GRAPH 1

Prime East of City in context

Graph source: Savills Research

GRAPH 2

By submarket



Graph source: Savills Research

sales, though looking into 2012 there appears to be a real shortage of new build properties which is likely to support prices in the short term.

Supply

Within Canary Wharf available new build stock is confined to the remnants of completed schemes, such as Streamlight and Pan Peninsula. Molior estimates there are just 60 unsold private units within such schemes and no schemes of more than 50 units under construction. Here the development pipeline has stalled.

> "Over five years new build sales have accounted for 42% of residential transactions"
>
> Lucian Cook, Savills Research

There are over 2,000 private units in schemes with full planning consent where development is yet to start. Of these just under 1,700 units are within five large capital intensive schemes that have proved difficult to fund in current lending market

conditions. This pipeline is supported by a further 1,350 private units in 50+ unit schemes where consent is obtained subject to reserved matters including s106 planning obligations.

By contrast, in the north of Canary Wharf there are some 660 private units available to the market in four large schemes currently in the construction phase. Aimed at the upper end of the mainstream market, though much lower value, what separates these lower density schemes is the ability to phase them and leave less borrowed capital outstanding during the development process.

The stalled development pipeline of prime property in the area has the potential to constrain supply of new stock into the Canary Wharf market for a period of at least two years, and this is likely to underpin medium term price growth. The timing of that growth will be dependent on the depth and nature of demand.

Demand

Through 2008 and 2009 demand became heavily dependant on a relatively small pool of domestic owner occupiers as investors and overseas buyers retreated from the market. This occurred at a time when employment and earnings in the financial and business services sector were under pressure.

In 2010 investors began to return to the prime East of City markets, feeding into price growth and progressively increased transaction levels. The first quarter of 2012 was particularly strong with investor demand accounting for one in four of such purchasers (see Graph 3).

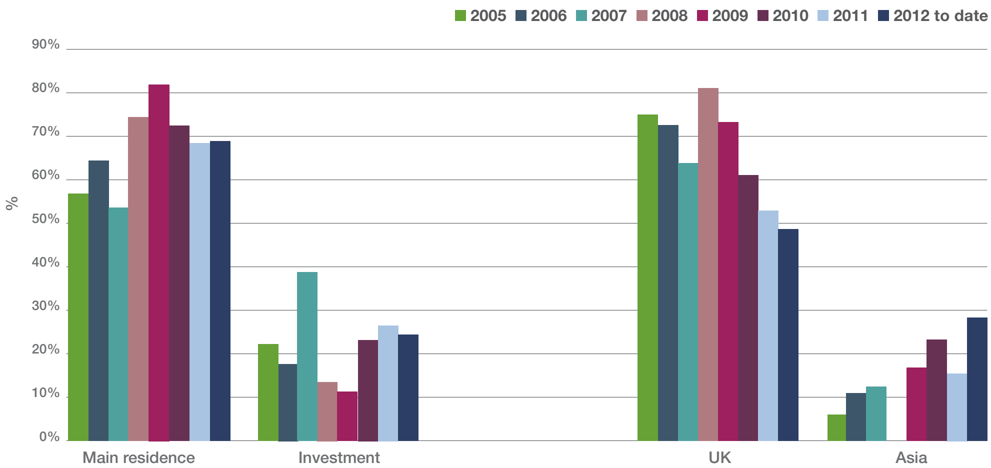
Overseas demand, particularly Asian, has been increasingly important, given the continued uncertainty surrounding the financial and business services sector upon which the market is heavily dependent. In 2006 and 2007, overseas buyers accounted for one third of demand for second hand product. In 2011 and the first part of 2012 it has been half of all demand.

Such buyers are attracted by the area's investment credentials. The prime East of City markets offer higher gross income yields than prime central London (4.9% v 3.8%). Added to this at the end of May, rents were some 3.7% above their level at the peak of the market in 2007.

> “Overseas demand, particularly Asian, has been increasingly important”
> Lucian Cook, Savills Research

Nonetheless, the market continues to be reliant upon buyers employed within the financial and business services sector who account for around six in every ten buyers. Accordingly, the extent to which we see an improvement in core owner occupier demand is likely to be closely linked to the economic

GRAPH 3
Buyer groups (resales market)



Graph source: Savills Research

TABLE 2

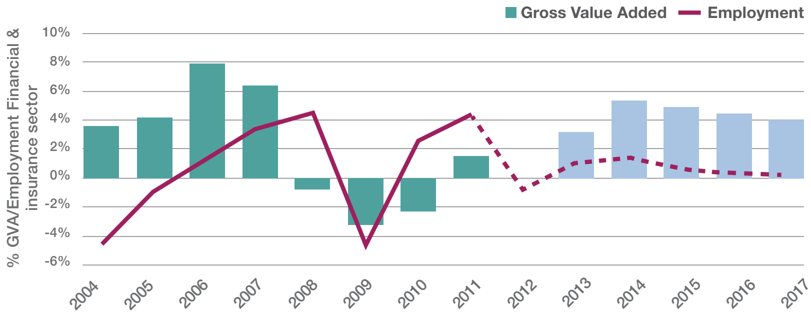
Five-year forecast values

Forecasts	End 2011 v Peak	2012	2013	2014	2015	2016	Five years
PCL	+16.9%	3.0%	0%	5.0%	6.5%	6.5%	22.7%
Prime East of City	+2.3%	2.5%	1.0%	5.0%	6.0%	6.5%	22.7%
All Greater London	-2.4%	-0.5%	1.0%	5.0%	6.0%	6.5%	19.1%

Table source: Savills Research

GRAPH 4

Performance and forecasts



Graph source: Oxford Economics

KEY FINDINGS

Continued buyer appetite

- Over the period since 2005, price movements in the prime East of City markets have tracked the wider London market.
- In this time the market has absorbed very high levels of new build stock. Over five years new build stock has accounted for 42% of all sales in the Canary Wharf residential market.
- However, the development pipeline has stalled. There are 2,000 units with full planning permission in Canary Wharf where development is yet to start. Of these, 1,700 are in just five large scale schemes.
- There is continued buyer appetite from overseas investors, though demand from owner occupiers employed in the financial and business services sectors will take time to rebuild.
- We are forecasting price growth of 23% over the next five years, with price growth peaking in 2015 and 2016.

performance of the financial sector in London and its impact on the Canary Wharf employment markets.

Finance is the dominant business in the Canary Wharf commercial market, accounting for 76% of the office space leased over the last five years.

Across London as a whole, the economic output and employment forecasts for the financial and insurance sector in 2012 are relatively weak (see Graph 4).

Oxford Economics forecasts economic growth in the sector will be just 0.1% this year and that employment will fall by 0.9% compared to 2011. This is likely to act as a constraint on demand and price growth in the short term.

The return of consistent economic and employment growth from this sector is expected from 2013, increasing into 2014. We expect this to feed through into increased demand for prime housing in the East of City markets from 2014.

Though we expect high deposit requirements and constrained bonuses to continue to be limiting factors, this should lead to an improvement in transaction levels and price growth from 2014.

This price growth is likely to peak in 2015 and 2016 given the constraints on the development pipeline and the supply of new product into the market before easing back as the pipeline begins to ease.

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