

Market in minutes

Prime residential markets in London and GB



Summary

- Following four consecutive quarters of price growth in the prime residential property markets, increases in central London slowed to just 0.6% in the three months to June. Similarly, outside the capital prime residential prices rose by just 0.5%, as hitherto constrained stock levels eased across the prime residential markets, and economic and political uncertainty took their toll upon demand.
- By contrast rental values continued to rise relatively strongly on the back of much reduced rental stock levels and an increase in corporate demand. In central London 2.4% rental growth brought rentals back to within 5% of their peak. Meanwhile, in the prime markets of South East England rents, which have previously been much slower to recover, increased by as much as 6.7% in the quarter.
- While the medium term prospects for the equity rich prime London markets are underpinned by overseas demand combined with continued weakness in sterling and its status as a world financial city, we anticipate that over the course of the year prices are likely to soften by -1%.
- Though driven largely by domestic demand we expect a similar pattern in the regions, where buyer confidence is also showing signs of waning.

► **Tipping point in prime London growth**

Given the negligible increases in prices in the last quarter, an annual growth figure in the central London market of 12.3% owes much to constrained stock levels and strong demand from foreign property buyers in 2009 and early 2010.

Those buyers were encouraged by the weak pound and a relatively rapid rebuilding of their wealth. The Cap Gemini/Merrill Lynch World Wealth Report reports that over the course of 2009 those with investable assets in excess of \$30million saw their wealth rebuild by as much as 21.5% as global equity market capitalisation increased by 47.1% in US \$ terms.

However, 2010 has brought further economic uncertainty, especially in the Eurozone. In some cases this uncertainty has added to the appeal of London as a safe haven, but perhaps more importantly the world's stock markets have softened, with the FTSE ending the half year at just over 4,900; down 9.2% over six months.

Combined with an easing of stock levels this has taken the heat out of the international central London market.

The more domestic 'needs based' prime markets of South West London continued to outperform those of central London in the second quarter of 2010. Values rose by 2.6%, down from 4.4% in the preceding quarter but leaving year on year growth at 22.0% and prices just 3.7% off peak on average.

Although stronger than in central London, in the latter part of the quarter demand has softened and without evidence of any significant bonus money entering the market. This means market conditions are expected to be weaker in the second half of the year, even though stock shortages – particularly for family housing – are currently supporting prices.

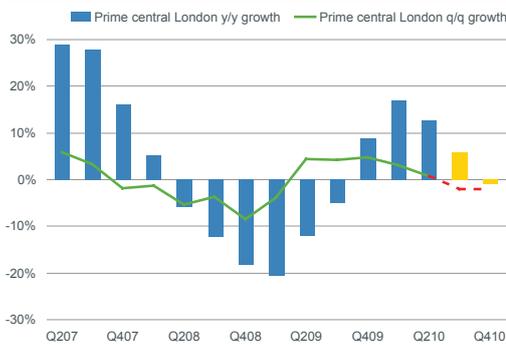
Prime Regional Property

Prime regional property values rose by just 0.5% over the second quarter of 2010, on a par with those in central London. While the political uncertainty in the run up to the election undoubtedly resulted in a sense of caution; arguably the speculation surrounding and subsequent response to fiscal and public spending policy changes have had a greater effect on levels of demand.

The markets furthest away from London, namely the North and Scotland where the buyer profile is more evenly balanced between the private and public sector, reported small falls over the second quarter as demand failed to keep pace of the rising supply levels. ►

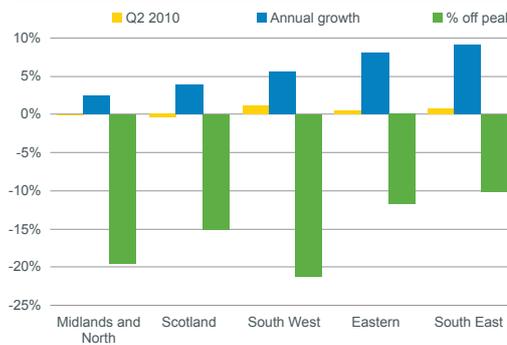
“2010 has brought further economic uncertainty, especially in the Eurozone. In some cases this uncertainty has added to the appeal of London as a safe haven.”

Graph 1.
Second slip likely in Central London



Source: Savills Research

Graph 2.
Slower growth in most regions in Q2 2010



Source: Savills Research

Table 1.
Q2 2010 prime indices results

	Q2 2010	Year on year	% recovery	% from peak values
Capital values				
Prime central London	0.6%	12.7%	17.6%	-9.6%
Prime SW London	2.6%	22%	29.8%	-3.7%
Prime regional markets	0.5%	7.1%	7.3%	-13.4%
Rental values				
Prime central London	2.4%	7.8%	7.8%	-4.9%
Prime SW London	7.3%	13.5%	15.7%	-5.4%
Yields		Gross	Net	
Prime central London	4.3%	2.8%		

Source: Savills Research



► Rental market

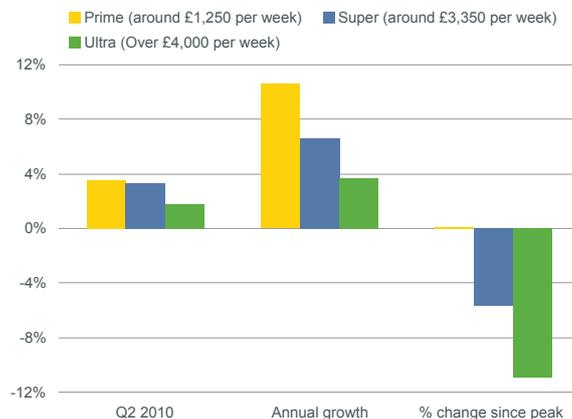
The rental market of prime central London continues to be characterised by low levels of supply together with increasing demand from corporate tenants. This has pushed rents up by a further 2.4% over the second quarter taking annual growth to 7.8% and leaving rental values -5% off peak.

The core prime market, where rents average around £1,250 per week, has outperformed the rest of the market over the last year as the tightening of corporate allowances has forced tenants to look at more affordable product, as well as private individuals looking for a less costly option in light of current economic conditions. A 3.5% rise over the quarter means that rents in this price band have now recovered to their peak levels.

Stronger rental growth compared to capital price increases has already begun to push out yields. Current gross yields of 4.3% in central London are likely to move out to 4.6% by the year end (their highest since December 2005) as values fall while rents continue to rise. This will add to the appeal of London as an investment opportunity and should encourage investors looking for both income and longer-term capital gains.

“Stronger rental growth compared to capital price increases has already begun to push out yields.”

Graph 3.
Rental growth strongest in lower price brands



Source: Savills Research

Outlook

- Against the context of subdued price growth in the last quarter, the recent emergency budget will do little to improve sentiment which will continue to suppress property transaction levels.
- As such, the prospect of a softening in prices over the second half of the year remains. Accordingly we continue to forecast that prices in the prime sectors will end the year 1% below those prevailing at the beginning of 2010.
- This second slip in prices is unlikely to become a double dip and our mid-term prognoses for the prime

markets still remain positive, as the fundamentals of the prime markets, particularly in central London, remain sound.

- While the threat of an increase in the Capital Gains Tax rate applicable to second homes and investment property created a ripple in the market pre budget, the limiting of the CGT rate to 28% for upper rate tax payers (from the feared 40% or 50%) is welcomed and, coupled with yields moving out, as rents continue to rise, should provide incentive for investors looking for both income and longer term capital gains. ■

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