Spotlight on…
Prime residential
East of City markets

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Prime residential East of City markets

In the early part of the last recovery, the prime residential East of City market outperformed the mainstream. Will that happen again?

"Since the early 1990s the performance of the East of City has tracked prime central London much more closely than the mainstream market."
Lucian Cook
Director

Executive summary

- In common with other residential markets, values in the prime East of City markets fell significantly, by 17.8%, in 2008.
- To date values have not recovered as strongly as other prime markets of London, given more discretionary demand and a less diversified residential offering.
- Nonetheless, values increased by 4.6% in the second half of 2009 and by a further 3.3% in the first quarter of 2010, while residential rents have increased by 3.6% in the past six months.
- Assuming London retains its pre-eminence in the global financial sector we expect the prime East of City market to outperform the mainstream markets of Greater London over the next five years, much as it did in the early to mid 1990s.

Introduction

Residential values in the prime East of City market fell by 17.8% during the downturn of 2008. However, compared to other prime London residential markets, or indeed the mainstream residential markets for London as a whole, this market was much slower in witnessing price growth in the improved market conditions of 2009.

This short-term performance has much to do with both the amount and nature of stock offered to the market prior to the downturn and the heavy reliance on buyers from the financial and business services sector.

By contrast, when we look back to the mid 1990s, the prime East of City market significantly outperformed the mainstream markets during the early stages of a housing recovery. Within this report we have looked at whether this is likely to be repeated as we emerge from the most acute post-war downturn in the housing market.

Price movements in a historic context

Since the early 1990s the performance of the prime East of City has tracked prime central London much more closely than the mainstream market. This was particularly the case in the aftermath of the previous price correction of the early 1990s, when it outperformed the mainstream markets of Greater London, albeit not to the same extent as the more mature prime residential markets of central London.

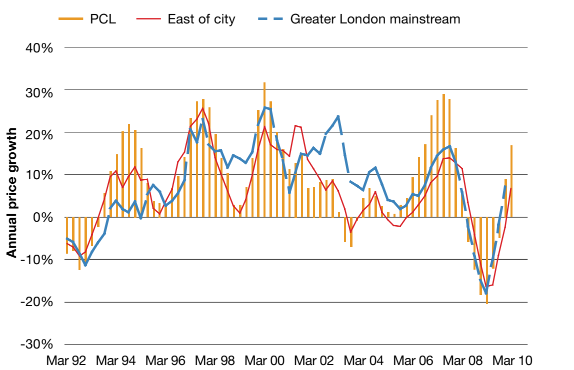
It is also reflected in the performance of the market in 2001 to 2005 when, in common with prime central London, its susceptibility to the political and financial shocks caused it to substantially underperform the mainstream market.

Yet in 2006 and 2007 it did not see the extreme price growth witnessed in central London, by virtue of a less diversified residential offering and much narrower purchaser base. Equally, whereas prices grew by some 8.9% in prime central London in 2009, despite an improvement in market conditions we had not seen a return to year-on-year house price growth in the prime East of City Markets by the end of last year.

Modest price growth of 4.6% in the last six months of 2009 partly reflects the extent of new-build stock that has remained available to buy within an area with such a historically high level of new development.

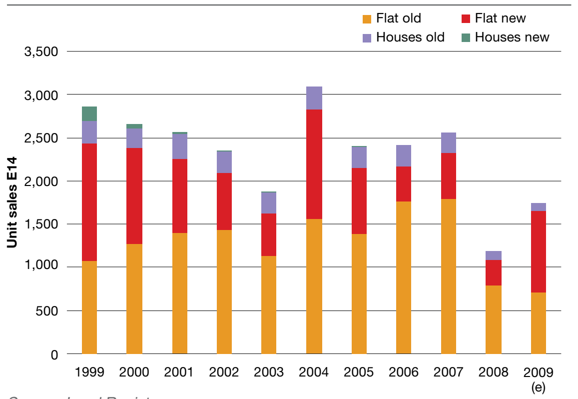
Within E14, sales of newly completed flats have accounted for more than a third of all sales over the past 10 years. Meanwhile over the past four years 68% of properties sold by Savills have been owned for less than five years. This means stock shortages, which have been apparent in more mature markets and have contributed to upward pressure on prices, have been less evident in the markets of Docklands and Canary Wharf.

Graph 1
Prime London annual price growth



Source: Savills

Graph 2
Annual Housing Transactions E14



Source: Land Registry

Forecast	2009	2010	2011	2012	2013	2014	2015
Prime Central London	8.9%	-1%	7%	11.1%	7.5%	6.3%	6.3%
Greater London mainstream	7%	-4.1%	2.1%	5.6%	7.3%	7%	5.8%
Prime East of City	-2.6%	-1%	4.5%	10%	7.5%	6.5%	6%

Source: Savills Research

Nonetheless, in the first quarter of 2010, demand continued to build in the prime East of City markets, resulting in both an increase in sales activity and values, with prices increasing by 3.3% over the quarter, resulting in an annual price growth for the first time in just under two years.

"Owner-occupiers account for 63% of demand within prime East of City residential markets, with high demand coming from discretionary buyers."

Demand profile

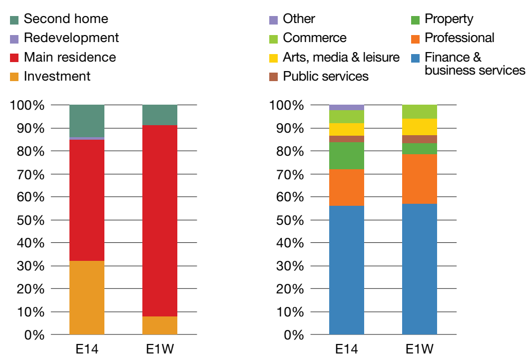
Against this supply context, demand tends to be highly concentrated among those employed in the financial and business services sector. This sector accounted for 53% of the buyers of prime property across the areas serviced by our Docklands and Canary Wharf offices through the strong market conditions of 2006-07 and the lower turnover markets of 2008-09.

Importantly, the owner-occupier buyers from within this sector have a much lower age profile than other prime areas, such as South West London where buyers with families have had a more pressing need to return to the market. Owner-occupiers typically account for 63% of demand within the prime East of City residential markets, with relatively high proportions of the demand coming from discretionary buyers such as investors (25%) and those, who, having their main residence outside of the capital, acquire a pied-à-terre for use in the week (12%).

In the depressed market conditions of 2008 and the first half of 2009, this meant that the market became dependent on a core of owner-occupier demand, which tended to shift towards the more mature and diverse Docklands markets and remained strongest for the larger higher-value units. Despite a fall in values, the changing profile in the stock that did sell meant the average £ per sq ft actually increased during the downturn.

This demand shows that the prime residential market in the area is highly dependent on: the general employment and earnings outlook in the financial services sector; the position of London as a world financial centre; and, more specifically, the ability to attract and retain major banks to Canary Wharf as a commercial proposition.

Graph 3
Prime East of City buyer profiles 2006–2009



Source: Savills

Source: Savills

The Olympics will put Stratford on the map, and the long-term regeneration is set to transform the area (see page 7).

London as a world financial centre

One of the conclusions of the recent CBI/PWC report *twentytwenty vision: the future of financial services* concludes that "London's role as a financial centre has not been damaged by the [credit] crisis so far, and the UK has retained its competitive advantages in financial services."

While it identifies a number of risks (including those of excessive regulation, politically motivated tax rises and a shift in the global centre of gravity eastwards) and acknowledges that London will have to work hard to maintain its position, given the international mobility of firms and talent within the sector, it notes that London has all of the advantages needed to retain its global pre-eminence in financial services.

According to Oxford Economics report *Emerging from Crisis: The Prospects for London,* the city's key economic strengths (the availability of skills and capital, access to international markets and the flexible environment in which businesses can operate) should ensure that the finance and business services sector will experience an overall growth between 2011 and 2020 albeit with less pace than was seen over the past decade.

The role of Canary Wharf

Demand for residential property in the prime East of City markets will be dependent upon how London's continued role within the global financial services industry translates into the continued development of Canary Wharf as a commercial centre. Business-space activity in Canary Wharf saw a decline during 2009 after the high levels of take-up seen in 2008. Just under 400,000 sq ft of commercial space was taken up in 2009, but by the end of the year vacancy rates had risen to 15.8% (compared with 5.1% at the end of 2008). Importantly, some activity did return to the market in the final few months of 2009. There was nearly 500,000 sq ft of office space under offer at the beginning of 2010, of which 350,000 sq ft was completed in January in a letting to Barclays Capital Finance Limited at 20 Cabot Square. Even though the Government's introduction of a bonus tax for bankers is reportedly causing J.P Morgan to consider alternative European locations, ground works have commenced on the proposed site of their European headquarters building at Westferry Circus. Meanwhile, Shell agreed to rent 250,000 sq ft at 40 Bank Street in February, and KPMG are due to move into their new European headquarters building at 15 Canada Square.

"Canary Wharf continues to be the fastest-growing office market in the UK, and is home to some high profile occupiers."

Given this activity, Canary Wharf continues to be the fastest-growing office market in the UK, despite the downturn and is home to some of the capital's highest profile occupiers.

Perhaps the strongest recent endorsement of Canary Wharf has been the rights take-up by one of the world's largest sovereign wealth funds to 24% of the ordinary shares issued by Songbird Estates Plc (the owner of the Canary Wharf Estate).

The supply equation

There are four main residential schemes within Canary Wharf, which are either completed or under construction, and will bring 1,500 to 1,800 units to the market over the course of 2010 and 2011. This would deliver approximately 800 units more than in 2009, albeit over a two-year period. While some of this stock has been sold off-plan during the boom years; we expect a proportion to be in competition with newly marketed property, as some of those off-plan purchasers who are unable to complete their purchases seek to assign their contracts; a feature of the market that emerged in 2009.

Looking further forward many of the remaining consented schemes within E14 are capital-hungry tower schemes of 30 storeys or more, which were purchased as development sites at or near the height of the market. This will affect their viability, particularly in a period of constrained development finance, which could lead to a dearth of new-build products in Canary Wharf in the period from 2011.

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Rental and investment markets

Average prime rents (per week)

Average rent achieved	1-bed flats			2-bed flats		
	E14	EW1	SE1	E14	EW1	SE1
2006	399	344	356	478	509	531
2007	413	398	329	595	569	617
2008	369	407	373	541	610	576
2009	321	404	370	456	537	576

Over the course of 2008 and 2009 rental values within the East of City flat market fell by some -22.8% from peak to trough, much more than -10.7% fall within the Prime Central London market. This reflects the exposure of the market to the huge falls in corporate rental demand experienced during the recession and the high levels of available rental stock.

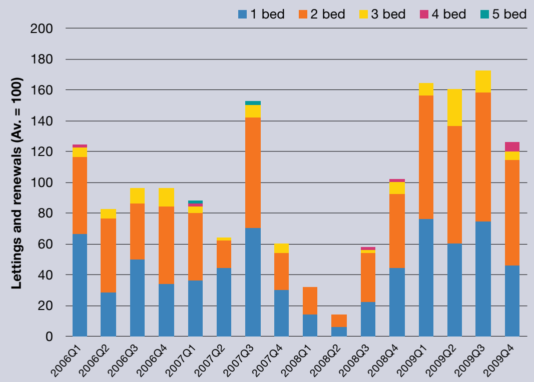
This was also reflected in the level of letting activity, which declined dramatically over the course of 2007 and the first half of 2008, before rebounding strongly with high levels of letting activity in 2009, allowing rents to stabilise and show modest growth in both the last quarter of last year (0.3%) and the first quarter of 2010 (3.3%).

This volatility reflects the fact that the East of City rentals market is heavily dominated by the supply of one and two-bedroom flats and demand from tenants employed in the finance sector, who have accounted for just approximately seven out of ten tenants, as an average over the past four years.

Rental values for one-bedroom flats tend to be concentrated around the £300-£400 per week level, while there is far more variation in terms of rents for 2-bedroom units, where premium rents are paid for the larger best-located properties.

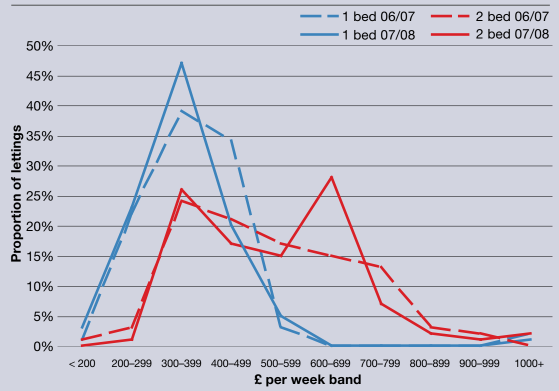
This has meant that gross income yields have consistently been in the region of 4.5%–5%. The current gross yield of 4.6% exceeds that of prime central London, which has added to the investment proposition for overseas buyers, who have been attracted by the prospects for capital growth that can be compounded by the opportunity to take advantage of the weakness of sterling.

Graph 4
Prime East of City lettings activity

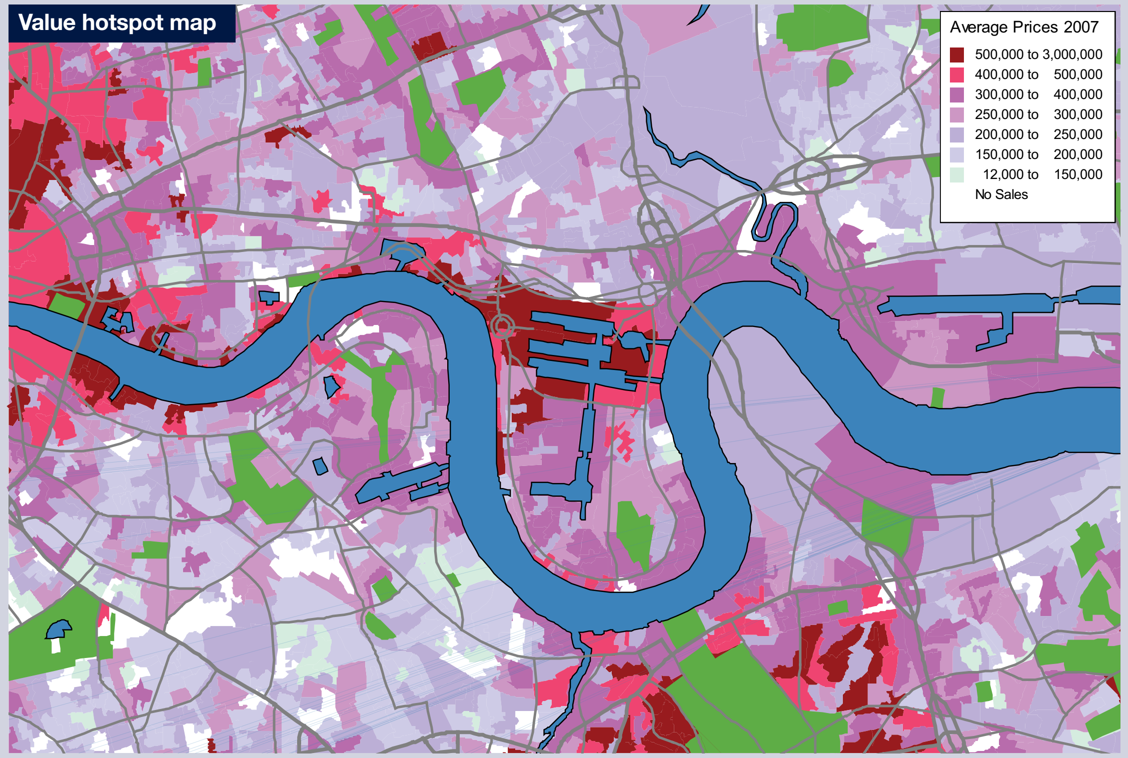


Source: Savills

Graph 5
Distribution of rents for 1 and 2-bed flats



Source: Savills



Delivering value

Recent analysis of asking-price data suggests there are three central boroughs in London where residential property prices average in excess of £1,000 per sq ft. These are: Kensington and Chelsea, City of London; and City of Westminster (with prime boroughs in South West London including Wandsworth and Richmond averaging around £500 per sq ft).

Against this context, prime East of City units averaged £539 per sq ft in 2008 and 2009; although this masks significant variations. Graph 5 shows the distribution of sales in the period 2006 to 2009, by reference to the value per sq ft that they achieved. Whilst the proportion of sales achieving more than £450 per sq ft generally falls away incrementally, the profile is spread over a wide range with identifiable peaks between £700-£750 per sq ft and over £800 per sq ft.

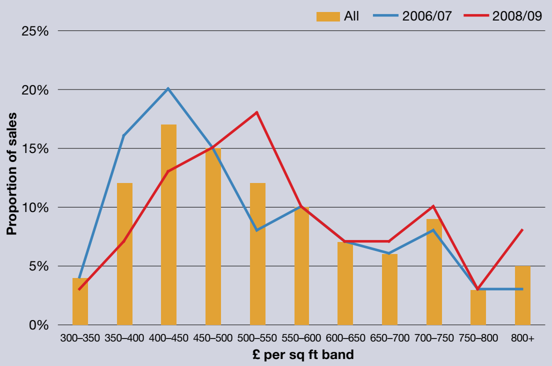
Looking at average prices across the area shows the localised nature of the highest value markets, with older well-established river and dockside developments, such as Ontario Tower achieving comparable value to mature locations surrounding Greenwich Park and Blackheath and identifiable premiums for the areas most central to the employment markets of Canary Wharf.

"Schemes such as Pan Peninsula have broken new ground in terms of lifestyle offering and product specification."

Even within these high-value East of City hotspots, it is the schemes such as Pan Peninsula that have broken new ground in terms of lifestyle offering and product specification, enabling them to achieve sales in the higher value £ per sq ft price bands.

As a consequence as much as 20% of sales have achieved in excess of £650 per sq ft, a premium that will often require a waterfront location, high specification and the provision of on-site services. In the market of the next five years, developers will and should pay close attention to how and where they can they secure such a premium in assessing future development viability.

Graph 5
Distribution of sale price per sq ft



Source: Savills

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Stratford: Major regeneration

Beyond 2011, the development focus within the prime East of City markets is likely to shift to Stratford where there is a consented pipeline of six schemes that will deliver 8,300 units, 60% of which will be in the athletes' village and, therefore, underpinned by the Olympics.

Land Registry figures suggest that over the past 10 years total house price growth in both Stratford (305%), and the wider borough of Newham (281%) has been significantly higher than in London generally (231%). However, this was fuelled by much stronger relative house price growth in the first half (rather than second, half) of the decade meaning that it occurred prior to the decision that London would hold the 2012 Olympics.

In the short-term the Olympic development will provide competition to schemes in the Canary Wharf and Docklands markets. Over the longer term, the Olympics will put the East of London in a unique position compared with other London regeneration areas to build on the momentum of the legacy presented by the games. The ability to maintain this momentum is key to the long-term success of the area.

The scale of regeneration within the Olympic Estate at Stratford is almost unprecedented since the creation of Canary Wharf two decades ago. This regeneration is principally 'driven' through two construction projects:

The Olympic Park, which includes the stadium, the aquatic centre and a host of other leisure and landscaping projects over approximately 200 acres, including the construction of what will be Europe's largest shopping centre: Westfield Stratford City.

"The Olympics will put the East of London in a unique position compared with other areas to build on the momentum of the legacy presented by the games."

In addition to these large-scale redevelopments there are a number of other residential developments in the pipeline in and around Stratford.

In 2009 the average house price in Stratford remained 34% lower than in Greater London. The challenge ahead will be attracting buyers from outside the local market to new schemes in Stratford, and establishing the area as one where higher income households can relocate to.

Importantly, over the past five years, new-build products in Newham have shown the capacity to deliver strong premiums. Over the past five years the average premium for new-build flats over their second-hand counterparts has been as much as 48%, which shows the capacity to support a higher value product than it has traditionally been associated with the area.

In this regard, it is important that Stratford starts not just with four tube lines but also with main-line connections including Eurostar. This should be compared to Canary Wharf's emergence in 1987, which was based purely on private enterprise and initially served just by the DLR.

Additionally, the new development taking place at Stratford includes a significant proportion of residential development, whereas Canary Wharf began life as an office location.

Summary and outlook

- During the downturn of 2008, prices in the prime residential East of City market fell by 17.8%. While the market did not bounce back as strongly as other prime London markets in 2009, they did see a price growth of 4.6% in the second half of last year.
- This reflects a reliance upon demand from investors and owner-occupiers employed in the financial and business services sector, as well as high stock levels that result from the new development, which having started prior to the downturn was delivered in 2008/09.
- We expect 1,500-1,800 units to be brought to the market in Canary Wharf over the course of 2010 and 2011. But given the nature of other consented schemes in the planning pipeline, we expect a dearth of new stock to be delivered subsequently.
- Against this context we have seen increasing levels of demand in the first quarter of 2010. This mirrors an increase in commercial property activity as stability returns to the financial and business services sector.
- As a consequence we have seen a further price growth of 3.3% in the first quarter of 2010, resulting in annual price growth (6.5%) for the first time in two years.
- Assuming London retains its pre-eminence in the global financial services sector, we expect prime East of City residential markets to outperform the mainstream residential markets of Greater London over the next five years (buoyed in part by the wider regeneration of East London, in which the Olympics and redevelopment of Stratford will play a part).

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Prime Central London	8.9%	-1%	7%	11.1%	7.5%	6.3%	6.3%
Greater London mainstream	7%	-4.1%	2.1%	5.6%	7.3%	7%	5.8%
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Source: Savills Research

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