CHESTERTON HUMBERTS RESEARCH BRIEF

London Prime Residential Sales Market Snapshot Winter 2012/2013

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SINCE 1805
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Prime London residential market's strong finish to 2012 bodes well for 2013.

There was a degree of symmetry to 2012 with the year ending as it began on a high note. After the disappointing performance of the summer and early autumn, the last quarter provided a welcome uplift in activity in the prime London residential sales market.

Whilst the prime markets have to some extent been cushioned from the full impact of the recession thanks to the financial strength of high net worth purchasers, they have not been completely immune. The spate of sales activity experienced by our offices in December is hopefully a sign that the "wait-and-see" mentality of purchasers and vendors alike which dogged the market for much of 2012 is beginning to change.

The increased activity can be explained by a combination of factors. Buyer interest is largely stock led and the increase in properties being marketed will have encouraged buyers who had been waiting for greater choice before making enquiries. A further trigger came from the Chancellor's clarification in December regarding the new taxes on high-end residential property which will have enabled buyers to plan ahead whereas before the uncertainty surrounding the changes was holding them back.

Figure 1: New Annual Residential Property Tax rates for high-end residential property held by non-natural persons

Assessed property value	Annual tax rate	Tax as a proportion of property value
£2m+ up to £5m	£15,000	0.75%-0.30%
£5m+ up to £10m	£35,000	0.70%-0.35%
£10m+ up to £20m	£70,000	0.70%-0.35%
Over £20m	£140,000	0.70%+

Source: HMRC

The last quarter of 2012 provided a welcome uplift in activity in the prime London residential sales market.

The government has finally confirmed details on the implementation of the Capital Gains Tax on enveloped residential properties with a value of more than £2 million. It is unlikely that this final piece in the tax jigsaw holds any surprises which will deter buyers to any significant degree as we have already seen a considerable reduction in the number of properties acquired by so-called "non-natural persons" since the new taxes were announced in the March 2012 Budget.

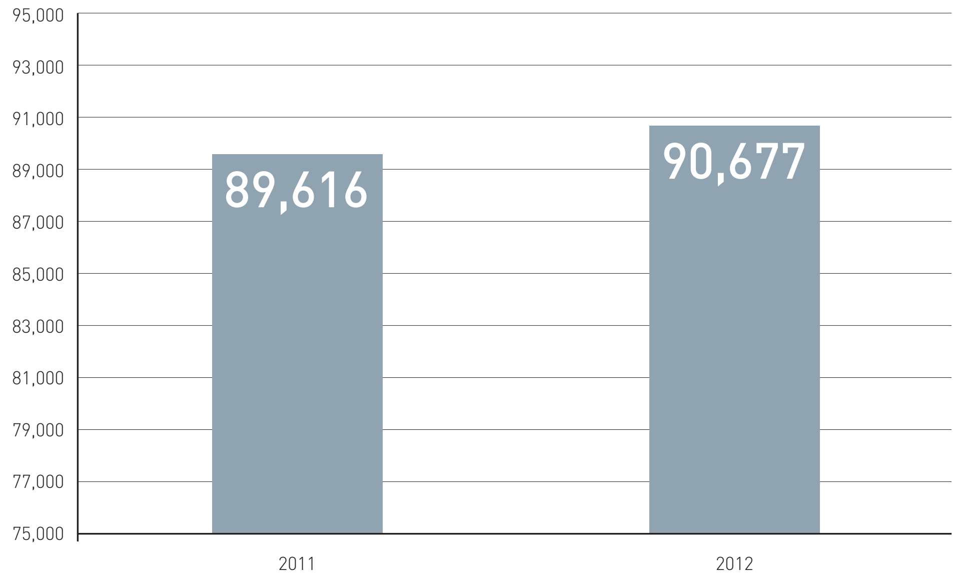
For their part, some vendors will have decided to sell in advance of the new taxes being imposed while others will simply have been testing the market. Availability is generally more limited in the prime central areas although stock levels have been boosted in some areas by the arrival of several new residential and mixed-use developments. For example, the Kensington submarket has benefited from the new schemes at 375 Kensington High Street and the re-development of the former Commonwealth Institute. The area will see further new stock being brought to the market later this year with the anticipated launch of the De Vere Gardens scheme.

Whilst not located in an established prime location, the success of the launch of Circus West is evidence of the appetite for quality residential property in London.

Elsewhere, the main new project is the redevelopment of the former Battersea Power Station which has achieved tremendous success in reserving around 75% of the first phase at Circus West within a week of launching. Whilst not situated in an established prime location, this is nonetheless further evidence of the appetite for quality residential property in London in areas which offer significant uplift potential.

In spite of the recent increased interest, there remains a gap between buyer and seller expectations which can still delay or scupper transactions. There are few forced sellers in this segment of the market and vendors are for the most part happy to hold out for asking price or near to it while buyers are still very selective about properties they will consider in spite of the relatively limited available stock.

Figure 2: London residential property transactions: 2012 v 2011



Note: 2012 figure is based on annualised data for first 9 months

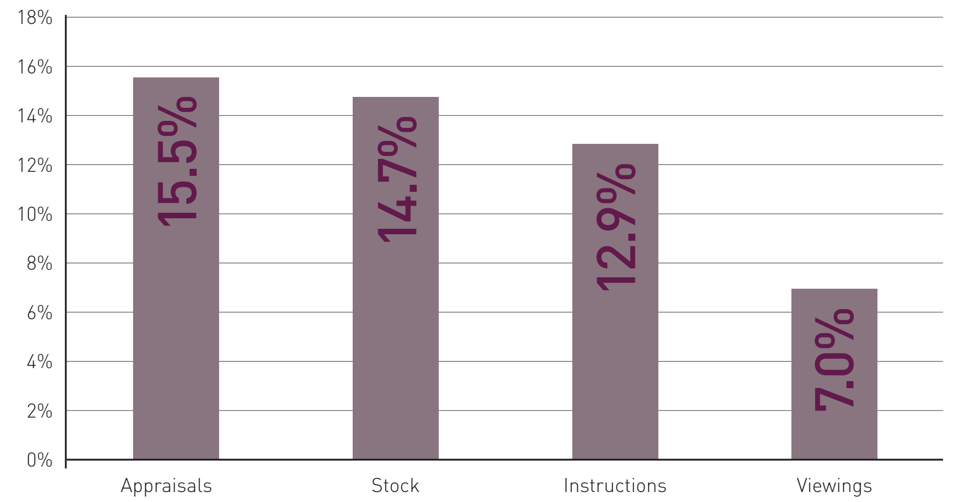
Source: Land Registry

Foreign purchasers continue to target London whether for investment or lifestyle reasons or to acquire safe, quality accommodation for their children whilst they study in the capital's higher education establishments. Whilst overseas appetite is focussed on the traditional prime central areas, there is demand for properties in decentralised locations offering proximity to good local schools and / or easy access into central London. For example, we understand that a high proportion of the reserved units at Circus West went to overseas purchasers, while Docklands has for some time been favoured by Asian investors in particular.

Investor interest is typically geographically more widely spread to take advantage of lower entry prices and higher yields as well as greater availability. The willingness of foreign investors to consider less traditional prime locations – but still offering high quality product – may also be a reflection of the need to place money outside their home country for economic or geo-political reasons. In some cases it may also reflect a relaxation of capital controls which, for example, are still in place in rapidly developing economies such as India and China.

Given the prolonged adverse weather conditions and the distractions of the Queen's Diamond Jubilee and the Olympic / Paralympic Games – not to mention an economy which languished in recession for much of the year – with which the market had to contend, 2012 data for the year as a whole were better than expected. Annualised Land Registry data based on the first nine months of the year suggest sale transactions were 1.2% higher than in 2011. Chesterton Humberts saw a 15.5% rise in appraisals compared to 2011 while instructions were 12.9% higher and available stock at the end of the year was 14.7% higher than at the corresponding point in 2011. On the buying side, viewings also increased by just under 7%.

Figure 3: Selected prime London residential property performance indicators: 2012 v 2011



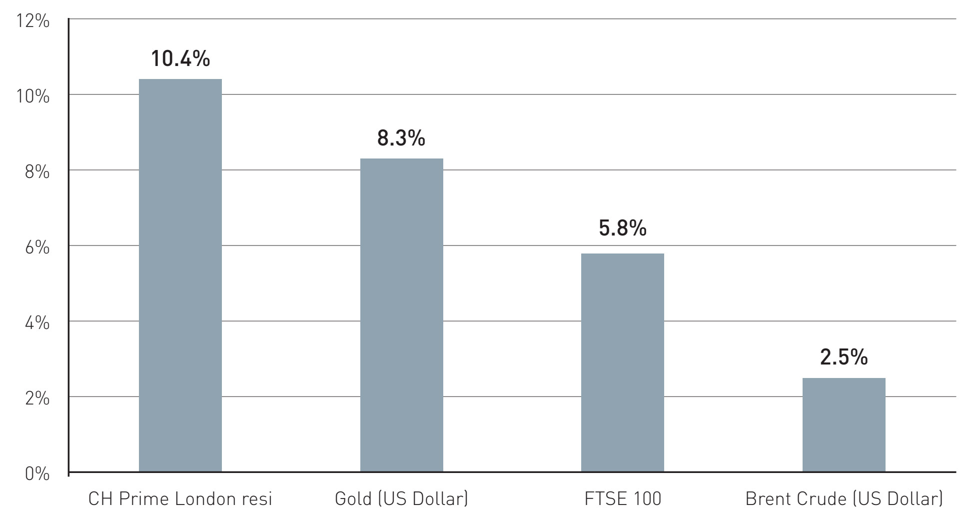
Source: Chesterton Humberts Research

Prime London residential capital value growth outpaced that of other asset classes in 2012.

However, despite the flurry of activity, price growth in the final quarter was subdued. The Chesterton Humberts Prime London Residential Capital Values Index shows that prices rose by 1.2% in Q4 compared to the previous quarter. For 2012 as a whole, however, prices rose by a healthy 10.4% in nominal terms compared to the previous year and comfortably outpaced growth in a number of other major investment assets in 2012 – 1.8 times higher than the FTSE 100 and over 4 times higher than Brent Crude. Even when measured on a US Dollar basis, gold prices only rose by 8.3% over the year.

As usual, the broader statistics mask the variation between submarkets. The submarkets with the biggest increase in price in Q4 were Knightsbridge & Belgravia, where prices rose by 5% and Hyde Park which recorded an increase of 2.8%. At the other end of the scale, property values fell by an average of 1.1% in Chelsea & South Kensington.

Figure 4: Prime residential property price growth in 2012 v growth of selected other assets



Source: Chesterton Humberts Research; World Gold Council; London Stock Exchange; US Energy Information Administration

We forecast prime central London capital values will increase by 3.2% in 2013 and average 7.3% p.a. over the next five years.

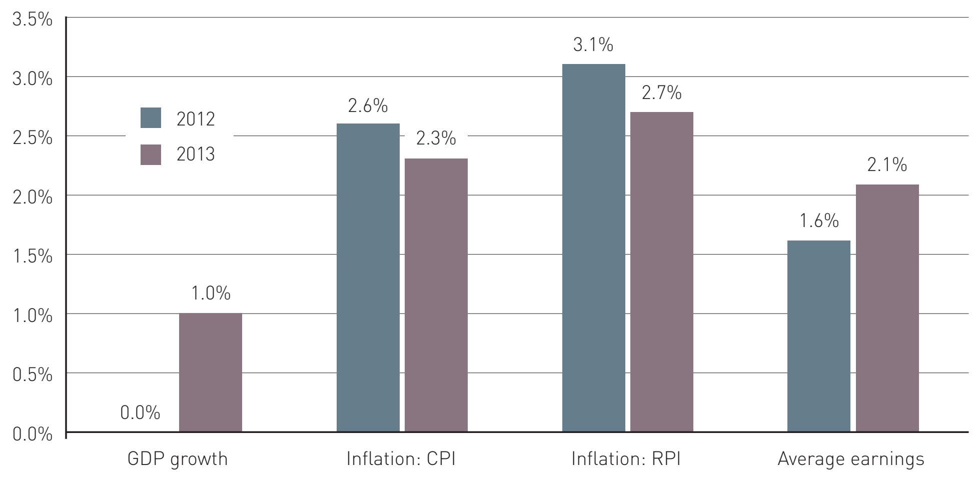
OUTLOOK

The outlook coming into 2013 looks encouragingly positive. Chesterton Humberts' pipeline is 41% higher than at the corresponding point last year and the highest it has been since 2009, while available stock is 14.7% higher.

There are a number of indicators which are conducive to sustaining the pick-up in activity witnessed in the last quarter of 2012. While some economists are talking of the possibility of a triple dip recession, the aggregate of HM Treasury's most recent comparison of independent forecasts suggests that GDP will grow by 1.0% this year – not in itself a strong rate of growth but an improvement on the zero growth initial estimate from the ONS for 2012.

Moreover, a number of lenders have announced plans to increase their mortgage lending in 2013 and interest rates are expected to stay low over the year. This should go some way towards restoring consumer confidence and releasing the undoubted pent-up sales demand of the past few years – indeed, RICS is predicting that residential sales in the UK market as a whole this year will reach their highest level since 2007.

Figure 5: Key economic forecasts



Source: HM Treasury Panel of Independent Forecasters

If this momentum is sustained and the economy improves as expected, in turn leading to a rise in consumer confidence, this could help to kick-start a new cycle of price growth – although no-one is suggesting a return to the heady property price inflation witnessed in the early to late noughties.

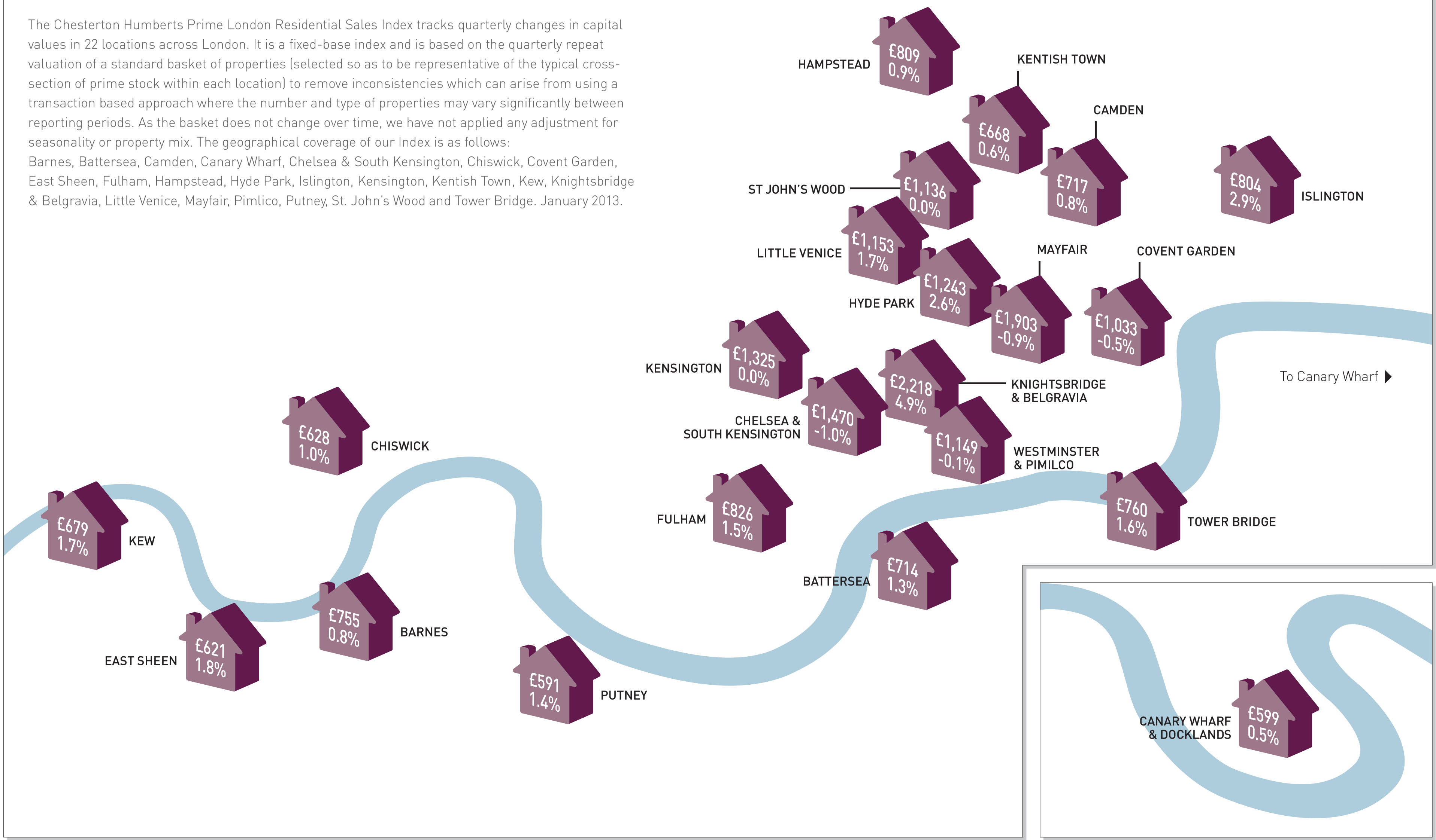
London should again be the stand out performer. Sustained demand from overseas buyers (combined with limited available stock) is key to the future health of the market and the pull factors of London combined with the push factors from overseas (e.g. economic and geo-political flight and liberalisation of capital controls) will surely continue to bring foreign investment into the capital in the quest for prime property if the evidence of Circus West is anything to go by. Meanwhile, the imminent taxation of properties held within corporate wrappers is more likely to be an irritant rather than a deal breaker for most buyers who will likely restructure their mode of acquisition.

One of the main concerns is likely to be a shortage of available stock sufficient to meet buyer demand. Although stock levels have improved they remain low by historic standards and with few forced sellers a significant change in availability is unlikely. It is the new development projects which, for the time being, will have most impact on stock levels and these are predominantly in the emerging locations and will be largely targeted by overseas investors. Supply is likely to remain limited in the established prime areas until domestic confidence grows. It is this imbalance between supply and demand which leads us to be upbeat about price growth this year. We forecast prime central London capital values will increase by 3.2% in 2013 and by an average of 7.3% per annum over the next five years.

On the downside, new homes could get a lot more expensive if the EU proposal to force the UK to apply a 20% VAT rate on the sale of new build residential properties is enforced. This is the last thing that the UK housing market needs as it struggles back onto its feet and hopefully something that our Government will be able to resist.

Figure 6: Chesterton Humberts Prime London Residential Capital Values Index: Q4 2012 average values per sq ft (and % change Q4 v Q3 £/sq ft)

The Chesterton Humberts Prime London Residential Sales Index tracks quarterly changes in capital values in 22 locations across London. It is a fixed-base index and is based on the quarterly repeat valuation of a standard basket of properties (selected so as to be representative of the typical cross-section of prime stock within each location) to remove inconsistencies which can arise from using a transaction based approach where the number and type of properties may vary significantly between reporting periods. As the basket does not change over time, we have not applied any adjustment for seasonality or property mix. The geographical coverage of our Index is as follows:
Barnes, Battersea, Camden, Canary Wharf, Chelsea & South Kensington, Chiswick, Covent Garden, East Sheen, Fulham, Hampstead, Hyde Park, Islington, Kensington, Kentish Town, Kew, Knightsbridge & Belgravia, Little Venice, Mayfair, Pimlico, Putney, St. John's Wood and Tower Bridge. January 2013.



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