

Prime Central London Residential Market

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December 2011



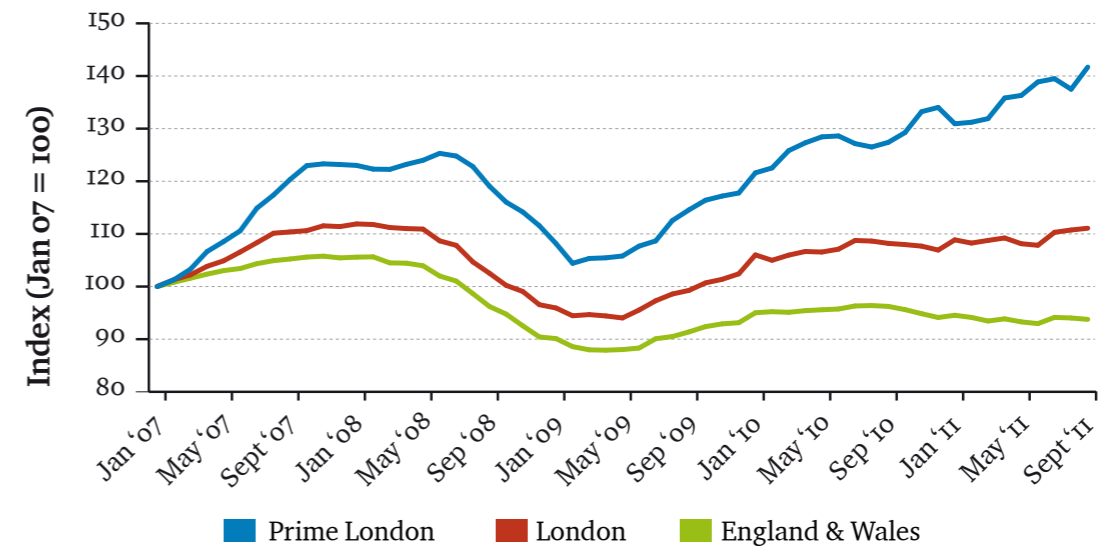
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Market Overview

House Price Performance from Peak, Indexed



Region	Peak	Trough	Movement from Trough to Sept '11	2011 Price Growth*
Prime London	June '08	Feb '09	36%	13%
London	Jan '08	May '09	18%	3%
England & Wales	Oct '07	June '09	7%	-2%

Source: Land Registry, Hamptons International Research., * estimate to end 2011

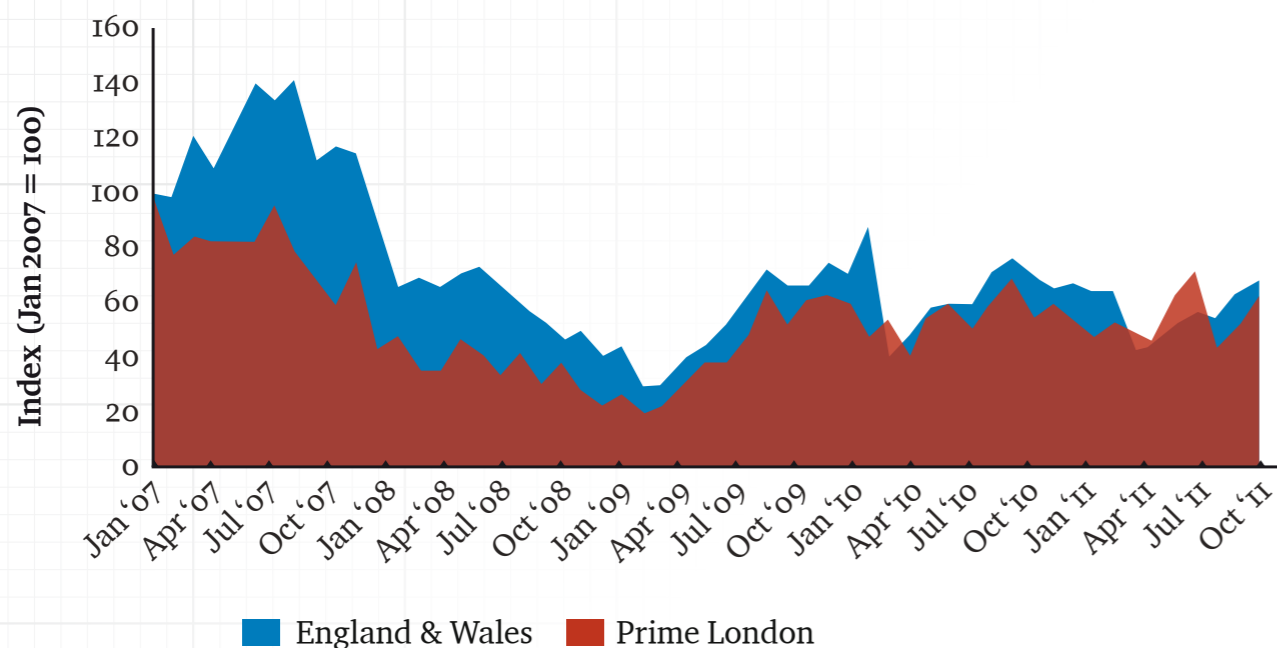
The Prime Central London housing market continued to outperform in the third quarter and is now likely to finish the year up 13 percent from January. This price growth has been ahead of the most optimistic market commentators and continues a bull run that began in October 2009, with prices now up 36 percent. In contrast, national house prices have been broadly flat over the past two years, with 2011 levels expected to finish down by 3-4 percent.

One of the overriding features of the current market has been the low average volume of activity. Nationally, housing transactions have averaged approximately 60 percent of January 2007 market volumes over the past two years. However, Prime markets have been further constrained; in January 2009, transaction volumes were one-fifth of the level from two years prior and were only 53 percent of the January 2007 level over the past two years.

Executive Summary

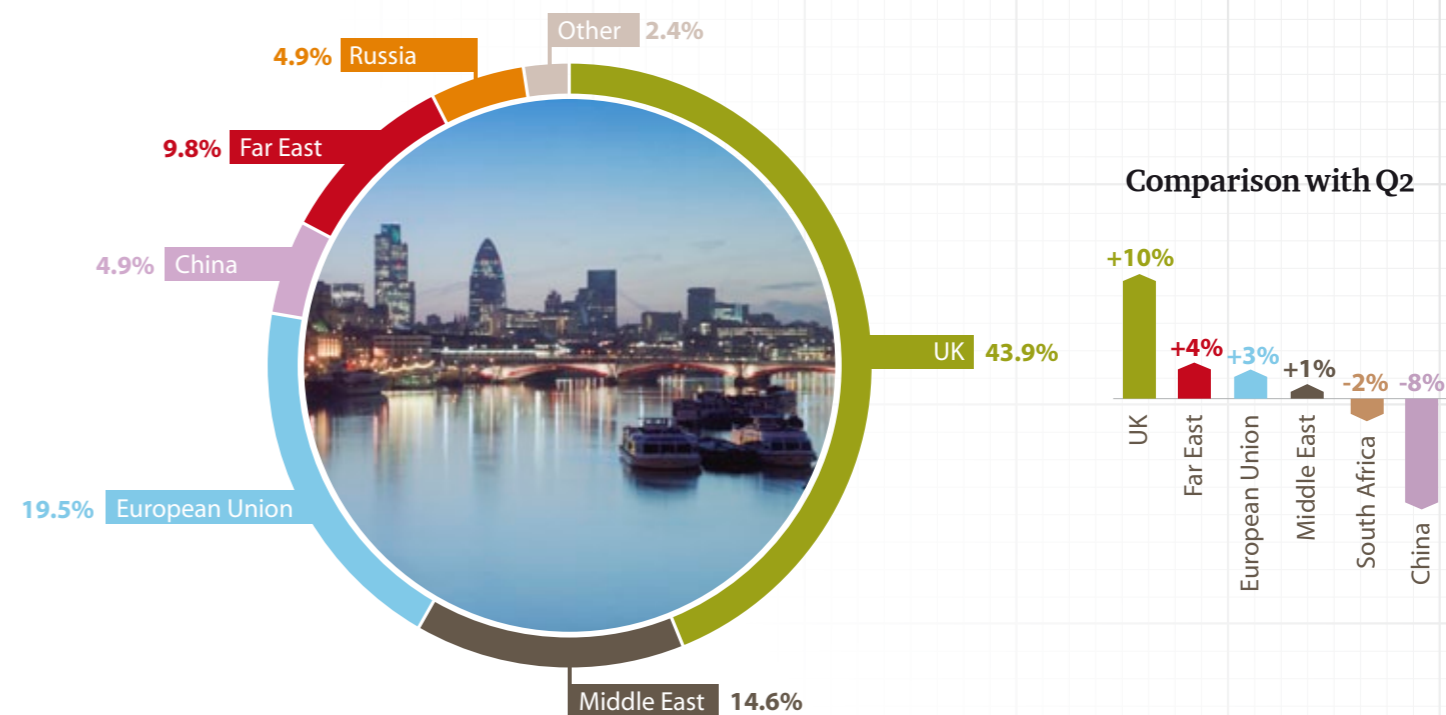
- Prime Central London house prices are likely to finish the year up 13 percent; having increased by 36 percent since February 2009.
- Prices are expected to continue growing, albeit at a rate closer to 4 percent over 2012. Demand faces headwinds from a number of areas; we remain concerned that taxation policy targeting wealthy individuals will reduce the demand for some to locate in the UK. This may be a real challenge for a domestic economy that is desperately seeking new avenues to generate investment and growth.
- Prime rents have also performed strongly in 2011, although there is a weakening of demand at the top end due to the ongoing economic challenges affecting corporate budgets. We expect Prime rents to be up 5 percent next year.
- Development projects in Prime London continue to be relatively rare, with very few large-scale sites likely to come forward in 2012. We are observing a growth in the demand for large, specialist stock, including lateral apartments and trophy home assemblies from blocks of smaller flats.

Transaction Volumes, Prime vs England & Wales



Source: LandRegistry

Q3 Prime Central London Buyer Profile



Source: Hamptons International Research

A lower volume of Prime property transactions began to occur well before the collapse in house prices that commenced nationally in Q3 2007. In fact, an undersupply of Prime properties is one of the buffers that supported Prime prices during this period and also contributed to the more rapid price recovery that began in October 2009.

Remarkably, Prime property transaction levels have remained below the national average, despite the fact that higher value properties (for which purchasers generally require lower loan-to-value mortgages) are the most active sector of the UK housing market. This implies that while improving credit conditions will slowly increase the volume of transactions at a national level, there are other factors that may continue to constrain activity in Prime markets.

On the lettings side, the Prime market has experienced strong rental growth over 2011, although unlike the sales market we are now seeing price sensitivity at the top end. Demand for the best rental properties has been held back by premium rents and a softening economic backdrop.

This has been particularly relevant for the important executive corporate occupier market. We have observed a genuine sensitivity to the weak economic climate, with businesses choosing to delay expansion plans in London. As a result, we are seeing a softening of corporate budgets for executive relocation that is likely to take some of the heat out of the Prime lettings market in 2012.

United Nations

The underlying theme of any Prime Central London market commentary this year has been the internationalisation of London's posh postcodes. Our buyer profile index reveals how international buyers continue to dominate the Prime London market, although this is now a lower 56 percent of all purchases in Q3 2011, compared with 73 percent in the previous quarter. There is a seasonality to demand from some internationals, however these results also reflect a modest receding of international demand overall. Most notably, Chinese and Indian buyers are less significant over the summer months. More recently, a Russian resurgence has been the result of a political risk to capital there.

The level of international demand for Prime London property was unusually strong in the first half of 2011, being a defensive investment akin to gold. Economic and political uncertainty across continental Europe and parts of North Africa and the Middle East has provided part of this migration of capital to London. In addition, turbulent equity markets have played a part in increasing the appetite from Asian investors, notably via Hong Kong.

In our recently released 2012 forecasts, we estimate that Prime prices will continue to increase modestly, up four percent over the year. However, in the face of ongoing economic headwinds there are material downside risks that could impact this forecast, including:

- Improving political stability in the Middle East and economic resolution in the Eurozone may weaken the case for international investment in Prime London as a defensive strategy;
- The pound sterling, currently severely devalued against major world currencies,

appreciates against the Euro and US dollar (and dollar-pegged currencies). This would weaken inbound investment in property;

- As Pound Sterling purchasers, domestic Prime buyers may find house prices too dear, further weakening demand from this erstwhile majority buyers group;
- Further destabilisation in equity markets may reduce the appetite from investors, most notably from Asian markets that make up 15 to 20 percent of buyers in the current market; and
- Political point scoring, or a more fundamental move from HM Treasury to increase tax revenue from High Net Worth Individuals (HNWIs)

The Robin Hood Addiction

Economic risks to the housing market are largely beyond the control of Government. However, the targeted taxation of HNWIs, which generates considerable debate in the media, is entirely the responsibility of HM Treasury.



Although the voting public is unlikely to take umbrage at taxation weighted towards well-off citizens, Government has a delicate balance to strike between the optimum level of tax from wealthy individuals, compared with the potential loss of spending and investment from these same citizens were they to move elsewhere.

In recent years, wealthy individuals in the UK have had to come to terms with new and proposed legislation aimed directly at increasing the tax take from this group. They are summarised in the table below.

In times of austerity it is a relatively straightforward argument that society's well-off should take a bigger share of the burden from new taxation. Very few will feel sorry for the wealthy, meaning even fewer would dare complain.

However, and this is the important part for the UK economy, these individuals are already relatively at ease with movements around the globe. As a result, the package of taxation measures that impact on HNWIs must be compared not just with taxation in the UK generally, but with high-earner taxation in competitive jurisdictions.

Where there may be savings to be made by being based in these alternative locations, the UK stands to lose out on considerable investment from these residents. For example, a recent report from Lloyds TSB International suggests that 15 percent of ex-pats have decided to cancel plans to return to the UK over the past 12 months, in part due to UK cost of living issues. There is debate about whether some of these schemes generate significant new revenue for the Chancellor, but very little debate that a program of taxation which is biased against the wealthy could encourage leavers from the UK, as well as prevent new wealthy migrants into the country.

This is not intended to be an argument for or against any one tax policy. However, it is important to recognise that in a period of time when there is very little positive economic news to point to in the UK, wealthy international buyers, and the investment they bring, are a notable counterpoint. It may not be a politically straightforward argument to make, but it is one which provides a demonstrable upside to an economy currently without many better prospects.

Targeted High Net Worth Taxation Policy

Tax Policy	Date Enacted	Summary	Impact
50% rate of income tax and personal allowance reduction	Apr 2010	New top rate income tax for earners of over £150,000 and personal allowance tapering to zero for £100,000 earners	Tax expected to earn £1.5 billion in 2011. Affects 1% of taxpayers who pay 24% of income tax
Stamp Duty Land Tax for £1M + Properties	Apr 6th, 2011	New 5% rate	Hamptons estimates up to 5,000 homes in London affected per annum. Increase in avoidance schemes has limited the financial contribution to the Treasury
Non-Domiciled Residents	2008; proposed change Apr 2012	Annual charge for non-doms increased from £30,000 to £50,000 for residents of greater than 12 years	Generated £162 million for the Treasury in 2008/09. Increase currently under consultation
Bank Bonus Tax	2009	One-time 50% tax on bank bonuses of greater than £25,000	Generated £1.4 billion in revenue for the Treasury
Mansion Tax	Proposed	Tax on sold properties worth more than £1M	Lib Dem proposal to replace top rate of income tax, should the Chancellor wish to repeal it

Source: Hamptons International Research, HM Treasury

Prime (Under) Supply

The laws of supply and demand represent a fundamental tenet of economics. When referring to Prime London property prices, commentary often focuses on the insatiable level of demand for a fairly fixed volume of supply. Although it is absolutely true that development land and new build property remain limited in this area, it is also the case that Prime properties have a lower 'churn rate' compared with the national average, as noted earlier in the report. This means that there is a lower frequency with which the same property returns to the market. In other words, Prime owner occupiers move less often, further restricting the supply of 'for sale' properties at any one time.

But, why is it that Prime owners should want to move house at a slower rate than anywhere else? Part of this has to do with a higher proportion of 'mature' owners, well past the years of trading up to coincide with the demands of growing families. But there is also a cultural element, related to the desire of increasingly foreign ownership to hold Prime London properties in the family, often for generations.

As James Wardle, Director of Hamptons International Knightsbridge office notes:

"Over the last decade we have seen increasing numbers and indeed a greater diversity of international buyers purchasing Prime Central London trophy properties as long-term assets. Frequently these properties are purchased as offshore Special Purpose Vehicles (SPVs), which increases the chance that they will be passed from generation to generation, further reducing the likelihood that they return to the market."

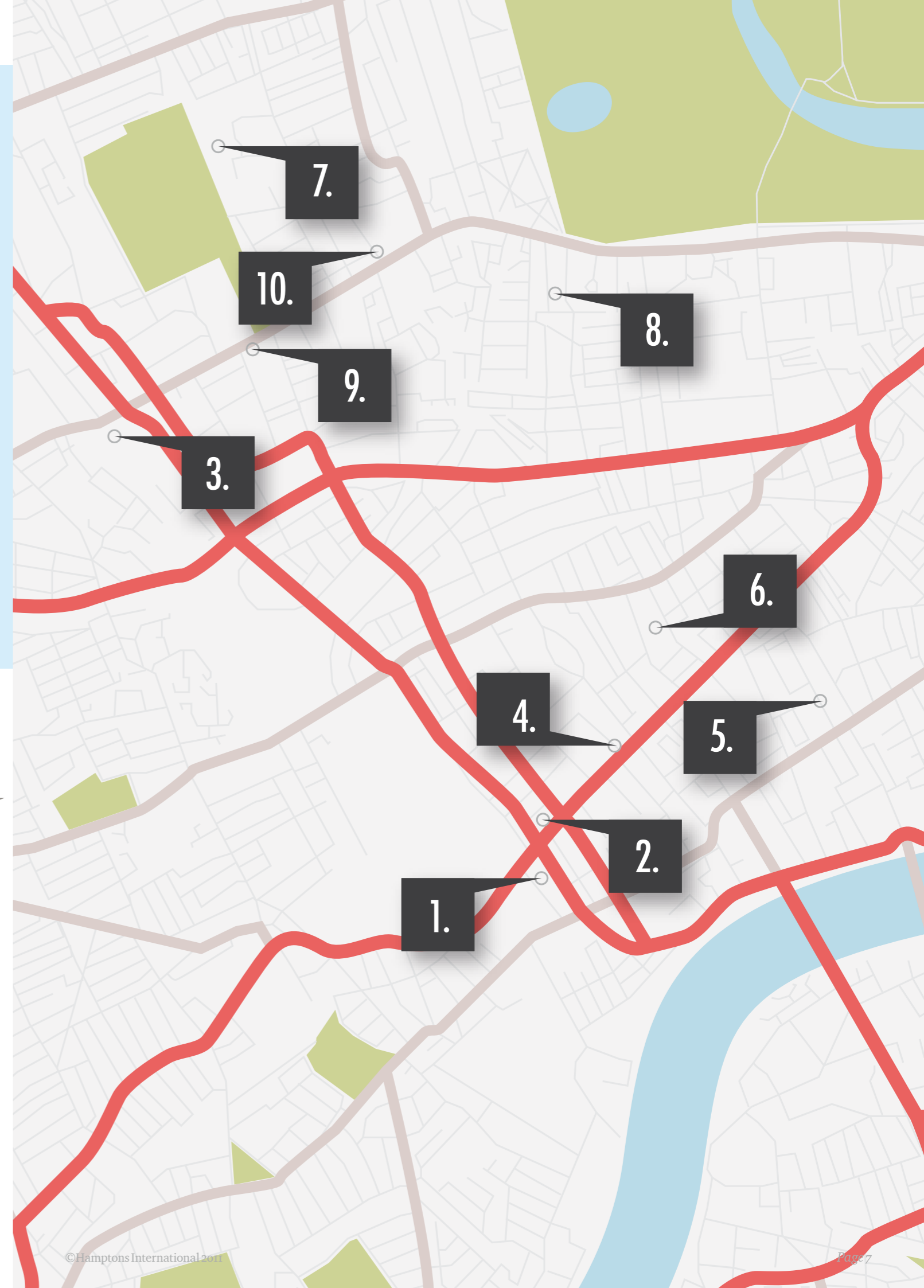
The supply constraint for existing stock is an endemic feature of Prime property, placing an even greater pressure on rare development sites to meet the demand. Candy & Candy has dominated this scene for several years, with developments like 21 Chesham Place, One Hyde Park and formerly with the highly political Chelsea Barracks site.

However, there are a number of relatively lower profile developers that specialise in the area, continuing to plug the gap in Prime London housing supply. Recent development launches have sold well, with a strong off-plan interest from Asian buyers that have flattered sales rates. The largest of these schemes are summarised in the table below.

Prime Central London Development Pipeline

Map No.	Development	Developer	Address	Private Units (Sold)	Average Prices
1.	Chelsea Apartments	Manhattan Loft Corporation	Hortensia Road, SW10	45 (19)	£1,140 psf
2.	Chelsea Walk	Thornsett Group plc	270-296 Fulham Road	56 (11)	£1,100 psf
3.	375 Kensington High Street	St Edward Homes	Warwick Road, W14	467 (140)	n/a
4.	Redcliffe Apartments	Parsons Green Development Ltd	192-200 Fulham Road	12 (11)	£935 psf
5.	Henry Moore Court	Carlyle Group	Manresa Road	17 (3)	£2,800 psf (est)
6.	22-24 Cranley Gardens	Juliet Properties	n/a	11 (8)	£2,000 psf
7.	Campden Hill (former Holland Park School)	Native Land	Airlie Gardens, W8	69	n/a
8.	De Vere Gardens	Lancer Asset Management	16-30 De Vere Gardens	97	£2,500 psf (est)
9.	Kensington Odeon	Minerva	263-265 Kensington High Street	40	n/a
10.	Commonwealth Institute	Chelsfield	230 Kensington High Street	62	n/a

Source: Hamptons International Research, EGi, Molior



The specialist nature of Prime London also means that a significant contribution to the supply of new stock comes from very small developments or refurbishment schemes. More recently, Hamptons International has been advising on the assembly of smaller flats within the same or adjacent buildings for the creation of large lateral apartments and trophy homes.

These bespoke developments appeal to wealthy individuals who are seeking a less conspicuous but highly contemporary property. They can be personalised to the demands of the occupier, creating truly unique and prized residences that achieve premium prices.

Jonathan Godfrey, Director of Valuation at Hamptons International highlights a recent

example from a Prime Central London garden square:

“After purchasing a number of different flats in the building, the developer was granted planning permission to create a lateral flat of over 3,000 sqft with a roof terrace. Even in an unmodernised state it has a value of over £2,000 psf, with an end value of closer to £3,250 psf. In contrast, small (sub 700 sqft) flats in the same building are worth £1,300 psf.”

This trend for specialist properties will increase in 2012. At the same time, there will be a 12-18 month gap in the new build market, with very few large Prime developments expected to come forward over the period. As a result, new build prices will continue to be well supported.



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