

Prime Central London Residential Market

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May 2011



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Executive Summary

- Prime Central London is leading house price growth in the UK, driven by an ever growing proportion of international demand, holding steady at 72 percent of buyers.
 - Supply remains well below historic levels, exacerbating the pressure on prices.
 - In general, activity levels increased from January to March. This was in part a result of the Stamp Duty Land Tax increase on April 6th for £1 million plus homes. The underlying trends suggest that demand remains relentless as we approach the important Spring buying season, although April was a negative aberration due to the shortened trading month.
 - Despite this, activity levels are very uneven across London. Sub-markets that are preferred by domestic buyers have seen more modest demand.
- In contrast, higher value and international-orientated locations are seeing frenetic activity, particularly towards the end of March.
- Lettings activity remains strong in Prime locations, although rising rents and growing supply are beginning to ease price pressure.
 - Sales levels for new developments have been quite buoyant since the start of the year and are expected to hold up well throughout the summer months.
 - New government regulation will make office conversion to residential easier across London, but not in Prime markets where it is already commonplace.

A Market Unto Itself

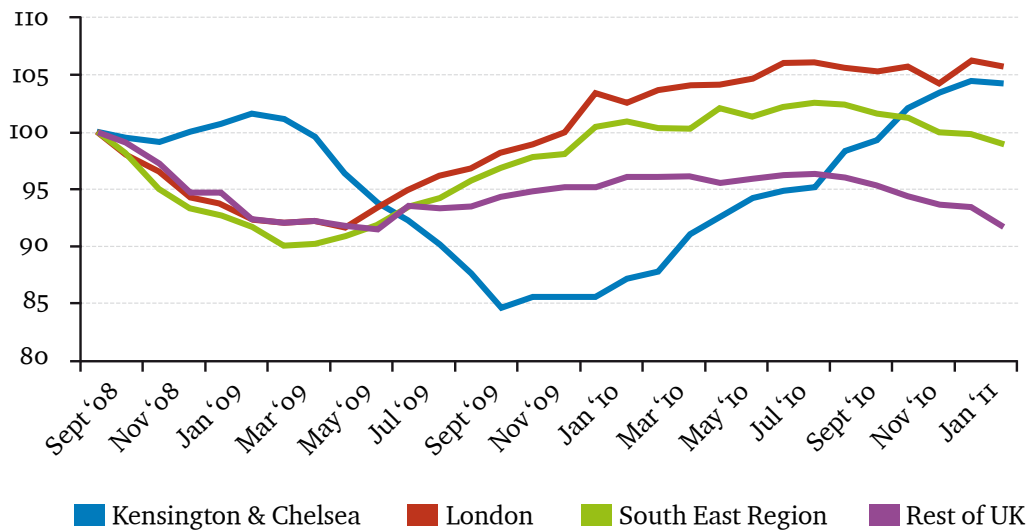
Rhetoric about the North/ South divide in house prices becomes most polarised in Prime Central London. The economic malaise that has gripped the UK housing market has had very little material impact on Prime prices. This means that, for the London Borough of Kensington & Chelsea as an example, prices have increased rapidly from the depths of the downturn in 2009 and are now 4.8 percent higher than the previous peak in June 2008. Across Prime postcodes we have witnessed price growth of over 10 percent in the past 12 months.

As can be seen in the graph below of average house price movements using Land Registry data, Prime areas (as shown broadly by Kensington & Chelsea LA data) were much later to show price falls as a result of weaker demand. However, the price correction was much sharper and deeper once it began in June 2008. Equally astonishing has been the subsequent price growth since the nadir was reached in February 2009, now 20.5 percent since that time.

Of course, even this dramatic divergence with wider market averages underestimates the upward price movements in the Prime postcodes. Our valuation team has witnessed price growth for some of the most expensive properties far in excess of this level, in some cases 20 to 25 percent above peak levels. How can this be?

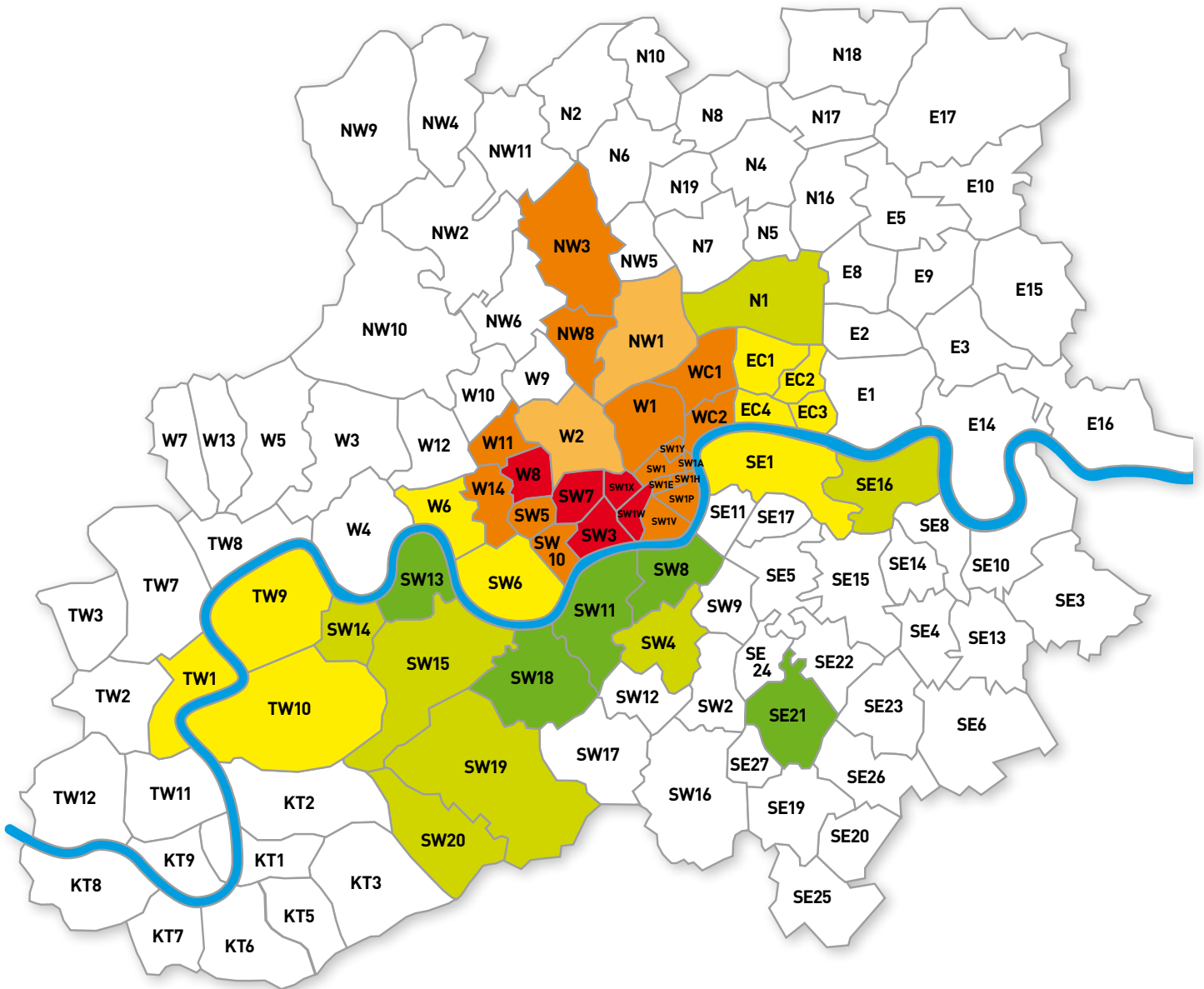
In reality, comparisons with the UK or even with wider London averages are becoming less relevant. There are two overarching reasons for this. First, house prices in Prime locations are driven by international factors and are only peripherally influenced by the same domestic fiscal problems that are holding back house price activity in the broader market. Second, Prime London property is used as a safe haven for investment in much the same way that gold is turned to in times of uncertainty. There is no question that there is plenty of economic and political uncertainty about in many corners of the world, pushing capital out of these regions into relatively safer assets and locations.

House Price Performance from Peak, Indexed



Region	Peak	Trough	Movement from Trough (Feb '11)
K&C	June '08	Feb '09	20.5%
London	Jan '08	May '09	15.2%
South East	Jan '08	Mar '09	10.0%
Rest of UK*	Oct '07	June '09	0.0%

Source: Land Registry, Hamptons International Research



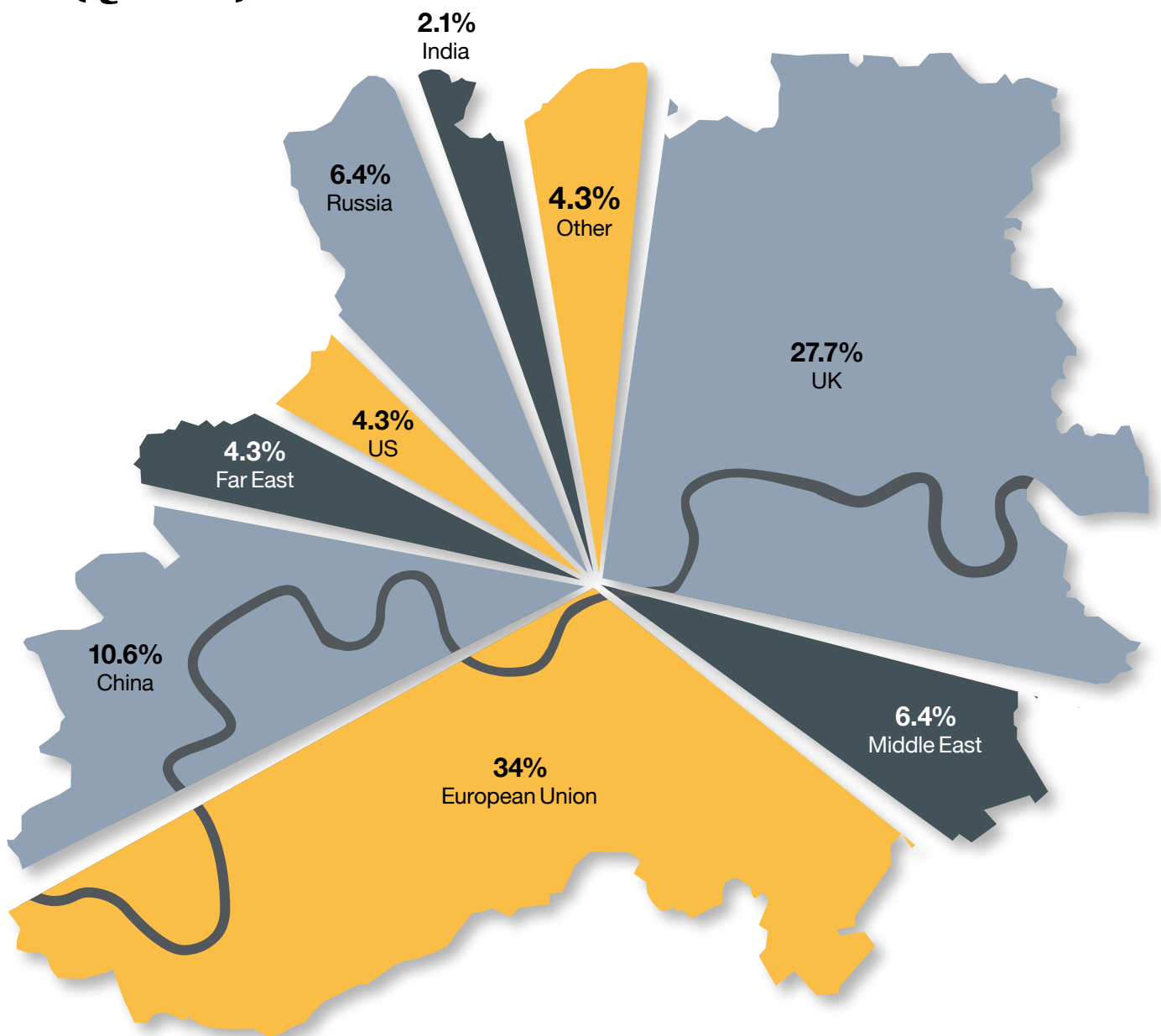
London Price Heat Map

Area	Av. Price	Area	Av. Price	Area	Av. Price
SWiX	£1,596	SWiV	£872	SWi9	£594
SW7	£1,245	W2	£856	Ni	£589
W8	£1,466	NW1	£855	SWi4	£577
SW3	£1,279	TW10	£706	SE16	£542
SWiW	£1,375	SW6	£696	SW20	£536
SW5	£1,140	SE1	£690	SWi1	£530
SWiP	£1,091	EC4	£695	SWi3	£530
SWiO	£978	EC3	£695	SW4	£523
W1	£975	EC1	£690	SWi5	£517
W14	£975	EC2	£685	SWi8	£488
W11	£960	TW9	£646	SE21	£462
WC	£945	TW1	£623	SW8	£459
NW3	£932	W6	£605	KT13	£453
NW8	£925				
WC1	£915				

These two issues converge in our quarterly survey of buyer profiles, which reveals a broadening demand profile for London property from around the world. International buyers made up 72 percent of all Hamptons International properties sold in Q1, holding steady with the average over 2010. While traditional buyers from China (via Hong Kong),

the Middle East and continental Europe have remained acquisitive, we saw increased interest from nationals of politically and economically unstable countries such as Greece, Nigeria and Egypt. Some of this activity is likely to contribute to a broader demand profile later in the year. The results of this survey are summarised below.

Prime Central London Buyer Profile (Q1 2011)



Source: Hamptons International



Prime Central London should in reality be compared to other top tier world cities, including New York, Paris, Tokyo, Hong Kong and Shanghai. These cities represent a peer group with truly international influence, with Prime house prices more closely aligned with global flows of capital. These cities are tied to global wealth and economic performance, not domestic; does this make Prime prices more volatile or can Prime property ownership be used as a hedge on the domestic market? In addition, the April IMF World Economic Outlook suggests the global economy will grow by around 4.5 percent in 2011 and 2012, providing further support for international demand of Prime property.

Historically, both Prime commercial and residential property prices are more volatile than wider averages, but as the graph on page 2 shows, Prime house price movements had a low correlation with the timing of price changes in the wider market. Taken together, this may suggest to many investors that Prime residential property, held over the long-term, can achieve better average returns if risk is partly offset with investment elsewhere in UK plc.

The experience of our Hong Kong office has shown the strength of demand for London residential

investment stock. Our recent survey of Asian buyers shows that the UK is the most preferred investment location in the world, with London receiving the vast majority of interest. For more detailed information on the profile of Asian buyers of London property please review our recently published report. Some of the main headlines are as follows:

- 70 percent prefer to buy properties in the core or periphery
- One-third prefer to buy off-plan, while 54 percent would rather wait until completion
- 26 percent are cash buyers and the majority are seeking to invest long-term for capital growth

This last point is crucial and one which is often missed in the discussion of the shortage of Prime housing stock. Prime properties are held for much longer periods by overseas families, often being passed from parents to children over generations. This effectively removes a proportion of Central London's housing stock from the market, reducing the 'churn rate' of properties in Prime markets and tightening available supply.

Leasehold Enfranchisement Market Update

Up until mid-2007 banks were generally happy to lend against leases of almost any length, almost irrespective of the level of gearing required. Naturally, this enabled a vast number of potential purchasers to consider short leases as a viable option, pushing up values.

By the end of 2008 banks had almost stopped lending altogether against leases with fewer than 60 – 70 years unexpired, dampening a market which now, particularly in Prime Central London, has rallied to price levels from the previous peak.

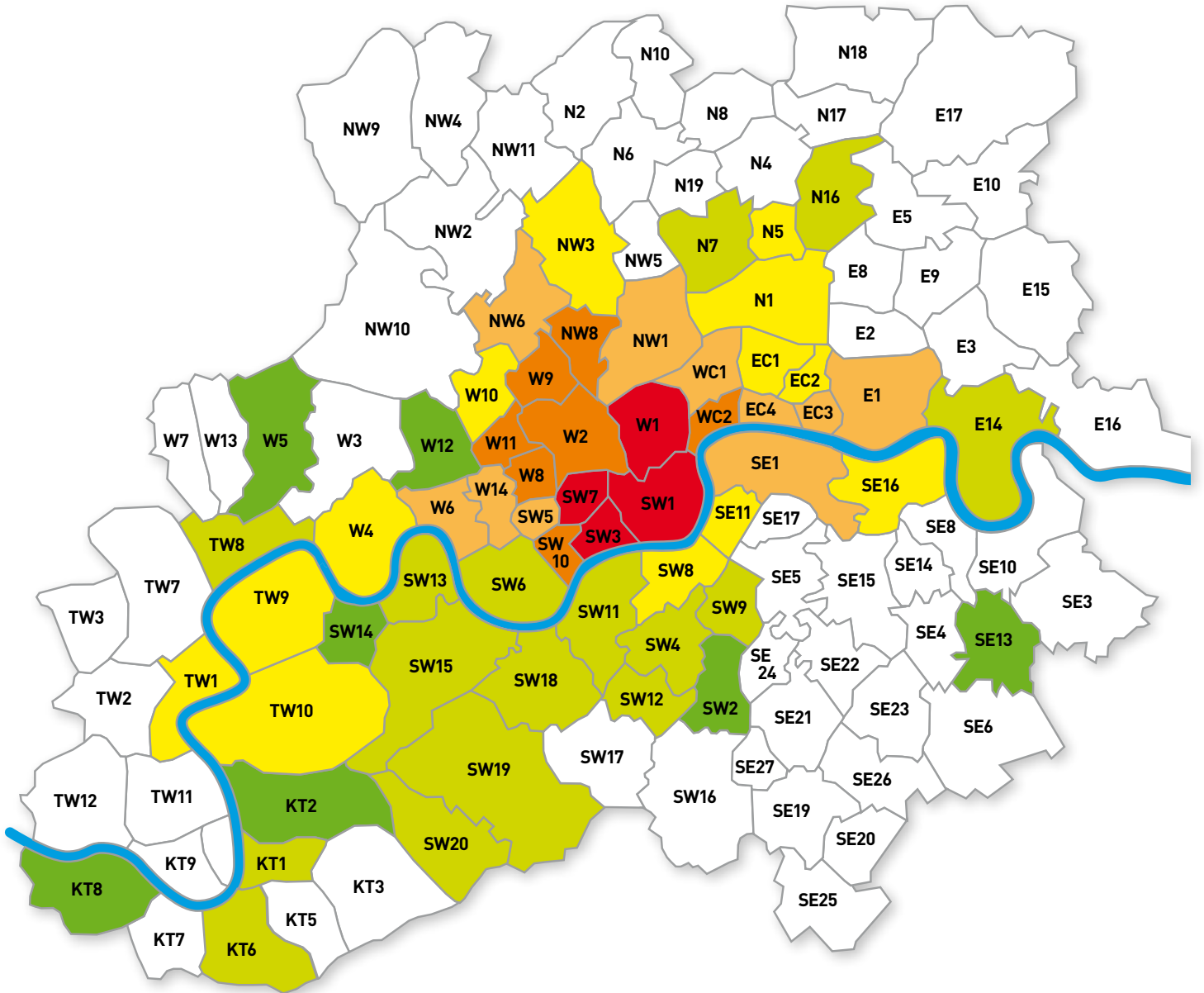
Over the last five years, the legislation which confers rights upon residential leaseholders has been subject to an overwhelming volume of case law. More recently (in the last 12 – 18 months) the tendency has been for the courts and tribunals to favour lessees in their decisions, following a long period during which things all seemed to be going the way of the landlords.

This has meant that, after a time where the cost of enfranchising and extending leases rose dramatically and suddenly, this cost is slowly creeping down again in real terms. However, this swing seems to have had little or no effect on the market and the prices that purchasers (especially in Central London) are prepared to pay for leases of any length. The reasons for this appear to be twofold:

1. The market is often not made aware of these shifts in position by the courts and are consequently ignorant of the effect of these decisions. The market is governed to a great extent by agent experience of previous sales. This frequently leads to short leases changing hands at extraordinarily high prices.
2. Particularly in areas where short leases are prevalent (Prime Central London in particular), property is so scarce that purchasers are willing to pay well over the odds to simply secure a property, safe in the knowledge that they have a statutory right to extend or enfranchise as and when they can afford to do so.

These two factors have contributed to a steady and significant rise in leasehold values over recent months.





London Average Rent Heat Map

Area	Av. Rent PW	Area	Av. Rent PW	Area	Av. Rent PW	Area	Av. Rent PW
W1	£860	EC3	£525	W4	£447	N16	£360
SW3	£789	W14	£522	N5	£442	SW18	£357
SW7	£771	W6	£519	TW9	£439	KT6	£338
SW1	£700	NW6	£514	SE16	£424	TW8	£331
W11	£688	EC4	£510	KT10	£404	KT1	£325
w8	£666	WC1	£510	TW10	£403	E14	£320
W9	£653	E1	£502	SW6	£391	SW9	£319
W2	£646	TW1	£493	SW12	£388	KT8	£294
WC2	£625	N1	£491	SW11	£387	W5	£278
NW8	£608	SE11	£490	sw4	£382	SW2	£273
SW10	£603	NW3	£489	SW20	£378	W12	£270
NW1	£563	EC2	£480	N7	£375	SE13	£269
SW5	£560	SW8	£473	SW19	£369	KT2	£264
SE1	£548	W10	£470	SW15	£363	SW14	£248
		EC1	£470	SW13	£363		

Prime Lettings

The residential letting market in Prime Central London is more closely tied to the fortunes of London itself, acting as a bellweather for the strength of the Capital's economy. High house prices and tight supply of rental stock both contribute to elevated rental demand. It has dominated available supply over the past year, although this gap has narrowed since the start of the year.

Average rents in Prime areas are now around £810 per week, having remained stable over the year. Ever present demand has meant there is sustained pressure on rents and we anticipate rental growth will moderate somewhat as stock continues to improve.

Development Market Improving

The supply of development land in London continues to grow, alongside strong demand from developers. The appetite for new development opportunities is broad-based, with an active market for both strategic land and sites with planning permission.

Most of the major housebuilders have refocused their business plans towards building larger properties, given the current weakness in first-time buyer demand. This can be seen in the higher average sale prices reported in the recent round of trading updates. It also appears to be a trend that is

set to continue according to data from Molior that shows nearly as many units started in Outer London in Q1 2011 as in all of 2010.

This general trend for London (and in fact for much of the UK) does not hold for Prime areas, where flats are purchased by the well-heeled and certainly not by many first-time buyers. The perennial scarcity of Prime development land supply continues to mean that sales of most developments are buoyant in the golden postcodes.

Relaxed rules that make conversion from commercial property to residential much easier will have limited impact on Prime areas, where there is already generous precedence for change of use. However, locations such as the City Fringe, Southbank, Fitzrovia, Soho and Canary Wharf are more likely to yield sites that will make an important contribution to the future residential development pipeline in Inner London.

Changing Market Regulation

On April 6th, Stamp Duty Land Tax (SDLT) for £1 million plus properties increased from four to five percent. Our calculations show that this change has impacted between 4,600 and 4,900 homes in London. To mitigate this cost, an increasing number of properties is likely to be purchased through Special Purchase Vehicles (SPVs), estimated to be around a quarter of all property sales above £2



million in the UK. To this end, the Government has pursued a number of measures to weaken the opportunities for tax mitigation.

These changes, alongside a raft of other reforms including an increased annual charge for non-doms (from £30,000 to £50,000 for residents of greater

than 12 years) are generally expected to have some negative impact on Prime demand. In reality the strength of demand far outweighs any loss from owners that have decided to sell up. As a result we anticipate a very minimal shift in preferences away from Prime property.

Concluding Comments

Prime Central London should maintain its leadership position, not just in domestic terms but as the international destination of choice for wealth home buyers. We expect Prime house prices to remain buoyant throughout the year, now looking more likely to exceed our expectations six months ago of a 5 percent increase this year.

Unfortunately this continues to be exacerbated by tight supply of new and existing stock. Although development starts are increasing supply, properties are selling well and there is little to point to as a genuine sign that this demand is moderating.

This demand pressure is also forcing 'Prime' to constantly be redefined. With £3,000 psf + achieved at The Lancasters on the north side of Hyde Park and a similar level on Cornwall Terrace overlooking Regent's Park, the boundaries of Prime London residential continue to push out.

It is this ripple effect that is perhaps the most important and compelling issue for the rest of London. The strength of international demand may make Knightsbridge property ownership increasingly inaccessible, but it is also the case that London's significance as a global capital city, if not the global capital city, is something that we all stand to benefit from. This demand reinforces the city's economic might, cultural offer and political significance. It is far better to be in the halo of this demand than anywhere else.

