

## PRIME CENTRAL LONDON: MARKET CONSIDERATIONS

- Residential prices in Prime Central London are showing signs of a legitimate recovery; prices have risen for six consecutive months.
- Sterling's weakness and prospective bonus payments in the FBS sector have fuelled demand for Prime Central London properties.
- Supply remains restricted due to low levels of properties being offered to the market and the difficulties faced by developers.
- The ongoing supply and demand imbalance means that Prime Central London will be fundamentally insulated from the 'double dip' which the rest of the country may be facing.

### HOUSE PRICES ARE RISING STEADILY...?

House prices in some parts of Prime Central London are rising at a much faster rate than house prices across England and Wales. For example, according to the Land Registry prices in Westminster rose by 9.3% since the trough in April 2009, whereas prices across England and Wales rose by only 2.1% over the same period. Perhaps surprisingly, prices in Kensington and Chelsea, are rising relatively slowly compared with Westminster. This reflects a number of factors relevant at the local level; Kensington and Chelsea traditionally have a high proportion of 'City/Bonus Money' this has been absent for the last two years and is just beginning to re-enter the market now.

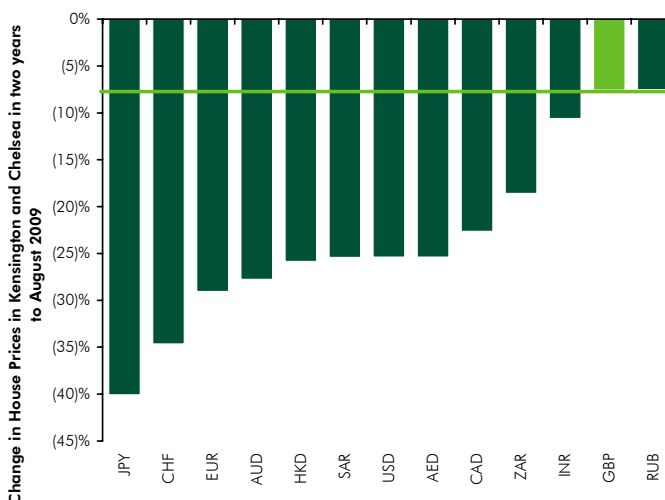
Despite the weaker recovery in Kensington and Chelsea, it remains the most expensive London borough (the average house prices is £741,200). Westminster is the second most expensive borough with house prices averaging £574,714 in August 2009.

The rise in prices in Prime Central London reflects a pick up in demand from both foreign investors and city bonus buyers, against a back drop of relatively limited supply.

### STRONG DEMAND FROM INTERNATIONAL INVESTORS

There remains a relatively strong interest in Prime Central London properties from foreign investors who are encouraged by the weakness of the Pound. The only major currency that has weakened against the Sterling in the last two years is the Russian Rouble (RUB) and this has been negligible.

### The Effect of Currency On Prime Residential Price Falls in Kensington and Chelsea



### Wilton Crescent, SW1X



Of particular note is the strength that the Japanese Yen (JPY) has gained against Sterling. According to our analysis, if buying with the Japanese Yen house prices in Kensington and Chelsea would be 40% lower than in August 2007. This is against an 8% fall over the same period in Sterling. However, there is only limited evidence of Japanese investors.

Instead, there are many Europeans looking to invest in Prime Central London with a notable increase of interest from Italian buyers who had previously been priced out of the market. Over the last two years Europeans purchasing with Euros (EUR) have seen house prices in Kensington and Chelsea fall by 29%.

The US Dollar (USD) has also performed well against Sterling with house prices (in US Dollar) in Kensington and Chelsea falling by 25% over the last two years. As a result, the investors from countries whose currencies are linked or pegged to the USD, such as Hong Kong, Singapore and Malaysia or investors holding 'Petro Dollars', are returning to the Prime Central London market. However, American investors are yet to re-new their interest in Prime Central London.

Despite the poor performance of the Rouble, Russian buyers are still in the market, but are largely buying with US Dollars. These buyers are still partly motivated by extracting money out of Russia.

Sterling may continue to weaken well into 2010. The drivers of this include lower than expected inflation, the announcement that interest rates may not increase above current low levels at least until 2011, and the UK's substantial budget deficit limiting Government spending. Some commentators are suggesting that Sterling will reach parity with the Euro in forthcoming months. This means the Prime Central London market will continue to be an attractive investment for international investors; resulting in a sustained demand going forward.

**BONUS BUYERS ARE RETURNING**

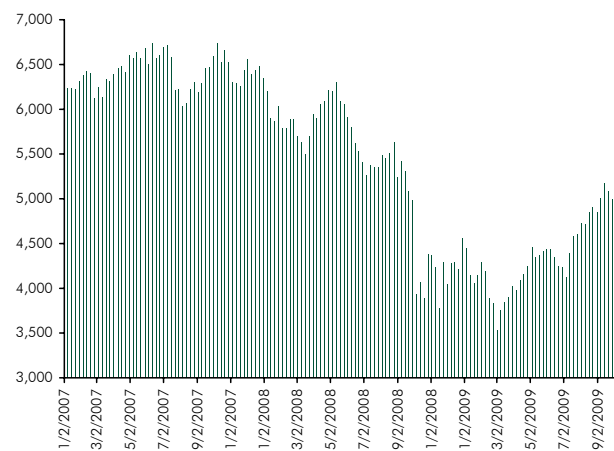
On the back of a rallying stock market (the FTSE100 has risen by around 46% since March) there could be a combined city bonus payout in the region of £5 billion this year. This has boosted confidence throughout the sector.

**Eaton Square - Belgravia**



There are already some tentative but encouraging signs that these high net worth individuals and "bonus buyers" are slowly beginning to return to the prime residential market.

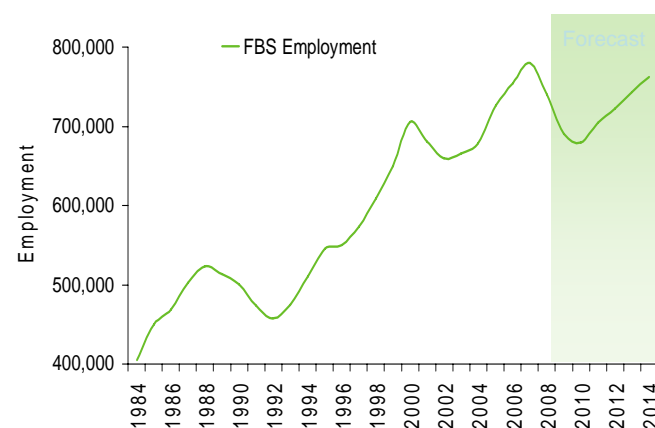
**FTSE 100 Adjusted Close Price (Weekly)**



On the downside, unemployment in the city's financial services sector is set to rise throughout 2010; potentially reaching 2004 levels. This, combined with the rise in income tax to 50% for the top earners next year and the government's threats to cap bonuses could lead to confidence falling away again. Similarly, the country's poor fiscal position is also likely to damage sentiment in the new year.

The combination of these factors is likely to stifle Bankers' and HNWI's demand for prime residential property. This in turn could limit the strength of the Prime Central London housing market recovery in the second quarter of 2010.

**FBS Employment in Central London**



Despite demand for prime properties in Central London returning, there remains very few properties being marketed and considerably fewer schemes being developed. There are currently 55% and 60% fewer transactions in Kensington and Chelsea and Westminster compared with pre-crunch levels. This supply and demand imbalance remains a central issue supporting the market.

**NEW BUILD SCHEMES STRUGGLE TO GET OFF THE GROUND**

There is a potentially healthy planning pipeline across Kensington and Chelsea and Westminster with 2,833 units with planning permission and 845 units under construction. However, the financial backdrop continues to constrain developers and several schemes have been delayed or mothballed, including 336-337 Strand and Westminster Theatre; no schemes have started so far this year.

The continuing difficulties in developing in the current climate suggests the demand and supply imbalance in the market will persist for some time to come. Unless the schemes with planning permission are built out and the development pipeline picks up, this further tightening of supply can only add pressure to price increases.

**Planning Pipeline in Kensington and Chelsea and Westminster\***

	No. Units
Under Application	661
With Planning Permission	2,833
Under Construction	845
Schemes Currently Marketing Units	10

Source: EGi  
 \* Based on Schemes with over 20 units

**The Lancasters**



**CONCLUSION**

House prices in Prime Central London are showing signs of a sustainable recovery. This has been driven by a return of the inherent demand and supply imbalance in the market.

However, the weakness in the Sterling has encouraged an increasing number of foreign investors back into the market, especially from the Far East, Europe, the Middle East and High Net Worth Individuals holding US Dollars. The low interest rate, low inflationary environment combined with the UK's substantial Budget deficit means Sterling is unlikely to strengthen in the short term and so this foreign investment in Prime Central London is likely to persist.

In addition, despite being particularly hard hit by the credit crunch, there are signs that 'Bonus Buyers' are returning to the market, after encouraging bonus payment announcements and the recent performance of FTSE 100. This demand is likely to be more sporadic than the demand from foreign investors in the short term with the effects of the probable tax hits at the beginning of next year yet to be seen. However these are two of the most important reasons why the Prime Central London residential market is likely to sustain much stronger price growth than across the rest of the UK.

This uplift in demand is against a backdrop of very low supply. The marketing of a number of new developments have been postponed and despite developers desire to buy land and build, financing remains a problem. This demand and supply imbalance is likely to support this specific housing market and the much talked about "double dip" in the housing market is unlikely to be seen in Prime Central London.

HOUSE PRICE INDICES				
	M-on-M	Q-on-Q	Y-on-Y	Level
Nationwide (Oct)	0.4%	3.4%	2.0%	£162,038
Halifax (Sep)	1.6%	2.8%	-7.4%	£163,533
Land Registry (Sep)	0.2%		-5.6%	£158,337
Hometrack (Sep)	0.3%		-5.6%	
CLG (Aug)	0.1%		-5.9%	£196,510
Rightmove (Oct)	2.8%		0.2%	£230,184

ACTIVITY INDICATORS				
	M-on-M	Q-on-Q	Y-on-Y	Level
Mortgage Approvals (Sep)	6.1%		68%	56,200
Gross Mortgage Lending (Sep)	2.0%	18%	-27%	£12.5bn
Housing Completions (Q2)		18%	-34%	21,600
Housing Starts (Q2)		-6%	-19%	29,800

ECONOMIC INDICES				
	M-on-M	Q-on-Q	Y-on-Y	Rate
GDP (Q3)		-0.4		
CPI (Sep)	0.0%		1.1%	
RPI (Aug)	0.0%		-1.4%	
Unemployment (May to Aug09)		0.3%	2.1%	7.9%

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