RESIDENTIAL INVESTMENT MONITOR

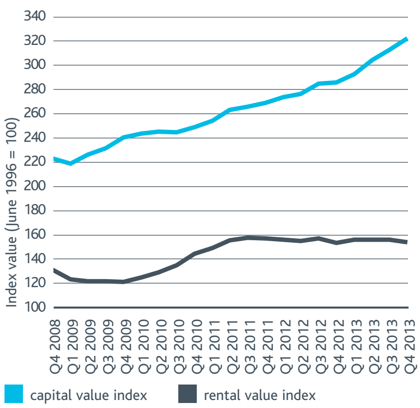
CENTRAL LONDON | Q4 2013

Q4 prime Central London

	Q4 2013	Q3 2013	Q2 2013
Gross residential yield*	3.29%	3.43%	3.53%
Capital value growth	3.00%	2.80%	4.03%
Rental value growth	-1.50%	0.00%	0.10%

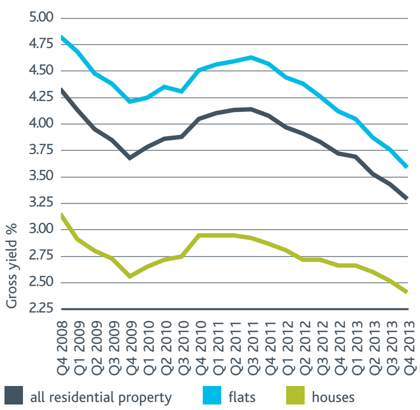
*Gross yields are based on calculations using rental and capital value data. Source: Cluttons research

Capital and rental value indices



Source: Cluttons research

Gross residential yields



Source: Cluttons research

Highest yielding submarkets - flats

Submarket (London region)	Gross yield	Capital value growth*	Rental value growth*
Belgravia (Central South West)	3.20%	1.80% (8.10%)	0.40% (-2.90%)
Mayfair (Central West)	3.86%	2.30% (9.10%)	0.30% (11.10%)
Isle of Dogs (Central South East)	5.22%	3.00% (12.60%)	1.40% (15.10%)
Maida Vale (Central North West)	5.31%	4.20% (22.60%)	1.70% (1.90%)

*Annualised (Q4)

Source: Cluttons research

House price growth retains momentum, while rents decline further

Capital value growth accelerated during the fourth quarter to 3.00%, from 2.80% during Q3, taking the total increase in values this year to 12.60%. This is almost twice the growth rate recorded during 2012 (6.40%) and the latest increase pushes the average property value across prime Central London to a record high of just over £1.70 million. Central North West (3.80%), which encompasses St John's Wood (4.70%), Maida Vale (4.20%), Hampstead (2.50%), Regent's Park (3.60%), and Highbury & Islington (4.00%), was this quarter's strongest performing London region. On a submarket level, Notting Hill (5.90%), in Central West, was the best performing during Q4, with average values standing at close to £2.65 million.

The Help-to-Buy scheme has contributed to the supply dearth across London by easing access to the first rung of the property ladder to those previously locked out by the magnitude of required deposits, as was confirmed by the results of our recent survey of home purchasers who cited the scheme as a driver for the decision to purchase (See 'Fear and Nesting' paper by Cluttons). This, coupled with the persistent and arguably strengthening appeal of London as an investment destination, in the face of a rapidly improving economic backdrop, means that supply is being eroded by both domestic and international buyers. This is to an extent reflected in the latest RICS housing market survey for London (October), which showed the balance of surveyors reporting new buyer enquiries surging to a level not recorded since April 2009. Concurrently, new instructions have slipped back sharply once more, which is likely to translate into further upward price pressure on home values. The shortage of stock across the prime core is likely to result in a busier than normal Christmas period as we head towards the end of the year, with house hunters eager to commit to deals as soon as a suitable property comes to market.

Although there has been an improvement in the access to debt financing, there remains a number of 'reluctant renters' waiting in the wings as they continue to save for deposits on properties whose values continue to accelerate, pushing the home-ownership dream further out of reach. Despite this cohort of renters bolstering overall requirement levels across prime Central London, net demand remains weak and is showing signs of further deterioration as we head into the festive period. The overall weakness in the market has translated into a -1.50% decline in average rents across prime Central London during Q4, leaving weekly rents at £1,007, which equates to a 0.30% increase on this time last year. On a submarket level, St. John's Wood (4.00%) in Central North West and Surrey Quays/ Rotherhithe (2.50%) in Central South East, were the capital's best performers in Q4. South Kensington (-6.9%) in Central South West and Notting Hill (-6.7%) in Central West experienced the most significant declines in average rents over the same period. With the festive period nearing, tenant activity has already started to abate, with most submarkets reporting an earlier than normal slowdown. Furthermore, the majority of those in the market appear to have budgets that are largely out of kilter with landlords' expectations. The tendency to move to locations that offer greater value for money persists and as a result, landlords are for the most part leaving rents unchanged at renewal, with token increases being reported across the board. This does however mask the fact that in some submarkets such as Wapping, landlords are planning ahead to next year, with uplifts of

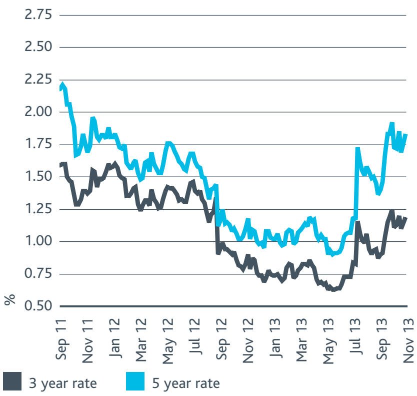
4.00% to 6.00% being planned as tenant demand in the area continues its upward creep, in line with increased job creation in the City. Between September and October, registrations in Wapping rose by 8.57%, driven primarily by tenants from the TMT and finance & banking sectors.

Residential investment undeterred by record low yields
With the diverging performance of the sales and lettings markets, calculated gross yields deteriorated further during the fourth quarter, slipping to a fresh record low of 3.29%. Overall, flats continued to outperform houses, with calculated yields slipping to 3.59%, from 3.76% during Q3. Maida Vale (Central North West) retained its position as the highest yielding submarket for flats, with calculated gross yields standing at 5.31%. This compares to a UK average of 6.00% according to the latest BDRC Continental Landlords Panel survey of 1,000 landlords. In general, the nationwide appetite for "alternative" asset classes, which include residential property, care homes and student housing, comprised 11.00% of IPD's £109 billion property universe, up from just 4.00% in 2001, underscoring the evolution of investment portfolios.

Across the capital, First Property Group launched a £40m fund targeting office to resi conversions, while Grosvenor Estate has announced an £80 million plan to convert a disused biscuit factory in Bermondsey, which is set to include private rented sector homes. Meanwhile, Mayfair Capital has completed the closure of its residential development fund at a total value of £28.2 million. The first £12.5 million tranche of the fund aims to provide investors with an annual return of 15%. Mayfair expects to be fully invested by the end of the year in development projects worth close to £200 million. Elsewhere, US based Atlas Residential and Saudi Arabia's Ghassan Holding Group have unveiled details of a £200 million joint investment in the UK's private rented sector. Plans include the acquisition and adaptation of serviced apartments and the development of private rented schemes in bundles of 100 to 300 units through the use of Spanish builder Modultec, which uses offsite modular building techniques.

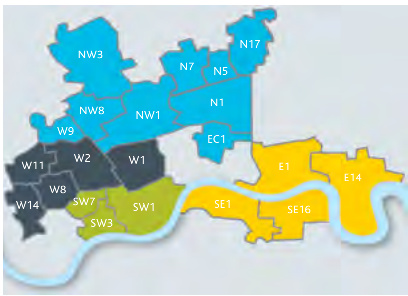
Despite these planned new build investments, the severity of the supply dearth in London's housing equation is expected to persist. This is being further catalysed by the sharp increase in the number of first time buyers in the market, aided in part through the easing of debt financing. The resultant impact on the housing market is already being felt, with residential growth rates in the capital continuing to move ahead of the long term trend. While the acceleration of property values is welcome news to those investors taking a longer term view of the market, new taxes being mooted by the government may undermine London's real estate investment appeal. The introduction of a Capital Gains Tax (CGT) on all properties sold by international investors from 2015 was announced during the Chancellor's autumn statement; overseas buyers are currently exempt from CGT. This may lead to a flurry of residential sales prior to its introduction in about 18 months. Furthermore, the deputy Prime Minister has indicated that the concept of some form of a "Mansion Tax", on properties valued over £2 million, may still resurface, despite a motion for its introduction being defeated in a House of Commons vote last year.

Cost of finance - 3 and 5 year swap rates



Source: Bloomberg

Prime Central London



Central South West South Kensington, Chelsea, Knightsbridge, Belgravia, Pimlico and Westminster

Central West Hyde Park, Notting Hill Gate, Marylebone, Bayswater, Kensington, Mayfair and Holland Park

Central North West St John's Wood, Regent's Park, Hampstead, Primrose Hill, Belsize Park, Maida Vale and Highbury & Islington

Central South East Shad Thames, Borough, South Bank, Surrey Quays, Wapping, Limehouse and Isle of Dogs

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