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A Developer's Dream but Buyers Beware

- A residential building boom is underway in many parts of greater London
- 20,000 units alone are in the planning pipeline around Vauxhall/Nine Elms/Battersea
- Overseas investors can't seem to get enough accounting for around two thirds of buyers
- There are already signs of owners trying to flip as early schemes near completion
- Typical prices for a good 1 bedroom flat in Zone 1 & 2 new schemes are around 14 times the average Londoner's salary
- A 4% gross yield represents around 70% of take home average income
- Developers of Battersea Power Station sold nearly all 800 units in Phase 1 over a few days (there are 7 further phases to come)
- By contrast there are around 1,600 apartments sub £2m on the market in the whole of Kensington & Chelsea (London's largest borough)
- London needs 50,000 homes per annum to keep pace with current levels of population growth.

- **Currently around 20,000 units are completed each year.**

- **The *median house price in inner London is £387,000. Assuming around 750 sq ft as typical unit size, this equates to approx. £516psf**
  Source Savills : * Median house price removes the distortion in average house prices when including high value prime London.

- **80% of the housing need/demand is at or below the median house price.**

There is just no stopping them.

What is it about London that makes it, by all accounts, the hottest property market around? Five years on from the GFC one can finally start to see the occasional bullish report on the recovering US economy or a complimentary article on the strength of the German economic model. Meanwhile, the marvels of the rising consumer markets in China, South America and Africa are the subject of many research papers looking to predict where wealth and economic power are to be created in the future. The on going shake up of the world economy rankings points to a significant change of order as the likes of India and Indonesia race up the listings. Yet one would be severely challenged to find a glowing report on the UK these days.

Despite the UK's moribund state in the eyes of many, foreign investors see London as a first choice destination where they choose to park their cash. Although the economy remains stubbornly flat, the commercial investment sectors are far from down and out, as prime office and retail assets are sought after from all quarters. The hotel sector is seeing valuations on a per key basis that sets new benchmarks. Yet it is the residential sector which is truly astonishing.

Asia's hotels are full of London property exhibitions

From Beijing to Bangkok and Hong Kong to Kuala Lumpur, you can barely walk in to a hotel without some London property exhibition going on. The developers have written their well prepared scripts and each sells its 'unique' angle to London. Whether this means buying Euston & Kings Cross because of the forthcoming Crossrail extension, or Nine Elms and Battersea because everyone recognises the iconic Power Station, or investing in Stratford because of the Olympic legacy, they all have their own take. Part of each pitch has some depth of course but to the uninitiated the realisation that Kings Cross is synonymous with drugs and prostitutes may come as a shock. Or the length of time it will take for all the light industrial units to eventually disappear around Nine Elms/ Battersea but not the sewage works & waste dump which are to remain. Or the realisation that the magnificent Olympic Park is bordered by some of the poorest and roughest boroughs in the entire UK.

There is still plenty of London left to develop

London is seen as being a City with severe land shortages and this is true, in the parts of the city where most would chose to live. There are in fact sizeable tracts of land that are ripe for development, even as central as Earls Court which has a major scheme to redevelop the two exhibition centres and surrounding area. One of London's main restrictions has been the planning constraints. In the recognised centre of London the greater majority of property is designated as being within a 'conservation area' thus placing heavy restrictions on how the façade of buildings are altered and, most importantly, how high a building can go.

New build schemes trade as much as double the price of the existing stock

The beauty of such emerging locations as Nine Elms or Woolwich (East of Docklands), for developers, is in the ability to build new and build upwards. A recent artists impression of the south bank stretching from Vauxhall Bridge to Chelsea Bridge looked more like Pudong than South London. The Economist article referred to below notes that the area is going to be three times as dense as London as a whole – jam packed with tall apartment blocks. This is just one part of the City outside of the traditional supply constrained prime boroughs of RBKC & Westminster. In fact there are new residential schemes popping up all over Greater London. Recently I was in a 22 story residential block close to Tottenham Court Road where all the units had sold except the four penthouses. These penthouses were asking £6-8m, maybe no surprise that they may take a while to shift, but all the other units however had sold out at around £1,300psf last year. In the immediate vicinity the average residential unit sells for around £750psf. Two bed flats rent for £475pw and the sales agent's projection for this block, when it is finished in May, is to achieve £900pw. The best unit on the highest floor may well be worth around £900pw but once all the other investors release their apartments for rent at exactly the same time, that £900pw will reduce dramatically as supply dictates price as much as demand.

Knight Frank recently wrote a 'research' paper predicting where values would appreciate the most over the next 5 years. They had Nine Elms showing a 140% increase. Beware of statistics, if you take the existing residential in the area and then compare that with the first marketed phases of Embassy Gardens, developed by Ballymore, you can already see the greater majority of that increase having taken place as the new build benchmark is established.

The local market accounts for less than one third of sales

UK buyers account for around 27% of new build sales with around 48% coming from Singapore, Hong Kong, China and Malaysia. Other notable sources for new build buyers include India, Russia & Turkey. Given the state of the UK economy, the growth markets for developers are clearly overseas, however at some point these off plan investors need to ask themselves who is going to rent these apartments when completed.

History tends to be repeated

A recent article in the Economist quoted Boris Johnson as saying 'Nine Elms/Battersea is possibly the most important regeneration story in London and in the UK over the next 20 years'. It went on to say that the last time so large and so central an area of London was redeveloped was after the Great Fire of 1666. At 195 hectares, the site is bigger than Hyde Park and spans a mile and half of river bank.

The tone of the article implies a rather unprecedented scale and by referring back to 1666, whilst throwing in the unique Grade 1 listed Power station that dominates the area, it helps over look any recent lessons from more contemporary history. To me this massive area has alarming similarities to the Docklands story in the 1980's and the grand vision back then which invited mass speculation at the time.

The Docklands regeneration in the mid 1980’s holds many lessons

Docklands was a vast project that came about on the back of the need to expand the city's financial district as London desperately needed office space post Big Bang. It was an abject failure to start and the principle developers of Canary Wharf went bust. It was in fact the residential that came initially to the rescue, first with domestic buyers speculating with 100% mortgages at the peak of the 1980's housing boom. That all imploded when interest rates started spiralling upwards in the very late 80’s, values dropped 40% in nominal terms (more if adjusted for inflation) and Docklands became the symbol of the most painful housing crash experienced coming, as it did, on the back of Thatcher’s ‘right to buy’ and vision of a home owning democracy. Around 1993/1994 Asian buyers started snapping up 'cheap' high yielding flats. The main market was from HK as this was at the peak of the pre 1997 rush for passports.

Eventually the commercial side gained traction and big space users moved in and the area started to realise its original rationale. For those who bought apartments in the mid/late 1980's it took well over a decade to see prices recover. Rents remained depressed long in to the noughties as new supply kept coming on stream. Today there is still a mass of brown field sites as you go East of the Isle of Dogs, all served by the slick Docklands Light Railway. Today Canary Wharf is a success, although in inflation adjusted terms it has never realised the rents originally forecast, and has become a genuine addition to London's financial centre. From Canary Wharf to Wapping the area has matured and Wapping still has some very sought after and hugely expensive loft conversions which are few in number and much sought after.

Are we witnessing a South River Bubble?

25-30 years on and the Battersea/Vauxhall regeneration looks likely to falter in its earlier stages due to its sheer size. In total there are around 20,000 units in the pipeline (outline planning approved) between Wandsworth to Vauxhall alone. Around 3,500 under construction currently just in Battersea and Nine Elms. Compare that with 1,600 flats in total sub £2m available in RBKC (London’s largest borough). Most apartments south of the river are of course sub £2m. As pointed out in my last send out, typical prices for a one bedroom apartment along the south of the river in one of the numerous new schemes start from close to £500,000 which is around 14 times the average Londoner’s salary. To achieve the promised 4% yields, an annual rent of £20,000 will be needed which would account for around 70% of post tax salary.

I believe most buyers at present are ignoring the basic fundamentals and simply buying off plan due in part to ease, low deposit payments, depressed local currency and the 'London story'. The currency may continue to play a key roll and might help when the reality, for many, comes in 12-24 months from now when the bulk of the payments are to be made. It is quite likely that higher taxes will be introduced for unoccupied ‘second homes’ and this may be a deterrent for some when completion nears. Most importantly will be the competition for tenants. The lesson from Docklands was that it took about a generation to truly start making money and I think the same may well be the case here, except the starting point is unlikely to be just before two decades of an uninterrupted economic boom. In fact, as with Docklands, it is easy to see the original market driver (the residential in this case) failing initially and other sectors being focused on. Most obviously this will be the retail/leisure elements at the old Power Station, the focus of most previous proposed schemes, and a few hotels which are in the planning pipeline, as London needs more quality affordable hotels with the new US Embassy likely to put the location gradually on the map.

Our simple advice……caveat emptor!

Prime London Property…………a luxury brand item where demand outstrips supply.

I am aware that our previous bulletin last month struck a rather bearish tone and so has this one, so far. However we do see reason for optimism and opportunity and this remains fair and square in the sector we have doggedly stuck with for 20 years.

Contrary to all the concerns voiced above, we see the prime London residential market remaining fundamentally sound. In part this is because it is not exposed to the extreme supply increases previously discussed and it has the ability to show a fair yield for investors based as much on high occupancy levels. It is also because it has perhaps emerged as a different type of asset to what it has been up until recent times, being as it is, removed from the usual fundamentals of the domestic housing market.

Brand appeal

With the BRIC economies now the economic drivers of global wealth and other emerging markets becoming key players, the power of branding has never been greater. Many cities have attempted to brand themselves in the past with varying degrees of success. The brand would typically be derived to appeal to the widest audience. London has a strong established brand identity and this was enhanced last summer by the Olympics and Diamond Jubilee, but within the broad London brand there is very clearly an exclusive luxury brand that has developed in recent years and that is Prime Central London real estate.

In earlier bulletins following the GFC, we have made much of our belief in investing in markets where there are the highest concentrations of cash to be found. The very wealthy have always looked to own the best and congregate with their peers. Locations such as Monaco, The Hamptons or The Peak are examples of this and they have become recognised as any professionally created brand. The brand identity is further underpinned through iconic events like the Grand Prix in Monte Carlo or the society magazine *The Peak*. Prime London property includes addresses like Mayfair, Knightsbridge & Belgravia and the dynamics that lie behind the demand and aspirations to own property in these locations has many similarities to other premium value branded goods where the value is as much in the brand as it is in the physical goods. If this is the case, as I believe it is, then the strong brand demand coupled with an investment grade yield return makes for a pretty compelling case.

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