Prime London

THE CHAMPAGNE TOWER EFFECT

London's undiminished standing as a world-class city continues to boost overseas investment into its prime residential assets

Words by Yolande Barnes

The marketing hype for London in the lead up to the 2012 Olympics is getting into full swing. Billboards announce that London is the world's capital while the media have long proclaimed it as the 'world in one city'.

There has long been a flow of overseas wealth, as well as people, into London. This has the ability to impact housing markets well away from its epicentre in much the same way as the champagne glass at the top of the tower feeds those further down the tier and out towards the periphery.

It is London's status as a world-class city that sets it apart in value terms from the rest of the country. We have seen that London's housing accounts for 18% of the value of all the UK's stock, a concentration of wealth and value that goes way beyond its status as capital city.

A significant proportion (37%) of this value is located in the most central areas of the capital, in the areas that we call prime. The two most prime of London's 33 boroughs – Westminster and Kensington & Chelsea – account for over a sixth of London's total residential property value, equivalent to around £115 billion and see significant inflows of overseas and London-generated wealth each year.

More international

London's cosmopolitan nature is not exactly breaking news, but our evidence suggests that central London is becoming increasingly international. Overseas buyers have accounted for 48% of all prime central London buyers over the past five years but just 31% of all sellers, and this overseas equity is increasingly dominant in higher value markets.

The effect is most noticeable at the top end of the market. Five out of ten buyers of central London property between £5 million and £10 million are now foreign nationals, rising to eight out of ten in the £10 million plus price bracket. Over the past five years, foreign national buyers have bought property totalling over £6.5 billion in the £5 million-plus price range alone.

Increasing importance

The effects of the prevailing exchange rate and London's role as a safe deposit for international cash mean overseas investors have assumed greater importance, accounting for 53% of purchasers of all prime central London property in the past two years compared to 45% in the preceding three.

In the higher price brackets, Russian and Middle Eastern money continues to dominate, while uncertainty in the Eurozone economy has meant that European buyers accounted for 21% of all prime central London buyers in 2010.

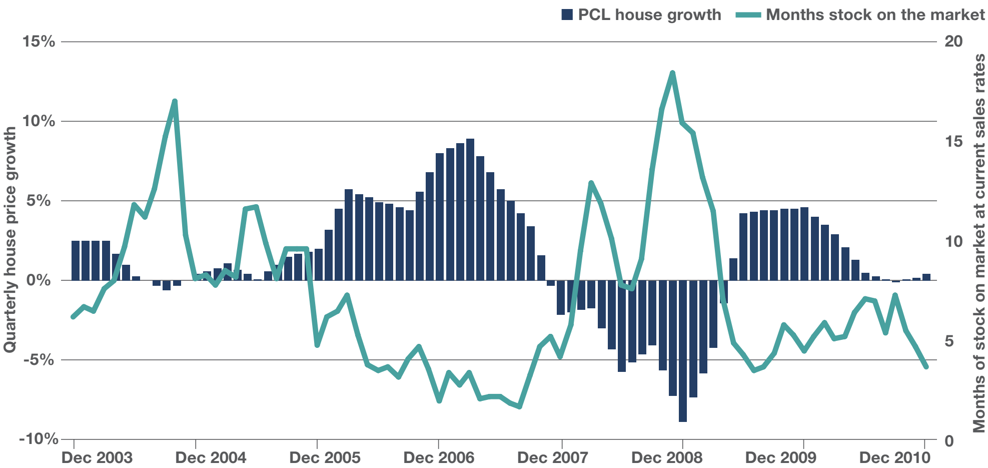
Overseas equity inflows have been particularly important recently as new domestic sources of housing equity have become relatively less important. City bonuses, for example, may have contributed as much as £5 billion to the London housing market in 2006 but are forecast to contribute just £1 billion in 2011.

Impact on stock

The drivers for overseas buyers to acquire prime London property have been the very same factors that have been motivating existing overseas owners to adopt a holding

GRAPH 2.1

Available stock vs price growth How low levels of available housing stock have historically supported house prices



Graph source: Savills Research

Above: The One Hyde Park development is testament to London's appeal as a global city

position. In the past two years just 26% of all sellers have been foreign nationals, down from 34% in the three preceding years. A lack of liquidity of foreign owned prime London property is therefore contributing to the current low stock levels which is, in turn, underpinning prime London prices.

A good measure of this effect is the number of months' stock on the market at the prevailing rates of sale. Over the past five years there has been on average 6.4 months' worth of stock publicly available in the prime central London market. In the period immediately post Lehman Brothers the figure peaked at 18.4 months as transactions dried up and the prime London market saw its biggest ever quarterly price fall. By September 2010, this figure had reached 7.5 months, but was back to 3.7 months by the end of December.

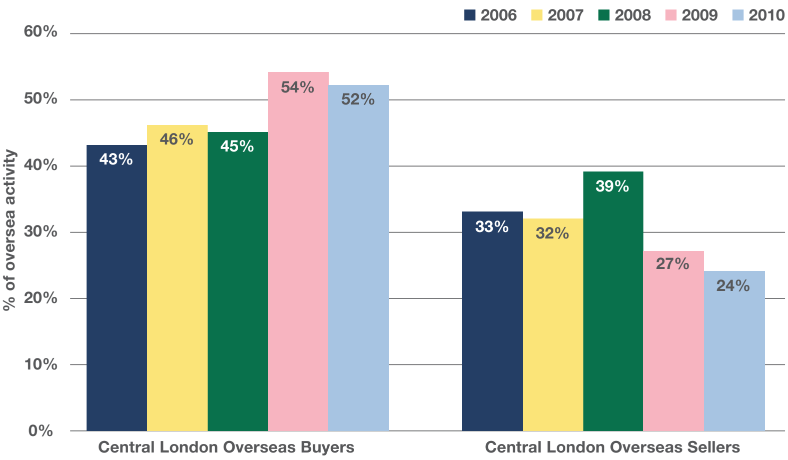
As a consequence, London's prime market continues to outperform the mainstream with price growth of 4.6% in 2010. Even as the market weakened in the second half of the year, locations in prime London still remained more resilient than the mainstream market and in the last quarter, prices were all but static (-0.2%) compared with a -2.5% fall in the mainstream market.

In 2011 we do not expect prime London to be completely immune to the second slip in values as weak market sentiment feeds up through the market.

However, supply constraints driven by actions of overseas owners and buyers will play their part in limiting the extent of the second slip in these markets. From 2012 onwards, they should have a positive impact on prices as the global economic recovery strengthens. ■

GRAPH 2.2

Overseas activity in PCL There has been an increased number of overseas buyers and a reduction in sellers



Graph source: Savills Research

THE PRIME RIPPLE

How overseas investment has expanded the prime market

As more international wealth has flowed into the most desirable locations, properties have increasingly been held as investment assets, so the number of locations deemed 'prime' have expanded over recent decades. This has happened in several ways.

As the core prime stock available to buy has shrunk, so high value developments have successfully opened up new areas to the prime market. More organically, the proceeds of sales from central London are often reinvested in other high value markets as domestic demand is displaced. As many as one in five buyers in southwest London come directly out of central London, as equity funnelled in at the centre migrates down London's wealth corridors.

So, as billionaires displace multi-millionaires from the top addresses, so they in their turn displace millionaires. Equity migrates to more peripheral areas of the capital and, eventually, out of the capital to the rest of the UK as homeowners invest their equity in country houses, second homes and retirement properties and so housing wealth and the prime effect spread.

"Foreign nationality buyers accounted for 53% of purchasers of prime central London property in the past two years."

Yolande Barnes, Savills Research