research

from Hurford Salvi Carr

MIDTOWN, CITY AND DOCKLANDS

RESIDENTIAL REVIEW 1ST HALF 2010

Hurford Salvi Carr is an innovative firm of property advisors and development consultants who have become synonymous with urban living in central London. Our experience and expertise in both the residential and commercial markets, in the City, West End, Docklands and East London puts us at the forefront of property agency.

Since 1996 Hurford Salvi Carr has been a driving force of the 'city living' phenomenon having sold more than 3,000 new homes in over 200 developments, the majority created from former commercial premises, and we have played a pivotal role in the repopulation of Clerkenwell and the City fringes.

As real estate agents we are widely respected throughout London and are well known in property circles around the world. Our reputation is based on the accuracy of our advice, the quality of our marketing, and most importantly for achieving results.

The Company is divided into six divisions, specialising in Residential Sales, New Homes, Residential Lettings, Residential Investment, Commercial Agency, and Property Management. In many instances the skills of each division combine to provide our clients with best advice. Our fresh approach and award winning marketing expertise complements our service.

We are committed to providing a personal service to each of our clients and we maintain the highest standards in every aspect of our business.

HURFORD SALVI CARR

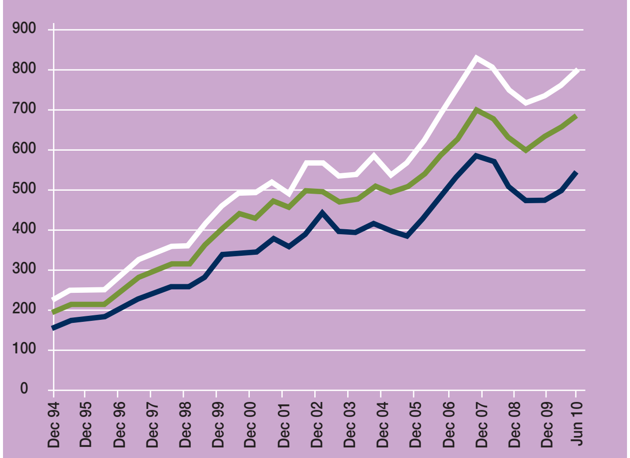
market overview

NEW COALITION GOVERNMENT DAMPENS MARKET ACTIVITY

In the first half of 2010, the Midtown, City and Docklands residential markets continued to exhibit trends for price and rental growth, trends which were established in March 2009 for the sales market and in July 2009 for the rental market. In the sales market enquiries, sales and price growth were concentrated in the first four months of the year.

Across the three sub-markets of Midtown, City and Docklands, January to April 2010 saw price rises of 6%. Prices had risen for 15 months in Midtown and City and at end June 2010 were only 3% off the September 2007 peak, while in Docklands prices had risen for 12 months from June 2009 and were 8% below peak prices (Figure 1).

FIGURE 1 : THE HURFORD SALVI CARR PRICE INDEX



Source: Hurford Salvi Carr, CCR

The rental market is normally subdued in the first half of the year, peak demand typically occurring in the second half, particularly the 3rd Quarter. In the first half of 2010 there was evidence of strong rental growth, averaging 7% in each of the three sub-markets. Demand for rental property continued to be artificially inflated, due to the difficulties that "frustrated renters" faced trying to become owner-occupiers. Not only was mortgage finance difficult to obtain, in spite of some easing in the first half of 2010, but also first-time buyers failed to find the bargains they expected, because a year of cash-rich purchasers pushed prices to near peak levels. Quite simply, renters were outbid and at renewal had to sign new leases at increased market rents.

At the same time the level of rental stock in the market was reduced as landlords, including "reluctant landlords" who had not wanted to sell when prices were depressed in 2008 and 2009, put units into the sales market in response to rising prices. Confidence in the residential market could, in part, be traced to a modest recovery in the central London employment market, especially in financial services, and that had the effect of maintaining demand for rental property as recruitment levels increased.

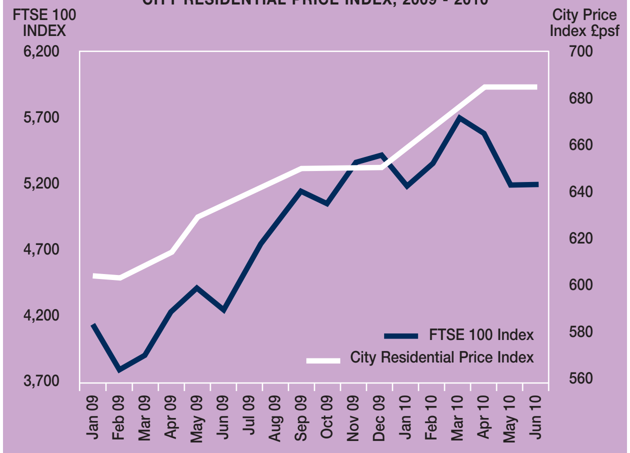
Across our sub-markets, where many buyers are either working in financial and business services in Central London or come from an international background, the sales market is very sensitive to national and global economic factors. In May and June the market was more subdued, for the following reasons:

- The uncertainty generated by the UK General Election on 6th May caused a reduction in enquiries from April onwards, with the expectation that, whatever Government came to power, there would be an increased fiscal burden on higher rate tax payers.
- Once in power, the Coalition Government compounded the uncertainty by stating that it would raise the rate of Capital Gains Tax (CGT) on non-business assets including residential property, without specifying the level until the Emergency Budget of 22nd June. Press speculation, fuelled by ministerial statements and leaks, indicated that the new rate could be as high as 40-50%.
- The sovereign debt crisis in Greece, and the potential for sovereign debt contagion to spread to other southern and eastern European states, led to widespread concern about the future of the Euro.
- This, and other economic factors, caused the FTSE 100 to lose 12% of its value in three weeks between 15th April and 7th May, the day after the initially inconclusive Election (Figure 2). On 25th May the Index fell by 2.5% to 4,941 after further uncertainty about resolving sovereign debt and the escalation of tension between North and South Korea.
- The Bank of England evidently had little room for manoeuvre, maintaining the Base Rate at 0.5% at each of its six meetings, as well as not extending further the Quantitative Easing programme.
- On 24th May 2010, the new Government announced a £6.2bn spending cuts package which will have a significant impact on GDP in the short to medium term.
- The Emergency Budget heralded an era of austerity as far as public spending was concerned, with a negative impact in the short-term on the rate of economic growth, with GDP forecasts downgraded to 1.2% for 2010-11, rising to 2.3% in 2011-12 and 2.8% in 2012-13.

MAY 2010 - CONSERVATIVE AND LIB DEMS TAKE OFFICE

As a result there was no evidence of rising sales prices during May and June, as Figure 2 illustrates which plots the Hurford Salvi Carr City Price Index against the FTSE 100 at month-end. Our offices, however, continued to agree a large number of transactions with cash buyers, overseas buyers and UK resident buyers seeking a home for capital as an alternative to bank deposits, the stock market and a long-term pension.

FIGURE 2 : THE FTSE 100 INDEX AND THE HURFORD SALVI CARR CITY RESIDENTIAL PRICE INDEX, 2009 - 2010



Source: Financial Times, Hurford Salvi Carr, CCR

Price changes in the local market were mirrored at the national level. In the year to the end of May 2010, the Halifax reported an increase of 6.9%, the biggest rolling annualised increase since October 2007. Nationwide, meanwhile reported prices up 9.8% in the year to May 2010. The data deriving from mortgage providers, however, has been weakened by the low level of transactions funded by mortgages, and are less likely to reflect local markets with a high proportion of cash buyers.

The inconclusive General Election was resolved by 12th May, seeing a Conservative-Liberal Democrat coalition led by David Cameron and Nick Clegg into Downing Street. There followed a period of "purdah" in the six weeks to the Emergency Budget of 22nd June, during which the Coalition engaged in horse-trading over policies and the press engaged in speculation. In terms of the housing market, the initial coalition agreement included a Liberal Democrat inspired policy to raise the level of CGT for non-business assets from 18% to "similar or close" the level of income tax. It was initially reported that this would mean in most meaningful instances of gain (such as in the sale of residential property assets) a rise to the new top rate of 50%. In the Budget the rate was increased to a significantly lower level of 28%, but the uncertainty during May and June deterred investors.

NORTH MEWS, WC1 - TWO BED FLAT SOLD MAY 2010 - £1.1M

On the plus side on 20th May, the Government used emergency legislation to scrap the unpopular Home Information Pack (HIP) which had been instigated and championed by the outgoing Labour administration. The energy performance element of the HIP will remain in place, however, under European directives on climate change. The scrapping of HIPs, which typically cost £450 to the vendor, will encourage vendors to place their property on to the market – a market where prices are rising due to under-supply rather than burgeoning demand. Enhancing the supply of second-hand homes will be critical to a market which is increasingly starved of new homes and where new homes are typically being acquired by overseas buyers and pied-a-terre second-home owners. We said that HIPs would fail and they did at every level, with the average length of time for existing transactions increasing from 7-8 weeks to 10-12 weeks since the implementation of HIPs in 2008.

NEW RIVERHEAD, EC1 - 3 x TWO BED FLATS, SOLD SPRING 2010 - £540,000 - £585,000

There was some evidence in the first half of 2010 of the easing of bottlenecks in the flow of mortgage finance. Two mortgage providers, HSBC and Santander (Abbey), tailored sensibly priced products for the market. As a result the two firms have, according to a report in the Evening Standard on 27th May 2010, increased their market share between 2008 and 2010 from 13.7% to 20% in the case of Santander and from 6.7% to 11% for HSBC. Over the same period Lloyds, which includes Halifax, went from 30% to 24% of the mortgage market. In addition, private banks targeting wealthy buyers entered the market, including JP Morgan, Standard Chartered and Investec Private Bank, and are potentially of benefit to Midtown, City and Docklands buyers. According to MoneyExpert.com the number of fixed rate mortgages on offer at a 90% loan to value (LTV) ratio doubled in the year to February 2010 from 78 to 147.

Overall, however, loan to value (LTV) ratios remain historically low and terms and conditions more onerous than in the past, leaving buyers to find 20%-30% deposits and pay high arrangement fees. The "Bank of Mum and Dad" continued to be a prime source of deposits, with parents and grandparents increasingly utilising equity release plans to get their children or grandchildren on to the housing ladder. At the national level the Council of Mortgage Lenders (CML) recorded very modest growth in lending, better than the first half of 2009, but still "quiet and subdued".

The General Election and its aftermath dampened the sales market at the end of the first half of 2010. The Emergency Budget and the general level of economic uncertainty at both global and national levels indicate that there is unlikely to be further price growth in Midtown, City and Docklands in the second half of 2010, so we are forecasting stable residential prices over this period. In the rental market, however, the supply and demand factors which created rental growth between June 2009 and June 2010 will still be in place, during the period of the year when demand for rental property is at its height. As a result, we expect to see a further increase of 5% in rent levels in the second half of 2010.

sales market

CASH OUTBIDS FIRST-TIME BUYERS

Price increases averaging 6% in the first half of 2010 in the Midtown, City and Docklands residential markets were driven by a lack of stock coming to the market combined with a significant 30% expansion in enquiries during the period January to March, a rise in activity mirrored across London as a whole. Enhanced interest in acquiring residential property came from four principle categories of potential buyers:

- First-time buyers, looking to enter the Midtown, City and Docklands markets.
- Renters already present in the market, now looking to buy and get on the housing ladder, which we describe as "frustrated renters".
- Pied-a-terre purchasers, seeking a second-home in proximity to the workplace where the primary residence is typically outside London.
- Overseas buyers of investment property (albeit sometimes buying for family members studying or working in London) deriving from property exhibition activity in Hong Kong, Singapore and Malaysia, where the perceived value of London along with currency movements encouraged buyers.

LIMEHOUSE MARINA, E14 - THREE BED FLAT SOLD APRIL 2010 - £750,000

There was little evidence of interest from the buy-to-let (BTL) sector, either amateur or professional, with yields still stubbornly stuck around 5%. Of the four groups, however, it was typically the pied-a-terre and overseas purchasers who were able to convert their interest in the market into puchases. The primary reason for this is that they were predominantly equity-driven purchasers, either buying with 100% cash or topping up cash with relatively low LTV ratios. The result, in a market with a relatively short supply of stock for sale, was to raise prices during the period January to April by 6%. The price of the illustrated typical one-bedroom flat in the second-hand sales market increased by £20,000 from £338,000 at the end of 2009 to £358,000 at the end of June 2010 (Table 1).

TABLE 1: ILLUSTRATED PRICE CHANGES FOR ONE-BEDROOM FLATS 1998-2010 IN MIDTOWN, CITY AND DOCKLANDS

Year End	Price Change %	One bedroom Illustration Market Value (£)	Change in Value (£)
1998	N/A	150,000	N/A
1999	+26%	189,000	+39,000
2000	+11%	210,000	+21,000
2001	+10%	230,000	+20,000
2002	+13%	260,000	+30,000
2003	-6%	245,000	-15,000
2004	+0.4%	246,000	+1,000
2005	+10%	270,000	+24,000
2006	+26%	340,000	+70,000
2007	+9%	371,000	+31,000
2008	-15%	318,000	-53,000
2009	+6%	338,000	+20,000
2010	+6%	358,000	+20,000

Source: Hurford Salvi Carr, CCR

TABLE 2: PRICES COMPARED TO THE MARKET PEAK FOR TYPICAL ONE-BEDROOM FLATS

Sub-Market	Peak to Trough Sept 2007 - Feb 2009	Trough to Current Mar 2009 - Jun 2010	Peak to Current Sept 2007 - Jun 2010
Bloomsbury, WC1	-13%	+10%	-3%
City, EC	-15%	+12%	-3%
Docklands, E14	-20%	+12%	-8%

Source: Hurford Salvi Carr

First-time buyers, whether new to the market or "frustrated renters", had largely failed to realise that price rises since March 2009 in Midtown and City and June 2009 in Docklands, had raised prices respectively within 3% and 8% of September 2007 peak levels (Table 2). Expectations of picking up bargains as the availability of mortgage finance eased were dashed. Cash buyers could move quickly to completion compared with buyers dependent on the time-consuming arrangement of loan finance. As we will see in the Rental Market section, this in turn bolstered rent levels, giving further encouragement to overseas investor purchasers.

As prices rose in the early part of the year, supported by a good performance from the stock market and an improving jobs market in financial and business services, vendors were encouraged to bring property to the market. With prices edging back to the 2007 peak, there was a welcome enhancement of the number of second-hand apartments and houses for sale, but the increase in the supply side was not sufficient to dampen price growth until May, when a significant expansion in stock for sale was stimulated by the abolition of HIPs and the threat of a higher CGT rate.

BLOOMSBURY SQUARE, WC1 - 2,900 SQ FT ACQUIRED FOR CLIENTS - JUNE 2010 - £2M

Taking a slightly longer historic perspective of 12 months, prices increased by 7% in the City sub-market, 9% in Midtown (here defined as Bloomsbury) and 14% in Docklands (Table 3). One bedroom flats in Docklands typically achieved just under £650 psf at June 2010, with prices of £780 psf and £840 psf in City and Midtown respectively.

TABLE 3: PRICES FOR TYPICAL ONE-BEDROOM FLATS (500 SQ FT) JUNE 2009 TO JUNE 2010

Sub-Market	June 2009 £	June 2010 £	June 2010 Price £psf	Change Jun 09 - June 10 (%)
Bloomsbury, WC1	386,000	420,000	840	+£34,000 (+9%)
City, EC	365,000	391,000	782	+£26,000 (+7%)
Docklands, E14	282,000	321,000	642	+£26,000 (+14%)

Source: Hurford Salvi Carr

Looking at the market by lot size, there were significant differences in the strength of the market according to the type of unit. In the first three months of the year there was strong interest in one-bedroom units, driven by demand from the pied-a-terre market. At the other end of the spectrum, during the whole of the first half of 2010, there was very strong interest from purchasers of "top end" apartments of size with features such as balconies, roof terraces, loft aesthetics, parking spaces and excellent specification. Units with asking prices in excess of £600,000 in Docklands, £900,000 in the City and £1 million in Midtown, often attracted multiple bidders and sold quickly.

The market for two-bedroom homes priced in the range from £500,000-£700,000, however, was perceptibly weaker. Given that prices had risen for a year or more, this segment was perceived by potential owner-occupiers to offer a lower than expected value for money.

In Midtown, including Bloomsbury, Holborn and Fitzrovia, lack of stock continued to drive prices towards the 2007 peak. During the first half of 2010, Hurford Salvi Carr sold a portfolio of 21 apartments in four blocks in Fitzrovia on behalf of a HSBC residential fund. 19 were acquired by second-home owners and two by investors.

In the City, the market was driven by strong interest in pied-a-terre's where the stock of property for sale was relatively limited, helping to raise prices. Purchasers are typically wealthy and well-established with a high proportion of equity in their principal residences, often buying outright with cash. Demand from overseas purchasers was also significant, including Europeans as well as the Far East. In the mid-market the price expectations of buyers and sellers were less often reconciled and this led to a slower market, where properties with unusual features tended to do well.

In Docklands, although June 2010 prices were still 8% off the 2007 peak, the market performance in the first half of 2010 was encouraging with a higher rate of price growth at 9%, than in Midtown and City. We experienced the highest level of transactions at our Limehouse office since 2006. There was strong interest for one bedroom flats, two bedroom flats and large apartments. Rising prices encouraged a significant number of "reluctant landlords" (owner-occupiers who have vacated their primary residence but either failed or not sought to sell) to test the waters by placing their flats on the market.

In May and June, there was a lower level of activity in the sales market because of uncertainty over the Emergency Budget and the potential threat of a hike in the CGT rate to 40%. Whatever we might say about the performance of the England team, the World Cup was a major diversion, with a lower rate of inquiries, viewings and transactions during the month from 11th June onwards.

OGLE STREET, FITZROVIA, W1 - SIX FLATS SOLD - £380,000 - £491,000

GREAT TITCHFIELD STREET, W1 - SIX FLATS SOLD £495,00 - £727,000

new homes market

SHORTAGES BRING PREMIUM PRICING

In the first half of 2010, the market for new homes overall was characterised by a dwindling supply of units under construction in Midtown, City fringes and Docklands, as the unwillingness of banks to fund residential development since 2008 cut off the development pipeline. There is an exact parallel with the commercial office market in central London, where starts also ground to a halt in the first half of the year.

By contrast, the City core did have a supply of new superbly fitted-out luxury apartments on offer at Bezier, Lamb's Passage, The Heron and Frobisher Crescent, with high sales rates and prices breaking through the psychological threshold of £1,000 psf.

This handful of significant City schemes will define pricing for the new homes market over the coming two years. In March 2010 Gerald Ronson's Heron Residences LLP started construction on a new 36 storey residential tower, **The Heron** - a contemporary addition to the 1970s Barbican cluster. The scheme comprises 284 units, 83 of which were launched to the market on 18th March 2010, with both on-line marketing and an impressive marketing suite. By June 2010 110 had been reserved at prices ranging from £415,000 for a studio and £2.5 million for a three-bedroom apartment. These prices break back to a range from around £900 psf to £1,325 psf, with an average price in the region of £1,100 psf. Between March and June 2010, the average prices increased 27% from £1,100 to £1,400 psf.

The building will have a full concierge service including, housekeeping, restaurant and theatre reservations, car service, dry cleaning, courier and messaging services, maintenance services, secretarial and travel arrangements. A private club with roof garden and a gymnasium will also be available to residents and their guests including a bar, café, screening room, meeting and conference rooms. The lower levels of the building will provide a new home for The Guildhall School of Music and Drama incorporating a 608 seat concert hall, a 227 seat theatre and a studio theatre.

Heron has succeeded in selling the vast majority of the apartments to owner-occupiers off plan, where the completion date of the scheme is anticipated in three years time. While selling to investors off plan has been achieved regularly in the past, we cannot recall a situation where such advanced sales have been made to owner-occupiers.

One street block to the west, **Frobisher Crescent**, part of the Barbican Arts and Conference centre has been converted by United House into 69 apartments, completed in May 2010. 45 of the 60 units that were initially marketed have been sold at an average asking price of £1,009 psf, with unit prices ranging from £375,000 to £1.875 million. In terms of pricing, it appears that Frobisher Crescent has benefitted from being in close proximity to Heron's glitzy tower.

A little further north on the south east corner of Old Street roundabout, Tudorvale launched its **Bezier** development on 11th March 2010 on completion of the scheme. Comprising two blocks of 14 and 16 storeys, with 126 private apartments, advertised prices averaged £866 psf with a range in unit prices from £325,000 to £3.15 million. The specification includes air-cooling, underfloor heating, impressive kitchens and bathrooms and stunning views over the City from the 5th floor upwards.

67 TURNMILL STREET, EC1 - LAUNCHED MAY 2010

In Clerkenwell, Hurford Salvi Carr is acting for Marldon on a boutique scheme of 13 units in a mixed use scheme with 12,000 sq ft of offices at **67 Turnmill Street, EC1**, beside Farringdon station. The first five units were launched on 21st May 2010 with four reservations, the balance of eight units will be launched in the summer of 2010. Prices for the first phase ranged from £430,000 to £720,000 sq ft at an average price of £870 psf. This development is set to reach a record high for Clerkenwell, off the back of a proven high end specification and a lack of competition in the City Fringe new homes market.

One of the features of the new homes market in the first half of 2010 was the re-emergence of off-plan sales to investor purchasers in a variety of locations in the Far East, including Hong Kong, Singapore and Malaysia. United House and Londonewcastle are responsible for the fitting out of a block of 56 private apartments at the recently completed, colourfully clad, **Central St Giles** scheme on St Giles High Street, WC2. Forming part of Legal & General's and Mitsubishi's mixed-use office, retail and residential scheme and designed by Renzo Piano, the private residential achieved prices of £1,400 psf in sales of 51 of the 56 apartments to Hong Kong, Singapore and Kuala Lumpar investors in March 2010.

For the final marketing phase of **One EC1, 1 Lamb's Passage, EC1**, in March 2010 Hurford Salvi Carr sold 25 of the remaining 31 units at an exhibition in Hong Kong, with a pre-let in place to a serviced apartment operator and finance from an Australian bank. The firm has also forward-sold in Hong Kong 16 of the 39 apartments at the **Saunders Apartments**, developed by Telford Homes, to Hong Kong Chinese buyers. The block forms part of a mixed-tenure regeneration of the British Estate in the heart of the East End, off Bow Road, E3. Completion is set for mid-2011. At **Chandler's Quay**, Cable Street, E1, also by Telford Homes, we had sold 50% of the 18 unit scheme in the Far East by the end of June 2010.

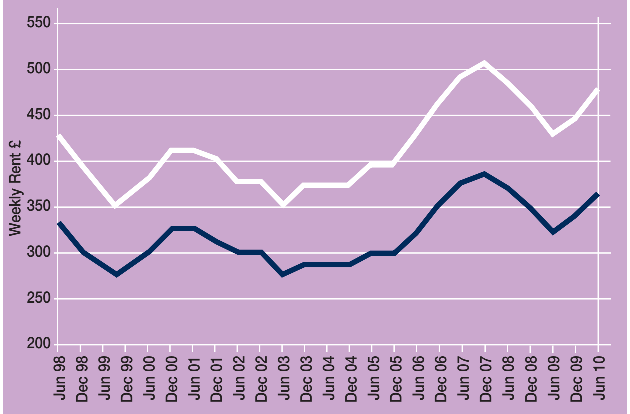
rental market

RENTS UP 7% DUE TO SUPPLY SHORTAGES

In the first half of 2010 residential rents in the Midtown, City and Docklands sub-markets increased on average by 7% in response to an imbalance in supply and demand (Figure 3). At June 2010, the rent for typical one and two-bedroom flats in the Midtown, City and Docklands market increased by £25-30 per week to £365 pw for one-bedroom units and £480 pw for two-bedroom apartments. There was also significant demand for larger and more expensive apartments and houses where rents can be as high as £2,500 pw.

Central London continued to emerge from recessionary conditions with a positive effect on recruitment in the employment market. According to Morgan McKinley, City job opportunities increased by 100% between April 2009 and April 2010, but the company, which publishes a monthly monitor, did note that job opportunities fell in April in response to the general uncertainly around the General Election. That ties in with our own data on the level of confidence in the housing market, where sentiment has been tempered since the General Election on 6th May.

FIGURE 3 : WEEKLY OPEN MARKET RENTS IN MIDTOWN, CITY AND DOCKLANDS 1998 - 2010



Source: Hurford Salvi Carr, CCR

In Midtown, City and Docklands, rental growth is normally associated with increased demand in the second half of the year. Significant rental growth in the first half of 2010 reflected both supply side and demand side factors. On the supply side, the level of development completions was reduced. At the same time, the proportion of new homes being sold to investors decreased due to the difficulties of raising Buy To Let (BTL) finance. Some accidental landlords put their properties up for sale in response to rising prices and this also reduced the size of the pool of rental property.

At the same time, "frustrated renters" were rebuffed in their attempts to become owner occupiers, due to high prices and the lack of competitive and reasonably priced mortgage products for first-time buyers. So the normal flow of renters to owner occupiers continued to be significantly stemmed. As a result, at renewal, we were able to negotiate increases in rents for our clients.

There were marginal differences between the three sub-markets, but each is predominantly affected by the structural factors mentioned above. In Midtown, although supply is restricted, tenant demand did not increase as much as in other markets. As a result rental growth here has been marginally lower at 5%. At the same time, there was a strong tendency for tenants to remain in situ at renewal, even though landlords typically sought increases in rents of between 2% and 5%. This created a relatively stable market with a low void rate.

Docklands continued to be driven by the continued recovery at Canary Wharf. In 2007 and 2008 Canary Wharf was badly hit by the banking crisis – not least, it was the London HQ of Lehman Brothers. Since early 2009, however, Canary Wharf has seen the arrival of office occupiers deriving from earlier pre-lets including KPMG and Fitch Ratings (Fimalac) and existing tenants such as Barclays Capital have expanded in situ. In June, Shell announced that it was to relocate 1,600 staff on a temporary (two to three years) basis from the Shell Centre at Waterloo to Canary Wharf while the Shell Centre is redeveloped. A return to growth in staff numbers at Canary Wharf has increased demand for rental property in locations such as Wapping, Limehouse, the Isle of Dogs and Poplar.

Investors in Docklands' rental property saw a return to price growth from the July 2009 and this has taken prices to 92% of the peak level achieved in September 2007. As a result landlords have placed rental stock on the sales market, where a very high proportion is being acquired by owner-occupiers (including first-time buyers), thereby stemming the growth of rental stock. As a result rents rose by 6% in the first half of 2010. Although there is a reasonable supply of standard two bedroom flats in larger blocks in Docklands, our lettings office at Limehouse reported a shortage of better quality stock in character warehouse conversions with features such as roof gardens.

The City witnessed burgeoning demand for rental property in the first half of 2010. Hurford Salvi Carr's lettings office in Britton Street, EC1, experienced a 40% increase in applicants registering for lettings between January and May 2010. Some of these applicants were seeking high-end properties at rents of £1,000-£2,000 pw.

In response to improved economic performance in financial and business services, the corporate tenant market which had been moribund in the recession, showed signs of renewed vigour in the first half of 2010. Early in 2010, Hurford Salvi Carr was approached by several serviced apartment operators seeking to acquire medium-sized blocks in close proximity to the City. This is also having the effect of removing capacity from the private rented stock.

JOHN STREET, WC1 - FAMILY HOUSE LET MARCH 2010 - £2,200 PER WEEK

investment market

OVERSEAS INVESTORS RETURN TO THE MARKET

In the first half of 2010 the residential investment market continued to be compromised by the lack of availability of bank finance on reasonable terms. The UK is evidently at the bottom of the interest rate cycle and potential investors are mindful that the cost of servicing loans is likely to rise in the medium-term.

As the FT commented, "The recession appears to have dissuaded casual Buy-To-Letters from re-investing, whilst the more professional investors continue to speculate." Indeed, as indicated in the rental market sector, some Buy-To-Let (BTL) investors are taking advantage of price rises to exit the Docklands and East London market and these units are more likely to be acquired by owner-occupiers than other BTL investors. UK-based BTL purchasers, although present in the Midtown, City and Docklands market, are few and far between in the circumstances.

That said, data from the Halifax on historic performance of a variety of investment media over the first decade of the 21st Century indicates that BTL property, with a total return of 187% was second only to precious metals (in itself a highly specialised investment). Each of the more common investments such as UK stocks, gilts and cash returned a lower rate than BTL property.

Gross initial yields in the Midtown, City and Docklands market continue to be low (Figure 4 and Table 4). In the first half of 2010 there were increases in both capital values and market rents. With rents rising at a very slightly higher rate, gross initial yields edged up by ten basis points to 5.3% on an average one-bedroom flat.

One significant addition to the investment market in the first half of 2010 was the expansion of the overseas buyers, mostly from the Far East. Exhibitions in Hong Kong, Singapore and Kuala Lumpar attracted strong interest from Asian buyers, as highlighted in the New Homes section. In some cases these were high net worth individuals looking for a safe haven, often cash buyers. Some buyers had strong links to London through children studying at London's third level institutions or working in the London offices of Asian firms.

In other cases, however, exhibitions offered individual investors a package deal including bank finance. This is a truly global market place, with say, an Australian bank lending to an Asian investor on the back of a pre-let to a US serviced apartment operator on an apartment block in London. One building, four continents! The decline in the value of sterling against Asian currencies had a significant impact on the willingness to invest, with London prices 20-30% below peak levels when taking currency fluctuations into account.

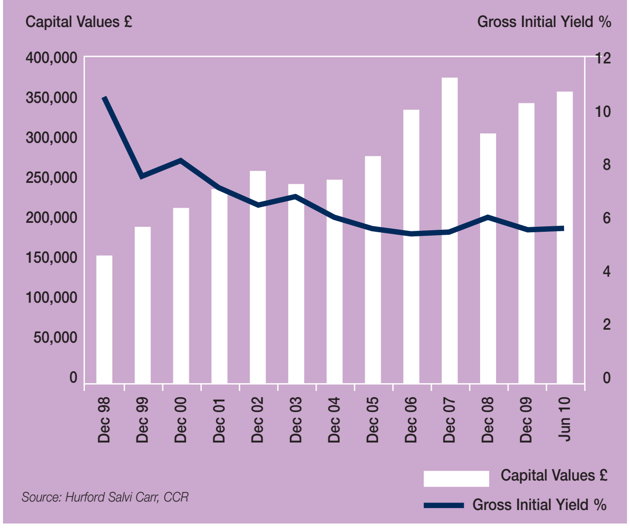
Residential development and investment still remains largely outside the purview of the main UK financial institutions, unlike in our European neighbours where insurers and pension funds play an important role in providing housing in markets where owner-occupation is less dominant. Private renting has increased in the UK in the last ten years as BTL emerged as a phenomenon, but it is in the hands of a huge number of diverse and small investors.

In order to better match the housing tenure and quality with a mobile labour force, successive UK governments have sought to promote institutional interest in the development of and investment in the UK private-rented sector. Such players could also bring a sense of scale to the private rented sector, with the potential to raise the standard and quality of accommodation and be more amenable to private-public initiatives such as estate regeneration schemes. A combination of expensive management issues and inappropriate fiscal rules and tax regimes have meant many false dawns.

In February 2010, the Treasury opened a round of consultation on reforms that could see the end of "bulk purchasing" rules for residential property. Because stamp duty is based on value thresholds in a block of, say, 50 units a bulk purchaser would have to pay the top rate of 4% (rising to 5% in April 2011 for transactions over £1 million), where individual buyers would pay between 1% and 3% depending on the price of each unit. The charges that property development and investment companies have to pay in order to secure Real Estate Investment Trust (REIT) status are also being looked into as these favour existing investment portfolios, whereas most entrants to the private rented sector would be looking to develop bespoke stock.

It has been reported that institutional investors, such as Aviva and Legal & General, are showing strong interest in getting involved in the private rented sector. These institutions are thought to be examining potential development and investment opportunities in the London residential market, including the Midtown, City and Docklands market.

FIGURE 4 : CAPITAL VALUES AND YIELDS FOR ONE-BEDROOM FLATS IN MIDTOWN, CITY AND DOCKLANDS 1998 - 2010



Source: Hurford Salvi Carr, CCR

TABLE 4: ILLUSTRATED INITIAL YIELDS FOR ONE BEDROOM FLATS IN MIDTOWN, CITY AND DOCKLANDS 1998 TO 2010

	Dec 1998	Dec 1999	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009	Jun 2010
Gross Annual Income £	15,600	14,300	16,900	16,120	15,600	14,820	14,820	15,340	18,200	20,020	18,220	17,680	18,980
Capital Value £	150,000	189,000	210,000	230,000	260,000	245,000	246,000	270,000	340,000	371,000	318,000	338,000	358,000
Gross Initial Yield %	10.4	7.6	8.0	7.0	6.0	6.0	6.0	5.7	5.4	5.4	5.7	5.2	5.3

Note : gross yields are typically reduced by 2.5% points by costs and voids

Source: Hurford Salvi Carr, CCR

market prospects

FORECASTS FOR 2ND HALF 2010 AND 2011

The first half of 2010 witnessed a continuation of trends established in 2009 for growth in both prices and rents in the Midtown, City and Docklands markets. The period ended, however, with a much more uncertain context for the future of both the sales and rental markets. The incoming UK Government's Emergency Budget is in effect an austerity package to correct the public finances, which will lead to pain before any future gain. On the positive side, however, the lower than expected rise in the CGT rate for gains arising from the residential investment market is unlikely to have a detrimental effect on investment in central London, where investors typically take a long-term view.

The Sales Market

In the sales market in Midtown, City and Docklands we expect to see prices remain stable in the second half of 2010, reflecting the impact of the Budget and the new Coalition policies on the economy in the short term.

A combination of factors is likely to maintain a healthy level of stock for sale during the second half of 2010. The abolition of HIPs has encouraged reticent vendors to put their properties on the market and test the enhancement in values over the past 12-15 months. The increase in prices is in itself a significant factor, as vendors no longer consider that they are anywhere near the bottom of the cycle.

Given that prices are close to peak level, we consider that even if demand picks up between September and November there will still be sufficient stock on the market to prevent prices from rising. We therefore expect no capital growth in the 2nd half of 2010.

Looking to the longer-term, it is structural factors which will determine price levels. The overall economic environment is likely to remain one of low inflation and low interest rates as the UK goes through a low growth phase due to an increased tax burden and the slashing of public expenditure over 5 years.

In the housing market, however, there is significant pent-up demand from "frustrated renters" seeking to become homeowners. Competition between mortgage providers in the longer term is likely to create the conditions allowing some of them to switch to owner-occupation, if they are prepared to pay current prices.

In the 1st Quarter of 2011 we expect to see an increase in the number of transactions for "high end" apartments in excess of £1 million, before the stamp duty rate at the £1 million threshold is raised from 4% to 5% in April 2011. We also expect to see individuals return to the residential market as an alternative to a conventional pension, allowing individuals independence from pension funds.

The Olympics is a significant local factor which is likely to lend an air of optimism to East London in 2011 and 2012 as the Games near. During 2011 the Stratford City retail development, which is alongside the Olympic Park will open with 1.9 million sq ft of retail and leisure space, that developer Westfield claims is the largest urban shopping centre in europe. As a result in 2011, we do expect there to be an effect on the demand side and there is no reason why nominal prices should not return to 2007 levels in 2011, albeit taking into account inflation they will be marginally lower, implying a growth rate of 3% in that year.

The coalition Government established the Office for Budget Responsibility (OBR) in May 2010, effectively a three person economic team led by Sir Alan Budd and including Geoffrey Dicks and Graham Parker. In both its Pre-Budget and Budget Forecast reports, the OBR included its independent view of UK house price change for the period 2010 to 2014. Its UK-wide projections are for 5.9% growth in 2010 to be followed by marginal growth of 1.6% in 2011. This is a not dissimilar to our own forecast for Midtown, City and Docklands which is, in effect, for 6% growth in 2010 to be followed by 3% growth in 2011.

Although the news for the macro-economy is not positive in the short-term, the Government's measures to curb spending will fall disproportionately on those parts of the country that are more dependent on public sector jobs. Central London is unlikely to be as badly affected by public spending cuts as other parts of the UK, due to the dominance of the private sector.

The Rental Market

Conditions in the rental market in 2009 and 2010, characterised by shortages of rental stock and increased demand from "frustrated renters", are likely to be maintained in the second half of 2010. Demand will be enhanced seasonally in September and October 2010 by the influx of students and graduate recruits into the Central London labour market. As a result we are projecting 5% growth in rents over six months, taking the annual increase to 12%. This is the most rapid rate of growth since 2006, when rents increased by an average of 18%. While this is good news for investors, it is a further burden to tenants and will provide a spur to those seeking to shift from being renters to owner-occupiers.

In 2011 we consider that the rate of rental growth is likely to be negligible as the market adapts to the new high level of rents. On the supply side, there is the potential for additional rental units to enter the market following the increased rate of sales over the past 12 months to overseas buyers, especially from Asia. On the demand side, the low rate of growth forecast for the economy combined with the impact of swingeing public sector spending cuts will impact on economic activity and job creation, even in the dynamic private-sector led central London labour market. Demand may also be reduced as some renters are finally able to secure mortgage finance on suitable terms to become owner-occupiers.

By 2012, however, the pendulum is likely to swing again. The low level of construction activity in most parts of our market will contribute to supply shortages. On the demand side, there will be a short-term effect from the Olympics. More significantly, the economy is projected to grow at twice the rate as in 2010 and London will have a significant part to play in that growth, leading to increased employment and enhanced job security. As a result, we anticipate that there is likely to be a return to rental growth in 2012.

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