research

from Hurford Salvi Carr

MIDTOWN, CITY AND DOCKLANDS

RESIDENTIAL REVIEW 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 complement 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.

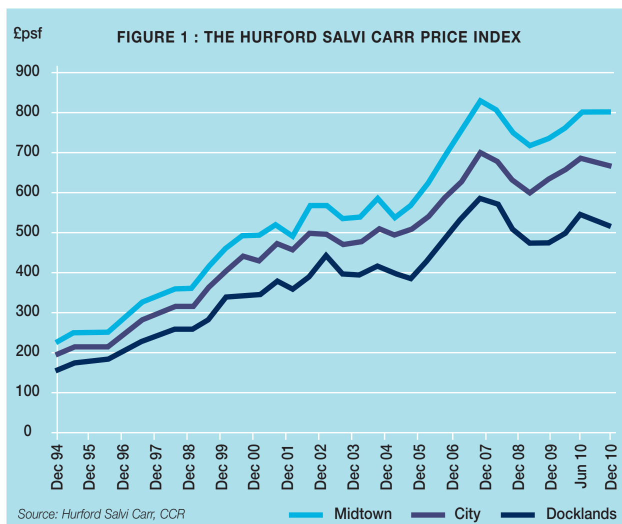
HURFORD SALVI CARR

market overview

YIELDS IMPROVE AS RENTS RISE

In the second half of 2010, Midtown, City and Docklands demonstrated the diverging fortunes of the sales and rental markets, illustrating at micro-level some of the broader structural changes in the UK housing market. After recording strong growth for 12 months to April 2010, sales prices stabilised in Midtown and fell marginally in City and Docklands during the second half of 2010. Confidence declined due to domestic political and economic factors, while interest in central London from Far Eastern investors, which had contributed significantly to the buoyancy of the new homes market, was more restrained. Although prices rose in 2010 by 4% due to growth in the first half, this masked an average 2% fall in prices in the second half of 2010.

Market fundamentals, however, continued to lend support to the rental market with demand exceeding supply. Rents rose on average by 4% in Midtown, City and Docklands over the six months to December 2010, in line with our mid-year projection. Annual growth in rents for 2010 was 11%. Falling prices and rising rents in the second half of 2010 led to increased initial yields for residential investment. Market prospects indicate that yields could rise further in 2011 to 6% or more, making investment in Midtown, City and Docklands residential property increasingly attractive, and we predict the return of UK Buy-to-Let (BTL) investors in 2011.



The Hurford Salvi Carr Price Index, based on average prices per sq ft in the re-sale market, illustrates the differences between the three sub-markets (Figure 1). In Midtown there was no evidence of price falls in the second half, while in the City and Docklands the reduction in prices was lower than the growth seen in the first half, so all three sub-markets showed annual growth in 2010.

- Midtown prices increased by 5% in the first half of 2010, but there was no change in the second half, giving annual growth of 5%.
- In the City, prices also increased by 5% in the first half of 2010, but fell by 2% in the second half, with annual growth at 3%, in line with UK headline inflation.
- In Docklands, a very strong growth in prices of 9% in the first half of 2010, was followed by a 4% reduction in the second half, so annual growth was 5%.

The rental market was supported by a range of factors in the second half of 2010. Demand continued to be inflated by the inability of frustrated renters to switch to owner-occupation in spite of the softening in the sales market. Prices remained historically high and loan-to-value (LTV) ratios required by the banks were in the region of 60-70%, requiring first time buyers to find a minimum of £100,000 deposit for a typical one-bedroom flat. At the same time, the level of rental stock in the market was kept in check by the lack of investment activity over the past three years (including bulk investment and BTL) and lower volumes of new construction.

Confidence in the sales market failed to recover in the second half of 2010 from the uncertainty generated during the lead-up to the General Election and its aftermath. The Emergency Budget of 22nd June 2010 laid out the Coalition Government's approach to reducing public sector borrowing from £149 billion to £60 billion by 2013-14. The detail of cuts in spending by department was the subject of the Comprehensive Spending Review (CSR) which, the Chancellor announced in his speech, would be published on 20th October 2010.

There was, therefore, a four month lead-in time to the CSR with much press speculation on where the axe would fall and the possible longer-term impact on the UK economy. This was not a context to engender confidence in the housing market. The Halifax index, for example, showed consistent negative quarterly returns for national house prices from April 2010 onwards. By the end of October 2010 annual growth in the index had been cut to 1.2% from 6.9% in May 2010.

UK volume housebuilders attributed a weaker than expected autumn selling period, second only in importance to the spring, to a lack of confidence caused by the build-up to the October CSR. Barratt, the UK's biggest housebuilder by volume, blamed the combination of the lead up to the CSR along with the lack of available mortgage finance. In November, its chief executive Mark Clare commented, "It won't come as a surprise to anyone if I say the autumn selling season was more challenging than we are used to. But there was a lot of media speculation about what was going to be in the spending review and potential buyers decided they didn't want to make a big financial commitment until there was more certainty."

In the CSR the Chancellor announced cuts in public spending of £81 billion between now and 2014-15. £46 billion of these savings are to come from cutting departmental running costs, with the Government aiming to reduce public sector employment by up to 490,000 by 2015. Inevitably there will be knock-on effects for the private sector. There is a broad consensus, however, that the impact on the economy will be most strongly felt in the regions where the public sector forms a higher proportion of economic activity. For central London, including Midtown, City and Docklands, the local impact of the cuts proposed in the CSR is likely to be less significant.

The availability of mortgage finance remained problematic and is likely to ease only marginally in future years. According to the Council of Mortgage Lenders (CML) gross lending in October 2010 was estimated at £12.4 billion, the lowest total for the month of October since 2000. The monthly average in 2007 was in excess of £30 billion and the CML commented that the mortgage market remained "subdued". Net lending was weak, amounting to only £112 million in September 2010, down from £1.62 billion in August according to The Bank of England. The number of mortgages approved for house purchase in September was 47,474, a fifth consecutive monthly fall and the lowest figure since February 2010. The Midtown, City and Docklands markets, however, are partially insulated from the weakness of the mortgage market by the greater proportion of equity-rich and outright cash-buyers.

The weakening in the sales market was mirrored in employment data for the City. In October 2010, The Centre for Economics and Business Research (CEBR) downgraded its earlier forecast of financial services jobs growth from 14,000 to 9,600 for 2010 and projected a rise of just 2,700 for 2011 in response to a hiring freeze reflecting an increasingly onerous regulatory environment and higher tax rates. Data on new job opportunities from recruitment consultant Morgan McKinley showed monthly figures declining from 6,048 in July 2010 to 4,725 in September, before increasing by 5% in October to 4,977. The firm's overall comment was that the trend for hiring was lower in the third quarter compared to the first half of 2010.

City bonus levels were projected by CEBR to be £7 billion for 2010 compared to £11.6 billion in 2007. Higher tax rates, however, mean that the net figure is actually £3.8 billion. The structure of bonuses, which include share options, is such that we do not expect to see a significant injection of bonus money into the Midtown, City and Docklands housing markets, which was a significant factor in the market up to 2007. On a more positive note, the stock market performed strongly in the second half of 2010, with the FTSE 100 Index rising from a 4,806 point close on 1st July 2010 to 5,875 on 9th November 2010, an increase of 20% and its highest level since mid-2008.

The Index weakened, however, in November 2010 in response to the deepening crisis in the Irish economy with the Irish Government having to call in the IMF and EU to rescue the country's banking system. There was concern that similar measures might need to be applied to other weak peripheral Eurozone economies such as Portugal, and even the zone's fourth largest economy, Spain. Confidence was also affected by the 22nd November "fire-fight" between North and South Korea.

The overall impact of these external economic factors was to reduce the level of confidence in the housing market in Midtown, City and Docklands resulting in a downward trend in new enquiries and in the number of sales agreed. Downward pressure on sales prices, however, was mitigated by limitations on the amount of stock on the market. Market conditions suggest that the level of stock for sale will continue to be constrained in 2011.

LIMEHOUSE MARINA, E14 - 2 BED FLAT LET DEC 2010 £390 PW, UP FROM £360 NOV 2009

As a result, the risks for price changes in the Midtown, City and Docklands sales market remain on the downside in the first half of 2011 with the likelihood of a further marginal reduction of 2%. In the rental market the combination of lack of mortgage finance, no growth in rental stock, a slow sales market and buoyant demand from tenants is projected to lead to a 5% increase in rent levels during the first half of 2011. Indeed, we consider that these factors will remain in place in the second half of 2011 with a further 5% growth in rents. Set against slack sales prices, we expect to see an increase in investment purchasers in the market as the 2011 progresses as evidence emerges of rising yields. This gives the potential for a modest recovery in sales prices in the second half of 2011, suggesting that across the year prices will remain stable.

sales market

A LOW DEMAND, LOW SUPPLY MARKET

In the sales market in the second half of 2010 there was a reduction in demand across all buyer segments for Midtown, City and Docklands residential property. This led to a reversal in the price growth evident in the first half of 2010, with an average fall across the entire market of 2%. There was a spectrum of pricing changes however from west to east, with no change in prices in Midtown, a 2% reduction in the City and a deeper 4% fall in Docklands.

During the period of rising prices, the growth in enquiries came from the following four buyer segments, but in each case the level of interest was reduced in the second half as follows:

- First-time buyers, already under pressure to find very large deposits retreated in the face of falling confidence levels.
- "Frustrated renters" already present in the market also faced difficulties with loan finance and with evidence of weakening prices many decided to delay potential purchase in the hope of further price reductions.
- Pied-a-terre purchasers, although at a lower level in line with market activity, were the main source of sales across all three sub-markets.
- Overseas buyers of investment property continued to be a feature of the market but at a lower rate than in the first half of 2010, with exhibitions converting a lower proportion of units into sales.

Pied-a-terre and overseas purchasers were driven by equity, giving these categories a distinct advantage over mortgage-dependent buyers.

Taking a chronological view, enquiry levels were reduced in July as the market absorbed the provisions of the Emergency Budget, including the changes to the benefits system, income tax, the raising of capital gains tax for higher rate taxpayers to 28% and the commitment that the VAT rate would rise from 17.5% to 20% on 4th January 2011. August was quieter than normal and then the hoped-for bounce back in September did not materialise. Overseas property exhibitions had a lower success rate than in the spring, while domestic buyers sat on their hands encouraged by continuing media coverage of the likely content of the CSR.

As banks continued to reduce their reliance on leveraging relative to the size of their balance sheets, analysts and fund managers were in agreement that the supply of credit would continue to reduce for some time. There was virtually no change in the second half of 2010 in the conditions attached to mortgages. Banks preferred to see

BERGLEN COURT, LIMEHOUSE MARINA, E14 - 3 BED PENTHOUSE SOLD NOV 2010 £770,000

40% deposits and were willing to offer more preferential terms to those borrowers, than those who could find "only" a 30% deposit. With mid-priced homes ranging from £500-700,000 in Midtown, City and Docklands, buyers typically had to find from £150-280,000 in cash deposits. The market is therefore restricted to buyers who can provide this level of equity from existing property, inheritance, the Bank of Mum and Dad (and Grandma and Grandad) or City bonuses. The banks are also under no pressure to significantly amend these terms, albeit it is expected that competitive pressures over the next few years will gradually increase LTVs as the public finances and the market stabilise.

On the supply side there was a distinct shortage of units for sale, especially in the secondhand market which is becoming increasingly important due to reduced levels of construction activity arising from the lack of development finance. The slowdown in new properties coming onto the market is of concern. Potential vendors have responded to reduced levels of buyer demand in three ways:

- taking their properties off the market for the time being,
- switching sale stock into the rental market, in effect becoming reluctant landlords,
- keeping property on the market at historic prices and refusing to consider lower offers.

SEKFORDE STREET, CLERKENWELL EC1 - FREEHOLD HOUSE SOLD SEPT 2010 £1,650,000

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	+4%	351,000	+13,000

Source: Hurford Salvi Carr, CCR

HARDWICK MEWS, WC1 - TWO BED FLAT SOLD NOV 2010 £1M

This protected prices and if there had been more units on the market then there would have been potential for a higher rate of price reduction. The price of a typical one-bedroom flat which had increased by £20,000 to £358,000 in the first half, witnessed a reduction of £7,000, shaving the annual increase to £13,000 (Table 1). In spite of this reduction, it remained the case that increased prices in 2009 and the first half of 2010 recovered most of the losses experienced in 2008, such that prices finished 2010 at close to historically high levels, only 5% adrift of the market peak in mid-2007.

There were important variations by sub-market in sales prices reflecting more localised supply and demand factors (Table 2). In Midtown, defined in the table as "Bloomsbury", prices were supported in the second half by restricted stock levels and robust demand which characterise this mature market. The annual price increase was 5%, leaving prices only 3% adrift of the most recent market peak in mid-2007.

In the City, the balance of supply and demand in the second half led to marginal reductions in prices of 2%, pegging back annual growth to just 3%. Prices remain relatively high, however, finishing the year 5% below the levels seen three years earlier.

TABLE 2: PRICE CHANGES FOR TYPICAL ONE-BEDROOM FLATS IN 2010 AND COMPARISON TO MARKET PEAK

Sub-Market	1st Half 2010	2nd Half 2010	2010	Peak to Current
Bloomsbury, WC1	+5%	0%	+5%	-3%
City, EC	+5%	-2%	+3%	-5%
Docklands, E14	+9%	-4%	+5%	-12%

Source: Hurford Salvi Carr

Docklands was the weakest of the three sub-markets in the second half, with prices drifting back 4%, but strong growth in the first half meant that annual growth was relatively high at 5%. Compared to the peak, Docklands prices were still 12% lower than the peak, reflecting local structural factors of higher supply and the greater impact on demand from weakness in the employment market in 2008 and early 2009.

Translating these changes into actual prices for an average one-bedroom flat in each market gives an indication of the range across the three sub-markets (Table 3). In Bloomsbury the price of a typical one-bedroom flat of 500 sq ft in December 2010 was £420,000 (£840 per sq ft) compared to £383,000 (£766 per sq ft) in the City and £308,000 (£616 per sq ft) in Docklands.

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

Sub-Market	Dec 2009 £	Dec 2010 £	Dec 2010 Price £psf	Change Dec 09 - Dec 10 (%)
Bloomsbury, WC1	398,000	420,000	840	+£22,000 (+5%)
City, EC	372,000	383,000	766	+£11,000 (+3%)
Docklands, E14	293,000	308,000	616	+£15,000 (+5%)

Source: Hurford Salvi Carr

In Midtown, including Bloomsbury, Holborn and Fitzrovia, the general shortage of stock for sale supports prices in a market which is driven more strongly by owner-occupiers and less by the rental sector and investors. The range in the market is from studios at £250,000 to period homes for around £4 million, but the main focus for the market is one and two-bedroom units priced from £400-800,000. In Docklands, on the other hand, the core of the market is two-bedroom apartments from £350-450,000, but the market has a stronger emphasis on the rental sector and investor purchasers.

The City lies somewhere between the two in terms of both pricing and buyer profile, with the most buoyant segment of the market being two-bedroom units priced at £500-600,000. One-bedroom pied-a-terre's in the City continued to be popular with buyers. Two-bedroom units priced in excess of £600,000 generally take longer to sell, but there is good interest in larger units priced in excess of £1 million for UK and international buyers looking for a home in the capital.

GRAY'S INN ROAD, WC1 - 2 TWO BEDROOM FLATS SOLD OCT 2010

new homes market

LACK OF SUPPLY SUPPORTS PRICES

Aside from the overall lower level of confidence in the sales market generally, the new homes market was influenced by two factors. First, on the demand side the level of interest in the market from the Far East, which had significantly boosted demand from mid-2009, was reduced with a much lower rate of sales to overseas purchasers in the second half of 2010. Second, on the supply side the number of schemes and units underway has been significantly curtailed by the absence of bank lending to the residential development sector. In terms of pricing levels, these two factors cancelled each other out and there was no change to new homes prices, but the rate of sales was significantly reduced. Major developments such as The Heron, Bezier and Frobisher Crescent experienced a much lower rate of sales in the second half compared to earlier in the year.

THE TAPESTRY BUILDING, EC2 - LAUNCHED SEPT 2010

Development launches which took place in the second half of 2010 give an indication of the state of the market for new homes across Midtown, City and Docklands. In the City September 2010 saw the launch of **The Tapestry Building**, New Street, EC2, where Westlin Homes has converted a listed eighteenth century warehouse into 14 very spacious apartments, immediately east of Liverpool Street station. The building was originally part of the East India Company's Cutler's Gardens, where the majority of the complex was converted into the Devonshire Square office scheme in the early 1980s by Greycoat, itself a ground-breaking development which helped to establish this part of the City as an acceptable office location.

The Tapestry Building's 14 apartments have retained many of the original features of the warehouse such as exposed timber beams and impressive cast-iron columns, while incorporating the best of contemporary design and finishes including comfort cooling, intelligent lighting and entertainment systems. Ranging in size from 1,325 to 2,708 sq ft for two-bed apartments and one 2,870 three-bed penthouse, prices start from £1.4 million averaging £1,100 per sq ft. By November two of the apartments had been reserved, but this was a reflection of the generally lower rate of sales market activity.

At **67 Turnmill Street**, EC1, after a successful launch of five units in May 2010, Marldon launched a second tranche of five units in October 2010. By the end of November each of these had been reserved at the asking price. Turnmill Street is beside Farringdon Station, which is set to become one of the best connected transport interchanges in London. Improvements are already underway to the existing station and by 2017 CrossRail services will commence in addition to the enhanced Thameslink services and existing Underground lines. There will be a positive impact on property values as a result. Prices in the second phase launch ranged from £470,000 to £700,000 for one and two-bedroom units, reflecting an average price of £856 per sq ft and illustrating the strong demand for high specification accommodation in Clerkenwell. The final tranche of three penthouse apartments is set to be released in January 2011.

LAVENDER HOUSE, E1 - LAUNCHED SEPT 2010

In East London, adjacent to Limehouse DLR station, **Lavender House**, Commercial Road, E1, was also launched in September during construction, with completion of this new residential building scheduled for January 2011. The developer, Magri Group, has a strong track record in East London and the building contains 23 one to three-bedroom apartments on 1st-5th floors. The development is strategically located between the City and Canary Wharf, with Bank station two stops and Canary Wharf three stops from Limehouse DLR. Prices range from £300,000 to £460,000 with an average price of £456 per sq ft. By the end of November eight of the units had been sold or reserved, reflecting a sales rate of 35%.

Although Far Eastern sales were less significant during the second half of 2010, there was a successful off-plan exhibition launch in Singapore of a new development **The Hawksmoors**, located on The Highway, E1, by Telford Homes. This new building, comprising an infill development on a council estate, will not be completed until the spring of 2012. 16 of the 52 units were reserved at the exhibition to investors in a package deal incorporating Hurford Salvi Carr's lettings service. Prices range from £235,000 to £375,000 for one and two-bedroom apartments.

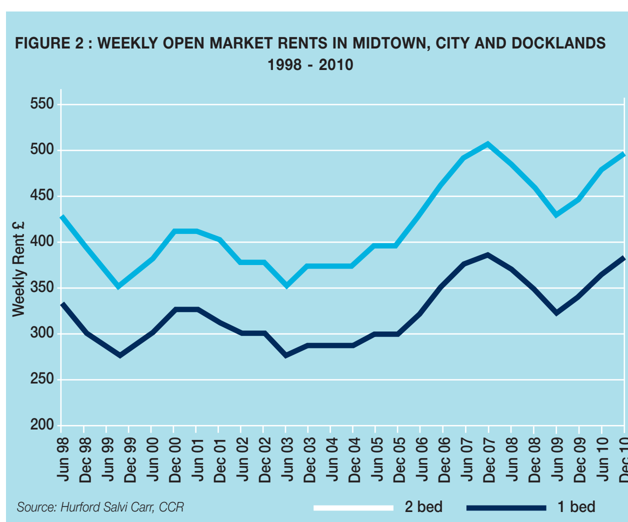
The market for new homes will continue to be influenced by lower levels of supply into 2011. In the second half of 2010, according to London Residential Research (LRR) there were 950 units completed across the Midtown, City and Docklands market, but 646 of these were in a single development, The Landmark, Marsh Wall, E14, leaving a further 304 units in just 17 schemes. In Midtown, including Bloomsbury, Holborn and Covent Garden, there were effectively no new homes available.

In 2011 completions are estimated at only 1,000 units spread across 26 schemes, around half the rate of completions in 2010. It is likely, however, that completions will increase in 2012 and 2013 with four major schemes already under construction set to complete with a total of 860 private units: Avant Garde, 32-42 Bethnal Green Road, E1, (257 units), 721-737 Commercial Street, E1 (215 units), Eagle House, 159-189 City Road, EC1 (206 units) and Central Square, Central Street, EC1 (182 units). The pipeline of smaller boutique developments of less than ten units across Midtown and the City also indicates that 2012 will see a better supply than 2011.

rental market

RENTAL GROWTH CONTINUES

In the second half of 2010 there was evidence of continuing strong growth in rent levels across the Midtown, City and Docklands sub-markets with an average rate of increase of 4% (Figure 2). This took the annual rate of increase to 11% and back to level of the most recent market peak in December 2007. Rent levels have been increasing since June 2009, since when there has been growth of 17% overall. Growth in rent levels reflected both enhanced demand and restricted supply. To illustrate the lack of supply, our offices would normally have 30-50 rental properties available at any one time, but in November 2010 rental properties on the market were restricted to single figures.



The demand side continued to be artificially inflated by "frustrated renters" unable to switch into owner-occupancy, a trend which is set to continue for the foreseeable future. In addition, the combination of local and national evidence of falling prices was a deterrent to buyers. Those frustrated renters who had not given up hope of being able to buy took a wait-and-see attitude with the prospect of the potential for lower prices in the future. Albeit, conditions in the mortgage market are unlikely to significantly improve the prospects of buying in 2011.

On the supply side the stock has become relatively fixed due to a number of related factors. The level of additional new homes being completed, as indicated in the new homes section, is running at lower levels than in the period up to 2008. In addition the proportion of new units being acquired by all categories of investors, including Buy-to-Let has been reduced as owner-occupiers increased their share of the market. There is also an impact on the supply side due to increased activity of serviced apartment operators, which largely address the corporate short-term lettings market. Serviced operators are acquiring mid-sized blocks across central London, including Midtown, City, City Fringe and Canary Wharf within our area, thereby removing stock from the conventional lettings market. There is some potential for additional supply, however, deriving from the slackening of the sales market, with some vendors becoming "reluctant landlords" until there is a return to price growth.

The impact of the imbalance between supply and demand was to reduce void periods to virtually zero. The choices for tenants seeking to move were restricted by the lack of supply, forcing occupiers to remain in situ and to negotiate new leases at higher rents. The rate of rental growth in the second half of 2010 did vary by sub-market, reflecting local market conditions and the supply and demand balance. In Docklands the rate of growth was only 2%, reflecting a greater level of available properties compared to the City and Midtown, in a market which is more dominated by investment property tending to increase stock levels. This was reflected in the turnover rate in our Docklands office which was at record levels. High levels of demand were matched by a healthy level of supply.

In Midtown the rate of rental growth was 4%. Here the supply side has been influenced by the strategy of major landowner, The Bedford Estate, to increase its stock of private-rented accommodation through change of use. Typically these are office to residential conversions although there have also been conversions of small-scale hotels into residential.

BLOOMSBURY SQUARE, WC1 - THREE BED FLAT LET JULY 2010 £850 PW

The highest rate of rental growth was in the City sub-market, where rents increased by 6% in the second half of 2010. It is in this location that demand has been most buoyant and the supply of new properties to the rental market the most restricted, with many tenants forced by market conditions to renew in situ, extending their tenancies at the end of their original twelve month term.

Provisions in October's Comprehensive Spending Review (CSR) for Government spending on housing may also have an impact on the attractiveness of the private rented sector as an investment. The CSR cut the affordable housing fund by 50% from £8.4 billion to £4.5 billion. At the same time, it was announced that although rental terms for existing social rented tenants will remain unchanged, new tenants will have to pay rents set at 80% of the market rate, up from the current threshold of 50%. New social housing tenants will also not have the security of "tenancy for life" but rather a "flexible tenure" based on regular means-testing. The result of these changes could be an increase in demand for private rented stock.

There was, however, a significant change to the social housing benefit system which currently accounts for £20 billion a year in spending. A national capping system is to be introduced ranging from £250 per week for one-bedroom to £400 per week for four-bedroom properties. This is likely to have significant implications for tenants in central London in receipt of housing benefits. Where landlords do not reduce rent levels to match the capped levels, there is the potential for tenants to be unable to meet their housing costs and be forced to relocate to cheaper areas. Broadly speaking there could be a shift from Inner to Outer London and beyond, thereby freeing up some private rented stock in Central London to non-DSS tenants. The latest indications at the time of writing were that this proposal would not be implemented until April 2012, giving more time for housing benefit recipients to make any necessary changes in response to the capping scheme.

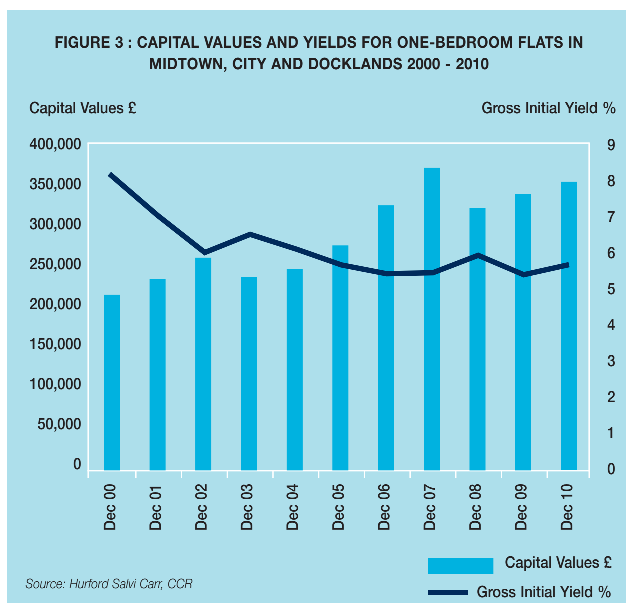
investment market

ACTIVE INVESTMENT IN SERVICED APARTMENTS

In the second half of 2010 there was some evidence of a revival of interest in residential investment in the Midtown, City and Docklands markets, albeit evidence of transactions remained thin and patchy. The availability of loan finance both for bulk and Buy-to-Let (BTL) investors remained restricted, while there was less demand for investment property from overseas investors. On the other hand, structural changes in the market restricting the ability of tenants to become owner-occupiers increased demand for rental property. This led to higher rent levels which created support for the investment market.

At the national level there was some encouraging data from the Council of Mortgage Lenders (CML). In November the CML reported an increase of BTL lending of 12% in the third quarter, supported according to the CML by "ongoing demand for rental property against the backdrop of a dysfunctional owner-occupier market." 26,900 BTL loans were advanced in the third quarter, an increase of 8% in volume and 12% in value and the second consecutive quarterly increase. By historical standards, however, the overall rate of new lending is relatively low, at levels last seen in 2002.

Individual mortgage providers also reported increased interest in BTL in the second half of 2010 with Largemortgageloans.com commenting in the Financial Times that "We are seeing an increase in buy-to-let enquiries as property prices have, in general, fallen slightly and rents charged have increased leading to more attractive yields." Lending terms remain onerous, however, with lenders requiring between 25% and 50% deposits and rental coverage of 125-130%. In September, Paragon, the BTL mortgage provider that had been out of the market since 2008, resumed lending to customers giving another indication of improving investment prospects.



The second half of 2010 saw an upturn in gross initial yields in Midtown, City and Docklands in line with wider national trends (Figure 3 and Table 4). With prices eroded by 2% and rents increasing by 4%, gross initial yields for a typical one-bedroom flat increased by 30 basis points from 5.3% to 5.6%. This followed a more modest rise in yields of 0.1% points in the first half of 2010, which was exclusively driven by rental growth. The last time yields were at this level was in 2008, but the context then was very different – rent levels were falling and the adjustment in yields resulted from a steep fall in capital values.

There was one significant bulk purchase in Clerkenwell in the second half of 2010 at 156 St John Street, EC1. Here the head lease of 48 private units in a single block was put on the market by the receiver to the development in September 2010, inviting offers in excess of £20 million. By November the building was under offer to a single investor after significant interest from a number of parties. The purchaser intends to put the units into the rental market.

One market segment which did see significant investment activity in Midtown, City and Docklands in 2010 was the specialist serviced apartment sector. These investments are typically underpinned by ten year leases where the base rent is equivalent to what would be achieved through AST lettings of the units. Demand from serviced operators has increased in line with the accommodation needs of major corporates seeking to accommodate staff for periods up to three months. As a result operators have been targeting individual units as well as whole blocks and this has underpinned the sale of individual investments – in some cases in the Far East.

In September 2010 The Treasury concluded its consultation on investment in the private rented sector, which had commenced under the previous Government in February 2010. In particular, the consultation addressed the issue of the Stamp Duty Land Tax (SDLT) rate for bulk purchases, where some consultees had argued for the payment of SDLT at the lower rates implicit for individual units of 1% to 3%, rather than the top rate of 4%, which is due to rise to 5% on 6th April 2011 for residential property over £1 million. The Government was unconvinced that such a change would have a material affect on viability and that in any case the cost to the Government would not be acceptable set against the need to reduce the budget deficit. Reducing VAT rates for management fees and repairs and maintenance of private residential property was also ruled out on the same grounds.

Press commentary indicates that institutions which are targeting the private rented sector will not be deterred by this lack of support from the Government. Consortia such as Aviva Investors with residential management firm Pinnacle, and Aegon with property developer Terrace Hill, are actively raising initial equity.

TABLE 4: ILLUSTRATED INITIAL YIELDS FOR ONE BEDROOM FLATS IN MIDTOWN, CITY AND DOCKLANDS 2000 TO 2010

	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009	Dec 2010
Gross Annual Income £	16,900	16,120	15,600	14,820	14,820	15,340	18,200	20,020	18,200	17,680	19,760
Capital Value £	210,000	230,000	260,000	245,000	246,000	270,000	340,000	371,000	318,000	338,000	352,000
Gross Initial Yield %	8.0	7.0	6.0	6.0	6.0	5.7	5.4	5.4	5.7	5.2	5.6

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

Source: Hurford Salvi Carr, CCR

market prospects

FORECASTS FOR 2011

In the second half of 2010 the Midtown, City and Docklands residential markets were strongly influenced by external political and economic factors. The May 2010 General Election and subsequent provisions of the Emergency Budget and the Comprehensive Spending Review dented confidence in the housing market. The austerity package will have a significant impact on economic conditions over the next four years, but particularly in 2011 due to the front-loading of public sector cuts. The international outlook, especially in the eurozone, is uncertain.

Recent growth in the sales market had been dependent on equity-driven overseas investors and UK cash-buyers, but by the end of the year there was a general lack of confidence, with lower transaction levels and reduced prices. The rental market, however, was buoyed by the relatively healthy central London employment market, barriers to owner-occupancy and a general shortage of rental stock. The trends for both the sales and rental markets established in the second half of 2010, we expect to see continue in 2011 against the background of an economy characterised by low interest rates and low growth.

The London 2012 Olympic Games will have an increasing influence on the residential property market in 2011 and 2012. Midtown, City and Docklands have excellent access to the Stratford Olympics site and will benefit from the positive publicity generated in the lead-up to the Games. In the meantime, 2011 will also see the opening of Westfield's 1.9 million sq ft Stratford City shopping centre which has secured Marks & Spencer, John Lewis and Waitrose as anchor tenants. This development will have a significant positive impact on residential markets within its extensive catchment.

The Sales Market

The implementation of the Government's austerity programme will continue to have a significant influence on levels of confidence in the housing market. On 4th January 2011, the VAT rate is set to increase from 17.5% to 20%, which is likely to dampen demand for goods and services with knock-on effects across the economy. On 6th April 2011 the new rate of stamp duty of 5% for residential sales in excess of £1 million comes into effect. We can expect to see an increase in activity at the high end of the market in response to this in the first quarter of 2011 and a concomitant slow down in activity once the measure comes into effect.

In the sales market in Midtown, City and Docklands we expect to see prices weaken slightly in the first half of 2011, with a marginal reduction of 2% continuing the trend seen in the second half of 2010. This reflects the reduced level of confidence in the market arising from the economic outlook, but is set against the restricted amount of stock coming on to the market.

In our view the overall level of transactions will remain relatively low in the first half of 2011. Some vendors will withdraw from the market given evidence of weakness. The fact that rents have been rising and look set to continue increasing will encourage some owners to put their property on the lettings market on a temporary basis.

On the other hand we do envisage the market being strengthened in the second half of 2011 by increased interest from investor purchasers driven by evidence of rental growth and higher yields. As a result, there is potential for the rate of transactions to rise in response to increased activity, including from Buy-to-Let (BTL) investors. This could lead to a stabilisation or marginal increase in sales prices in the second half, so overall we see no change in prices as the most likely scenario for 2011. This is in line with other forecasts for central London house prices.

The prospect of an increase in gross initial yields could become an increasingly important factor in the sales market as 2011 progresses. Our indicative average yield for a one-bedroom flat was 5.6% at the end of 2010. If rents continue to rise at around 10% per annum and prices remain flat, then yields will increase to 5.9% by mid-2011 and 6.2% by the end of 2011. Yields in excess of 6% are likely to attract investors and be supported by BTL mortgage lenders, so there is potential for a return of BTL investment, albeit not of the scale experienced up to 2007.

Meanwhile, pent-up demand from frustrated renters will continue to be a dormant presence in the sales market. As conditions in the mortgage market ease over the next few years, then we can expect a drip-feed of first-time buyers to enter the sales market and lend support to prices. The sales market is also likely to remain supply-constrained until there is a significant increase in new homes completions which is unlikely before 2012-2013.

The Rental Market

The fundamentals underpinning rental growth look set to be maintained in 2011 with:

- limited additions to rental stock in both the new homes and secondhand markets,
- demand for rental stock being maintained as employment levels in central London are maintained and possibly enhanced,
- barriers to securing mortgage finance keeping occupiers in the rental sector for longer than was historically the case.

As a result we consider that there is potential for rents to increase by a further 8-10% by the end of 2011. Under this scenario, rents will have risen by 29% over two and half years from mid-2009, based on fundamentals which are unlikely to be radically altered in the medium-term. Renting is now more expensive than buying when comparing monthly interest-only mortgage payments at a notional 5% interest rate for a two-bedroom flat, compared to monthly rent.

Ultimately the health of the Midtown, City and Docklands rental market is dependent on economic factors and their impact on employment levels in central London. There is broad agreement that the UK economy recovered more rapidly than expected from the recession, posting four consecutive quarters of growth in GDP to third quarter 2010. The IMF forecast 1.7% growth in GDP for the UK in 2010, increasing to 2% in 2011. The Purchasing Managers' Index (PMI) for September 2010 showed three key London indices move into positive territory for output of goods and services, new orders and employment. Increased activity the latter part of 2010 provides the basis for marginal growth in employment in 2011.

Looking further ahead, the rental market is also likely to be boosted on a temporary basis by the Olympics. In our view from mid-2011 onwards there is likely to be a premium attached to rental property with good access to the Olympic Park. Both owners and tenants will look to take advantage of a huge temporary boost to demand in the lead-up to and during the Games from support staff, temporary workers, the world's media and, of course, the spectators. Those who can sub-let or offer short-term lettings to meet these needs can expect to secure a welcome one-off windfall of premium rent. Hurford Salvi Carr is actively working with our clients to achieve premium rentals for the Olympic period.

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