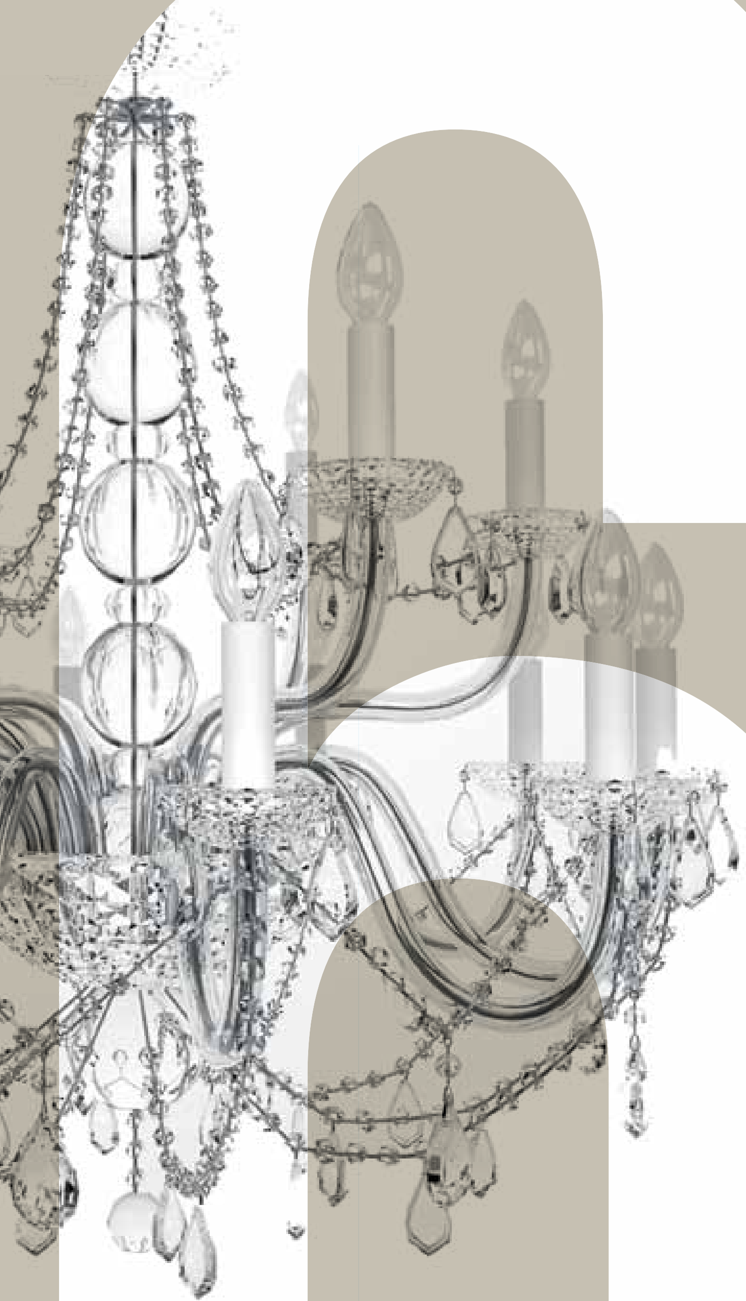

CHAPTER
SIX

IS PRIME RESIDENTIAL PROPERTY THE NEW GOLD?

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SAVILLS

CHESTER TERRACE
This beautiful four-bedroom home is in one of London's prime residential areas and has direct views over Regent's Park.

Prime residential property in the capital is outperforming almost every other investment sector. We discover why London's streets are paved with gold

THE BRIEFING

London's prime residential property is seen by wealthy overseas investors as a low-risk, high-growth asset.

Property assets offer higher yields than government bonds.

Prime residential property prices in central London rose by 81% between 2005 and 2011.

An ultra-prime market, based around Belgravia, Knightsbridge and Mayfair, has been created by cash-rich overseas buyers.

One Hyde Park, the luxury flagship Knightsbridge development, is the world's most expensive property. With architecture by Richard Rogers and interior design by Candy & Candy, the apartments have eye-catching selling points, including an unrivalled location, 21-metre ozone swimming pool, and a 24/7 concierge service from the Mandarin Oriental hotel next door.

But it's not just the luxury lifestyle that is attracting wealthy new owners. They are also looking to invest in a new asset class – prime residential property.

"This kind of high-level real estate investment represents not just a buying opportunity at the pound's current low levels, but a safe haven for wealth," says Yolande Barnes of Savills Global Research. "Central London residential real estate of this kind is increasingly behaving as an asset class of its own." →

Words: Heather Farmbrough

Prime property, as an asset class, acts like gold. In uncertain times, buyers are attracted by the stability and security of the investment, which is underpinned by attractive economic and political factors. Most importantly, demand outstrips scarce supply, creating a strong market. Add to that a stable currency and established political and legislative processes, and it's easy to see why London's prime property is considered to be a low-risk, high-growth asset.

But, like all investments, the devil is in the detail. Prime property doesn't apply to all of London, but refers to specific areas – most notably Knightsbridge, Belgravia, Mayfair, Chelsea, Kensington and Holland Park, South Kensington, Notting Hill and the north of Regent's Park.

So it's important for investors to pick wisely. These areas are outperforming the London market as a whole because they attract cash-rich overseas buyers. Prime residential property prices in central London rose by 87% from June 2005 to June 2011, compared with an average increase of just 25% for residential stock across London as a whole.

Within the prime market itself, one core area stands out – the triangle of Belgravia, Knightsbridge and Mayfair. "We are increasingly looking at an 'ultra-prime' market," explains Dominic Grace of Savills Residential Development. "The prime market is influenced by what happens in the City of London, but the ultra-prime market is about the global economy and is seemingly less immune to problems."

International uncertainty is motivating investors. As a rule of thumb, the more unstable a country is, the more likely its affluent citizens are to buy into London's prime property market. When Italy announced a tax amnesty, it triggered a release of money held by Italian citizens in Swiss bank accounts, which flowed directly into the London property market. Not surprisingly, estate agents are reporting that

SAVILLS

HAMILTON TERRACE

St John's Wood is tipped to join London's ultra-prime addresses. This six-bedroom house combines a luxurious interior with beautifully landscaped gardens.

Greek buyers have also been active, especially in the market for properties worth over £3 million. Political uncertainty in the Middle East is also creating an increased level of interest from Arab buyers.

"If you're looking for an investment in a safe haven when there's a stormy climate, you have to look at something you hope will preserve its value in a stable economic and political environment," comments Professor Colin Lizieri, Grosvenor Professor of Real Estate Finance at Cambridge University. "In those circumstances, the returns are less important than the preservation of capital."

Rupert Sebag-Montefiore, head of Savills Global Residential, is confident that the capital value growth of prime central London residential assets will outperform many commodity markets – rising in line with West End offices and UK gilts, which are also currently popular with investors.

"

PRIME PROPERTY IS CONSIDERED TO BE A LOW-RISK, HIGH-GROWTH ASSET

While he accepts that volatility in the eurozone will affect the family homes market outside the key ultra-prime areas, and bonuses will shrink in 2012, these factors will be outweighed by global investors looking for a safe haven.

"Investment in prime property, whether for lifestyle, business or stability reasons, is a growing trend among the world's super rich," he explains. "It's a trend we believe is set to continue."

As well as the economic basics of supply and demand, there are macro-economic forces that are also driving the prime property market. Globally, overly indebted countries and persistent inflation, together with decelerating economic activity,

PRIME NUMBERS

Wealthy overseas buyers have joined UK nationals to drive the prime residential market, creating a sustained boom in key locations

Over the past six years, prime residential prices in central London rose by 87%, compared to an average of 25% across London as a whole.

£5 MILLION

Thirty years ago the average price of a property in Savills Prime Cental London index was £314,000. Today it is £5 million.

Over one in five foreign nationals is buying for investment. Less than half of buyers are acquiring property as their main residence.

KENSINGTON & CHELSEA THE CITY OF WESTMINSTER

They have 6.2% of the city's housing stock but account for 16.3% of its value.

Prime Mayfair property now costs, on average, between £2,500 and £3,000 per sq ft.

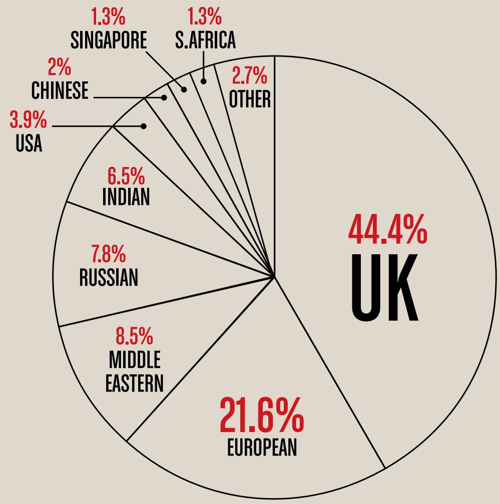
TOP 10 PRIME RESIDENTIAL AREAS BY PRICE GROWTH, 2005-2011

1. MAYFAIR 117%
2. MARYLEBONE 107%
3. BELGRAVIA 94%
4. KNIGHTSBRIDGE 93%
5. CHELSEA 91%
6. NOTTING HILL 89%
7. REGENTS PARK 88%
8. KENSINGTON/ HOLLAND PARK 80%
9. SOUTH KENSINGTON 77%
10. ST JOHN'S WOOD 69%

EATON SQUARE SW1
CITY OF WESTMINSTER

London's prime address is Eaton Square, where price growth has averaged 130% over the past six years.

THE MOST ACTIVE BUYERS OF PRIME CENTRAL LONDON PROPERTY



Complied by Laura Latham Source: Savills are presenting investors with a challenge – how to turn cash into capital.

It's not an easy problem to solve. The usual investments are underperforming. US Treasury bond yields are at record lows and equities are likely to remain volatile. Even the prospects for gold are looking uncertain. Oxford Economics expects the price of gold to fall by 37.1% by 2016.

At BNP Paribas in London, Andrew Cruickshank argues that given low bond market returns and high stock market volatility, real estate appears an attractive investment. "Property assets offer higher yields than government bonds," he says. "The vast majority of investors stay interested only in the most secure products in core markets."

While equity markets can reasonably be expected to recover over the longer term, prime residential property offers considerable short to medium-term potential. Compared to the factors impacting on other asset classes, the potential downsides to London's prime property are very low.

Property prices in the core market could be adversely impacted by external events, such as terrorism, but historically and relatively the risk is minimal. There is also the possibility of services and infrastructure failing, as happened in New York in the late 1970s and early 1980s, but this seems relatively unlikely.

Indeed, the underlying picture is positive. London has fought back as a city and remains the world's leading financial services centre. It's evolving into one of a handful of worldwide super-cities in the early part of the 21st century and, in an Olympic year, all eyes will be on the capital.

What's more, property has the ultimate benefit of being an asset that it is possible to gain income from – in the form of rent. Failing that, a valuable home in the centre of London is still seen by global investors as the jewel in the crown. ❖

SAVILLS

ONE HYDE PARK

Jonathan Hewlett, Head of Savills London Residential

≥ Smart investment and smart living combine at One Hyde Park. Designed by renowned architect Richard Rogers, it's in the best location (close to Harrods and overlooking Hyde Park), has five-star concierge service provided by the Mandarin Oriental hotel and beautiful interiors created by Candy & Candy. The on-site amenities and facilities rival any five-star hotel and include a private cinema, a 21-metre ozone pool and a state-of-the-art gym and spa. So it's not surprising that apartments here have regularly reached on average £6,000 per sq ft – and most recently £7,000 per sq ft – a record for London that establishes One Hyde Park as the capital's most exclusive address.

A fund of ideas

IS IT TIME FOR INVESTMENT FUNDS TO TARGET PRIME RESIDENTIAL PROPERTY?

The residential Prime Central London (PCL) market has delivered long-term capital growth of 8.5% a year. It's a strong performance that's attracting the attention of institutional funds.

"We are increasingly involved in the bulk purchase of flats in London," says Ed de Jonge of Savills Development. "This is very much a symbiotic relationship between the developer and the investor, with the latter benefiting from a discount to market value on a purchase of, say, 50 units or more and the developer off-loading risk by selling part of a scheme at the outset of the construction process."

Even so, volume can be an issue for investors. "The difficulty for a big fund like ours is to get enough assets of sufficient value to be significant," says Philip Nell, manager of the £1.5 billion Aviva Investors Property Trust.

Successful investors tend to focus on capital growth (accounting for around 80% of PCL total returns) rather than income. The rewards can be impressive. Naomi Heaton, who is the CEO of London Central Portfolio, which is fundraising for its second closed-ended PCL fund, expects to generate 60-80% returns over the five-year life of the fund, adding value through refurbishment.

Words: Faith Glasgow

AT HOME IN THE OFFICE

Tim Whitmey of Savills London Residential Development reveals a new type of office conversion

The disparity between commercial and residential values in London has created a new development trend – the conversion of redundant offices into apartments. In the borough of Westminster alone an estimated 4 million sq ft of office space has become residential in the past decade. The trend is escalating, with niche developers like Amazon Properties, Brooks Place Properties and Dukelease now specialising in office conversions. In the next few years some iconic buildings, including the US Embassy and Centrepoint, are set to be converted.

The government appears to be in favour of the move. Chancellor George Osborne has gone on record saying the estimated 9% of office space that is lying empty across the UK could be turned into as many as 250,000 homes by 2026. His administration now wants to relax the current planning laws to make it much easier for developers to win consent for office conversions.

However, the momentum is not unstoppable and investors should be aware of the technical, commercial and political obstacles that can make conversions expensive and sometimes unfeasible.

Tim Whitmey of Savills

The physical dimensions of offices mean very few can be converted to homes on a simple storey-for-storey basis. Offices that were built more than 30 years ago usually have low ceilings, while modern buildings tend to have tall ceilings packed with air conditioning equipment. Both can make the space expensive to convert.

It's also worth bearing in mind that not every borough in London is keen to see the loss of office accommodation. In fact, some are actively resisting the idea.

The City of London has made the running on the opposition to conversion, arguing that its status as a global financial services centre could be jeopardised if no "spare" office space is available when the economic recovery appears.

Finally, some industry analysts believe potential conversions have fallen victim to political infighting. Planning authorities, which are unhappy at reduced government funding, fear the relaxation of planning laws would mean that future conversions would no longer require consent. As a result, there would be fewer "planning gain" payments by developers, of the kind that typically provided funding for local projects, such as social housing.

These obstacles haven't deterred investment interest in office conversions, especially as demand for prime London residential stock remains high. But they certainly add unique challenges. That's why it's essential for investors to select the right building in the best location, having put in place the appropriate financing. ❖