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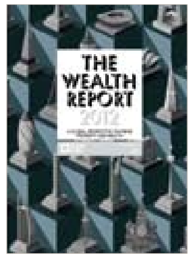
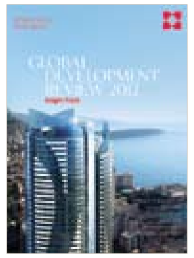


The Wealth Report 2012

Prime Central London Sales Index August 2012



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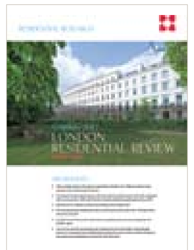

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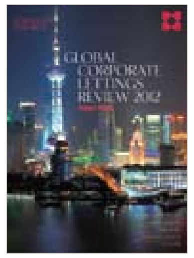

Global Corporate Lettings Review 2012

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RESIDENTIAL RESEARCH

SUPER-PRIME LONDON REPORT 2012

The world's most desirable residential market uncovered

Knight Frank

2012

QUIET SUCCESS

London's super-prime residential market has weathered the global financial storms over the past year. While 'booming' would be too strong, 'blooming' wouldn't be an unfair description, argues Liam Bailey.

"The usual reluctance to speculate about future tax changes among policymakers is now discarded if the target is perceived to be the ill-defined 'super-rich'."

Liam Bailey, Head of Residential Research

In the 2011 edition of the Super-Prime London report we painted a picture of a market in recovery from the downturn of 2009, but one which faced some substantial economic, financial and political challenges.

During the course of 2012 these and other challenges didn't disappear, but the top of the London market has performed much better than many observers predicted last year when the renewed Eurozone crisis began to weigh on the global economy.

This performance is best illustrated by market activity. Figure 1 shows that 2011 represented a record year for £10m+ sales in London in terms of the volume of sales. It was also a record year for deals agreed above £5m, with the first half of 2012 pointing to a continued solid performance.

Price performance in the £10m+ sector has been weaker than the wider prime central London market, but as figure 2 confirms, the market has still delivered an almost 40% uplift in prices since the market upturn in March 2009.

With such a positive analysis I could almost finish the report here, and save you the trouble of wading through more of my statistics and market chatter. But things are of course a little more complex behind the scenes, and those 'challenges' I mentioned in passing at the outset? Well, let's just say they have become more interesting in recent months.

It's the politics that matters

Despite the chaos in the Eurozone and the seemingly intractable UK recession, wealth generation is continuing apace in pretty much every other part of the world, a subject covered in depth in the 2012 edition of The Wealth Report, produced by Knight Frank in conjunction with Citi Private Bank.

A portion of this wealth is attracted to London, by investors looking for lifestyle, security, stability, education (see box opposite) and all the other drivers we identified in last year's edition of this report.

So far, so good. There is plenty of money around and much of it is targeted at the top of the London market. The problem is that this process means the consequent outperformance of the prime and super-prime London property market becomes very striking and attracts the attention of politicians in the UK, something we assessed in our recent London Residential Review.

Why does this matter? Our survey of wealth advisors on page 6 confirms that uncertainty around legislative, especially tax, changes is the key concern for potential investors at the top end of London's market.

It appears that the new top rate of stamp duty for individuals at 7% has not undermined the market significantly. Sales are down in the £2m to £5m bracket but above that level the market has been relatively resilient. The problem pressing on the market is the uncertainty as to whether politicians have done their worst yet.

An interesting vignette was provided by the UK's Shadow Chancellor, Ed Balls, in September who announced his support for a 'mansion tax' (an ill-defined proposal for an annual levy on expensive houses).

The element I found interesting was the fact that Mr Balls' intention in raising this issue was generally understood not as a serious tax proposal, but rather as a means of causing irritation to the Lib Dems, by promoting the pet policy idea of Vince Cable, a potential future leadership candidate.

This intervention provides a telling insight to the current attitude of British politicians to wealth. The usual reluctance to speculate about future tax changes is now discarded if the target is perceived to be the, again ill-defined, 'super-rich'. This is irrespective of whether idle speculation damages inward investment and the UK's reputation for stability.

The terms of the political debate in London have been reflected across the developed world. One only has to look at Italy and France for confirmation that governments in the developed world are in competition to maximise their tax-take from the global footloose wealthy.

What this footloose nature confirms however is that there are limits to how far you can push the wealthy before they decide to move their assets and their taxable income elsewhere – something that, behind the bluster, is recognised by at least the two main political parties in the UK.

London's global appeal

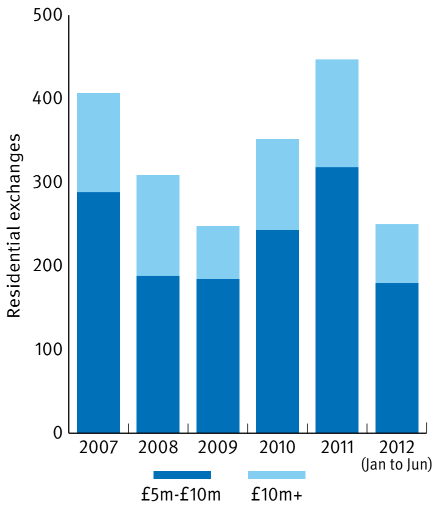
Despite the best efforts of the UK's political establishment, our data confirms that the world's wealthy are still finding that the positives outweigh the negatives when it comes to selecting London over global alternatives.

Figure 3 illustrates the spread of buyers who are targeting the top of the London market, with nearly 67% coming from overseas over the past two years. This global spread is London's trump card. New York might capture the new wealth pouring out of Brazil, and Singapore might be the first port of call for mainland Chinese investment interest, but no other global city draws on such a diverse range of buyers as London.

Over the next few pages we provide an overview of the key trends in the sales and lettings markets, along with an overview of the key risks as seen from London's wealth managers.

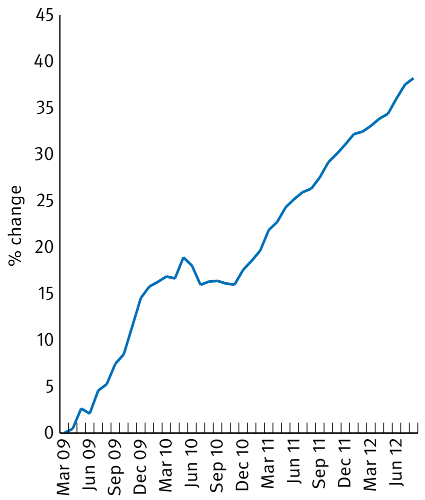
Global Briefing
If you have any thoughts you'd like to share on the super-prime market in London please comment at **KnightFrank.com/GlobalBriefing**

Figure 1
Prime and super-prime sales
£5m+ residential exchanges, Greater London



Source: Knight Frank Residential Research

Figure 2
Super-prime price growth
% growth in £10m+ London prices since March 2009



Source: Knight Frank Residential Research

THE EDUCATION INDICATOR

Education has become a critical part of the London 'offer' for wealthy international buyers, many of whom send their children to popular international schools in the Capital. Many of these schools are reporting that pupils are staying longer than before and that there has been a marked increase in new enquiries from particular nationalities, underpinning continued demand in the super-prime property market.

According to Richard Northey, Managing Director of The Education Consultancy, many of the international schools in and around London are reporting that fewer pupils are leaving each year as their families are staying in the UK longer than before. Where these schools normally see between 20% and 35% of students leave each year as their families move abroad, this figure has been reduced to between 10% and 15% in many cases. This can be explained, Mr Northey says, by trends in the banking employment market. "Until recently, bankers who moved to the UK with their families for work purposes were often contracted to stay for two to three years, but many are now signing five-year contracts," he explains.

Many of these international schools have also noted an uptick in interest from particular nationalities, he adds. "A number of schools noticed a marked increase in interest this year from French, Italian, Greek, Russian, Kazakhstani, South American, Japanese, Chinese, US and Israeli families." There are regional patterns too, with Japanese increasingly prominent in west London due to the presence of a Japanese school in Ealing, French in central London due to the popular Lycee schools, and Russians and Kazakhstanis in Surrey due to the presence of energy giant Chevron in the area.

One school held a promotional event in Moscow and had to put a cap on the number of Russian-speaking pupils, following the resultant surge in applications from Russians, Kazakhstanis, Ukrainians and some Belarussians. Another school has seen applications from Israelis surge. In the previous year they received 17 enquiries and enrolled seven students. By May this year they had already received 32 enquiries and enrolled 10 students.

Mr Northey has also noted more South Americans, notably Brazilians and Colombians, looking to move to London, often because of safety and security concerns in their home countries.

Super-prime market performance

Prices in the £10m+ market have risen risen 9.4% in the 12 months to August, demonstrating the continued strength of the market, but the rate of growth is slowing.

> "One factor that will determine the direction of the market will be the performance of the pound."

Annual price growth hit more than 12% in November last year, but has since fallen back to sit at below 10% over the last six months. In fact where the three-month growth rate was upwards of 3% in the three months to May this year, by August this had slowed to 1.8%.

Anecdotally the explanation for this slowing in price growth lies with resistance from buyers to ever higher price rises, rather than a shift in the balance of supply and demand.

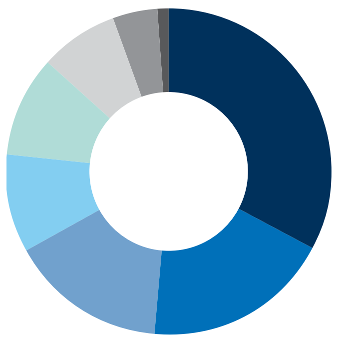
This market observation is borne out by figure 4, which provides an overview of the ratio of new £10m+ buyers entering the market each month to the number of new £10m+ instructions to sell. While the ratio has never recovered to its pre-crash peak seen in 2007, 2012 has seen the ratio maintained at a level far higher than that seen in 2011.

Looking to the future, our view is that price trends are likely to remain fairly subdued over the next 12 to 18 months. We have set our forecast for 0% growth in 2013, with a return to positive growth from 2014 and beyond.

One factor that will determine the direction of the market will be the performance of the pound. In figure 5 we have calculated the likely trajectory for the market taking into account our price forecast and the Economist Intelligence Unit's forecast for the exchange rate between the pound and the Euro and US Dollar.

The data in figure 5 is expressed as the % change in prices over time compared to 2007 for pound, Euro and Dollar-based buyers. The striking element to this analysis is the fact that the relative saving for dollar-based buyers caused by the 2008 devaluation remains relatively untouched through our forecast period. In fact, dollar-based buyers only see a recovery to 2007 prices by early 2015.

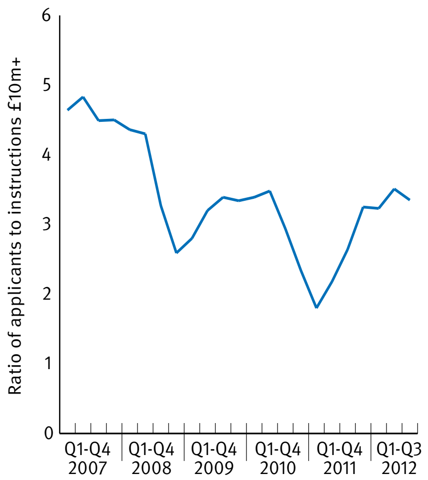
Figure 3
Super-prime buyers
Sales split by purchaser nationality (broad region), 2010 to 2012



UK	33.0%
Russia & CIS	18.7%
Middle East	15.4%
Asia-Pacific	9.9%
Europe	9.9%
North America	7.7%
Africa	4.4%
South America	1.1%

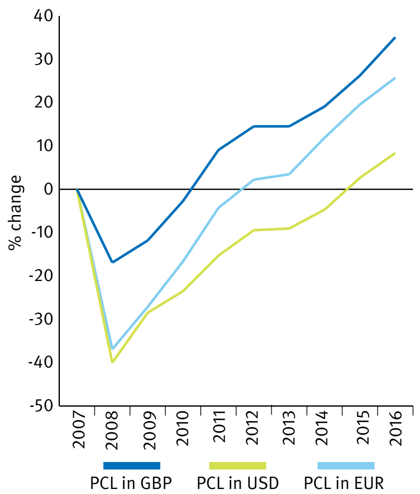
Source: Knight Frank Residential Research

Figure 4
Demand and supply
Monthly ratio of £10m+ new buyers to new properties for sale



Source: Knight Frank Residential Research

Figure 5
Exchange rates and pricing
Prime central London price change relative to 2007, allowing for currency fluctuations



Source: Knight Frank Residential Research

Rental market performance

The super-prime rental sector (£6,000+ per week) recorded a modest outperformance compared to the wider prime rental market in the Capital. Weaker employment market prospects in the City have pushed prime market rents down across the board in London over recent months, although in the £6,000+ per week market the falls have been limited to -1.3%, compared to -1.7% in the wider prime market.

While supply has been steadily rising in the prime rental market and demand has failed to keep pace, the super-prime rental market has remained more balanced, strong sales volumes in the super-prime price bracket have helped to keep rental supply at a low level (figure 1).

Anecdotally, the super-prime rental sector is slightly more protected from short-term employment market weakness, due to the greater preponderance of entrepreneurs and senior management.

The number of international tenants in the super-prime sector rose substantially between 2010 and 2011 and the number agreed in 2012 to date is on track to meet or exceed this.

In 2011 Knight Frank arranged tenancies for 33 different nationalities and 18 nationalities in 2012 to date. Europeans and North Americans accounted for the majority of tenancies in 2010 and 2011 and this has carried through to 2012. In 2011 just under a quarter of all tenancies commenced were to North American tenants.

The number of nationalities is also increasing significantly each year. In 2010 Knight Frank agreed tenancies with tenants of 15 different nationalities. In 2011 this figure more than doubled, rising to 33. In 2012 to date the figure is 18.

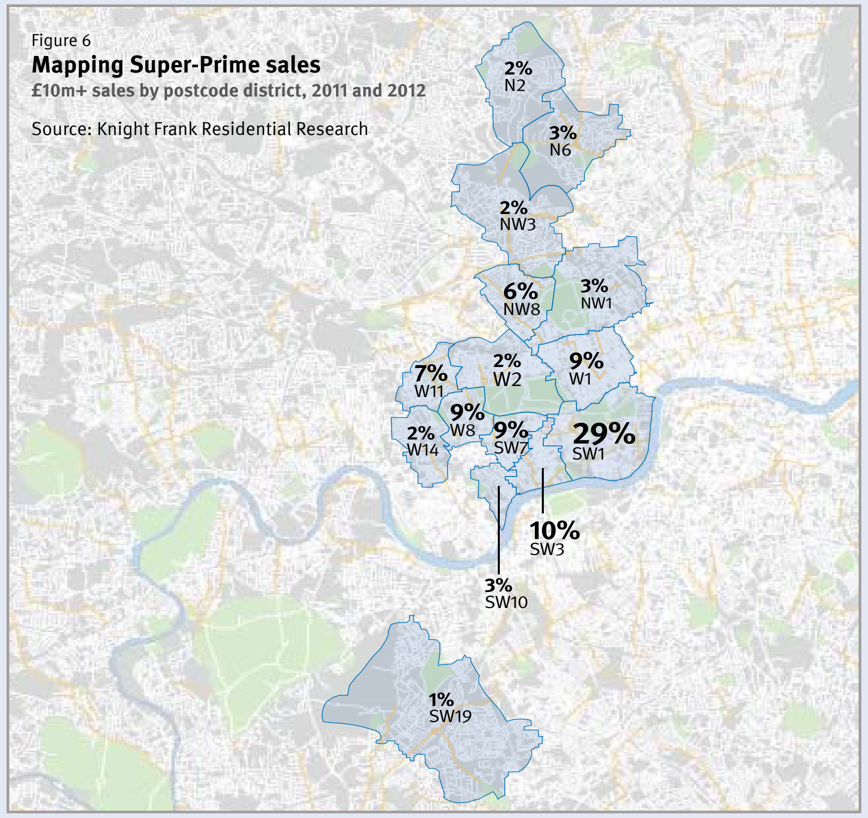
WHERE IS SUPER-PRIME?

The super-prime London residential market is relatively tightly contained in a number of key postcodes, as shown in figure 6. The top five postcode districts account for almost two-thirds of the total, with SW1 accounting for 29% alone.

This concentration has proved a challenge for developers who have attempted to widen the reach of the super-prime market and encourage buyers into new areas of London. As we note in our London Development report, this process has been met with mixed success.

It has been easier to extend the accepted boundaries of prime London, especially the £1m to £5m market, with the advent of new development on the South Bank and in the City. Once pricing at £10m or above is considered, buyers become more conservative. Yet some new developments now underway might help to widen the spread of super-prime properties from the current Hampstead-Mayfair-Holland Park arc.

Figure 6
Mapping Super-Prime sales
£10m+ sales by postcode district, 2011 and 2012
Source: Knight Frank Residential Research



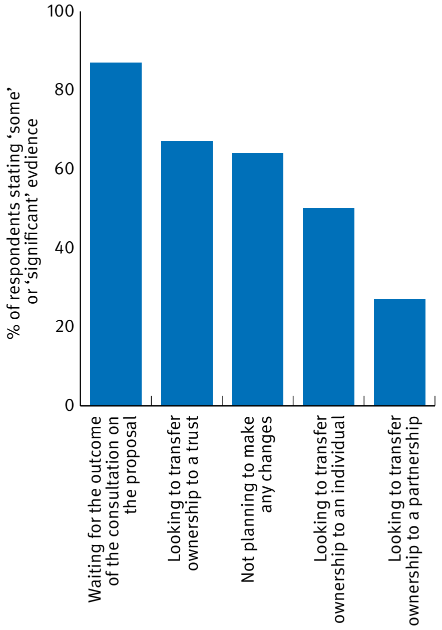
WHERE ELSE IN THE WORLD?

London's biggest competitors when it comes to super-prime property*

1. New York
2. Paris
3. Hong Kong
4. Singapore
5. Geneva
6. Monaco
7. Zurich
8. Miami
9. Copenhagen
10. Toronto

* According to survey respondents

Figure 7
Property tax shake-up
How have clients reacted to the proposal for an annual change on properties owned by a 'non-natural person'?



Source: Knight Frank Residential Research

Sentiment survey results

For this edition of the report we surveyed a range of wealth advisers, from tax accountants and lawyers to private banking and wealth management professionals. The results presented in this section reflect their views on London's desirability on the global stage, as well as the current and future threats, all of which could impact on super-prime residential performance.

In recent years London has become increasingly regarded by the world's wealthy as an appealing place to invest in prime property – not only for its lifestyle and cultural offer, and its status as one of the world's most important financial centres, but also, and perhaps most importantly, because it offers a safe haven in a world where geopolitical uprisings and economic crises have become commonplace.

It may not come as a surprise then, that geopolitical and security concerns in other countries were cited as the most positive influence on those considering buying or renting super-prime property in London.

When it came to identifying the strongest negative influence, respondents overwhelmingly (88%) opted for 'the UK's changing tax environment' – something we delved into further in the following question.

We asked respondents which of a number of statements most closely fit their view on the potential risks to London's attraction as a future wealth hub. Once again, tax changes attracted the biggest response (figure 7).

Higher rates of general taxation, such as the 50% income tax rate, and one-off wealth taxes, such as bonus taxes, were deemed by 88% of respondents to be either a real concern now, a real and significant concern now, or a concern for the future. 82% said the same about non-dom tax changes, while 71% expressed concern about the potential loss of broader financial service sector activity to Asia.

Asked whether their existing and potential client base would be deterred from buying £10m+ property in London following the recent stamp duty increase from 5% to 7%, just under two-thirds of respondents said either 'no', 'unlikely' or 'only if buying as a non-natural person'. Just 5.9% said a definitive 'yes' while 29.4% said 'possibly'.

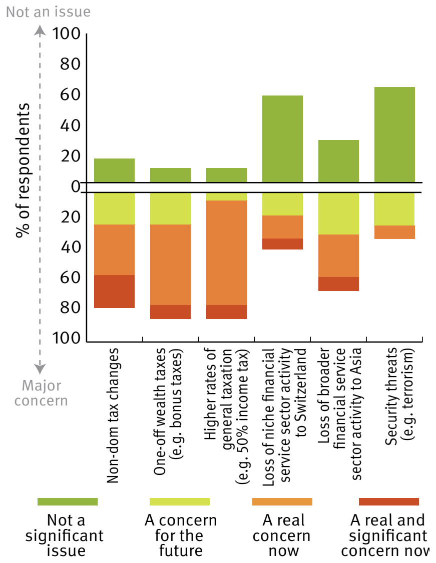
Unsurprisingly, the proposal for an annual charge to apply on properties owned by a 'non-natural person' has either already spurred, or is anticipated to spur, a bigger reaction.

Although 87% said they believed clients would wait for the outcome of the consultation on the proposed changes, 67% said there was either some or much evidence of them looking to transfer ownership to a trust. 50% said the same with regard to clients transferring to an individual, and 27% to a partnership. 64% expected that clients would not be looking to make any changes.

With the cost of buying one of London's super-prime properties having increased with the stamp duty changes, we asked respondents if they thought it likely that clients would rent instead of buying. This was deemed unlikely, with the majority (76.5%) saying either 'no' or 'unlikely'.

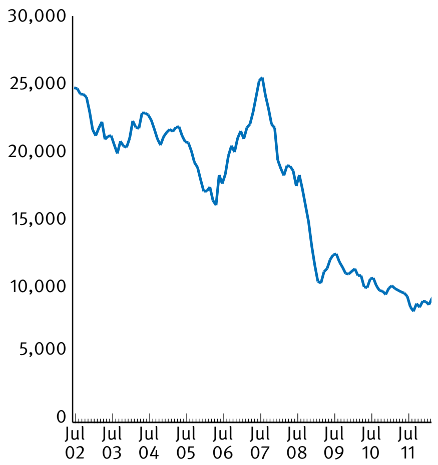
With international buyers representing an increasingly important source of demand in the market, we asked respondents which nationalities they thought would become more prevalent. The most frequently mentioned were buyers from Russia and the CIS, China, Middle East, France, India and Africa.

Figure 8
Potential risks to London's attraction as a future wealth hub?



Source: Knight Frank Residential Research

Figure 9
How many Ounces of Gold needed to buy a Super-Prime London house?
£10m PCL house price deflated to 1976 divided by market price of gold



Source: Knight Frank Residential Research

Safe haven?

The term 'safe haven' is probably one of the most dangerous labels an analyst can place on an investment asset class. I think I have used it rather too many times to describe prime London property, and certainly in terms of super-prime property, and I am well aware that many in the investment world roll their eyes when the term is applied to anything other than gold.

The fact remains, however, that the behaviour of the central London market since 2010 has shared some pretty compelling similarities to a safe haven. As the Eurozone crisis worsened, so prices in the wider UK housing market began to weaken as consumer confidence was undermined. But in central London demand and prices moved steadily higher.

Back in 2008 when the world was falling apart, the most noticeable trend in the central London market was not the fact that prices fell 25%, but rather that people stopped selling – most owners of prime property are not price takers and will not sell if they don't like what the market is offering.

But what about the comparison between gold and super-prime London property? Since 1976 gold prices have risen by a staggering 802%. Central London house prices have climbed 2,685%.

I expect the response to the above statement will be that this confirms that super-prime residential prices are now overvalued. It rather depends when you pick your time horizon, because over the past decade the price of a typical super-prime residential property in London has plunged in gold terms.

In 2002 it would have taken you 24,000 ounces of gold to buy a super-prime mansion in SW1. A decade on, you would get change from 9,800 ounces (figure 9).

To visualise this, 9,800 ounces would be a cube about the size of a small footstool, admittedly a heavy one.

I have no doubt that as the debates over the longevity of the developed world's fiat money system become ever more urgent, gold will have a stronger claim to safe-haven status. But if things get really tough you can at least live in your mansion, or let it out, with or without a footstool.

TAX IN THE SPOTLIGHT

With tax changes highlighted by our survey respondents as the biggest risk to London's attraction as a future wealth hub, we asked Mike Walker, an International Tax Partner at KPMG, for his views.

The most significant risks to London's attraction as a future wealth hub are higher rates of general taxation, such as the 50% income tax rate, and non-dom tax changes. There has been a huge increase in the international mobility of people, capital and business in the last few years and these days **few, if any, of our conversations with clients are solely concerned with one jurisdiction.** The UK and all jurisdictions are effectively in competition with each other and the right balance therefore needs to be found in a fair tax system that also attracts people to locate here. Our judicial system and our financial system are much admired around the globe.

Our history, honesty and sense of fairness are often commented on by clients. A lot of economies are currently very unstable and the London property market, and to some extent our currency, are perceived to be both safe and a good investment. However, very high rates of tax **(50% or even 45% income tax is on the very edge of what most international clients tell me they will stomach),** coupled with any 'noise' that internationally mobile clients are in any way unwelcome in the UK, would probably be the breaking point for many. The main reaction to the recent stamp duty changes is that the 15% charge might be argued to be unnecessary. It will probably yield little if anything. Admittedly, it will massively reduce the use of offshore companies for UK residential property purchases and may therefore increase the yield from inheritance tax. But that assumes the international client will still own the property when they die, which may not be for many years and may be after yet another change in the tax system. Perhaps the 7% charge on purchases over £2m which is now in force might have been sufficient in terms of raising tax revenues.

New York is probably London's biggest competitor, only when one considers property as an asset class/investment. The main obstacle that seems to bother clients in respect of the US is, ironically, their tax system. Arguably it is more complex than ours and once in the US tax system it seems that – to borrow a line from Hotel California by the Eagles - you can check out any time you like but you can never leave. **The UK is perceived as being far more flexible** and a clear statutory residence test, which should come into force on 6 April 2013, is likely to enhance that perception.

Go to www.knightfrank.com/globalbriefing to read the full interview.