2011

RESIDENTIAL RESEARCH

LONDON HOTSPOTS

Residential development opportunity areas

Knight Frank

INTRODUCTION

London property prices have outperformed the wider mainstream market in recent years, buoyed by continued demand from British and overseas buyers, despite the economic turmoil since the financial crisis.

We expect this trend to continue, but we also forecast that prices for new-build property are likely to perform particularly well in some areas of the Capital, as regeneration, new transport links and increased demand, or a mixture of all three, boost values.

We believe prices for new-build properties in these 'hotspots' will outperform even the 30% increase in prices expected in the prime central London market between now and the end of 2015.

Demand for housing in London is not in doubt. Employment in the capital is expected to rise steadily in the years to come with employment growth in the financial sector in central London expected to rise by 17% over the next four years, compared to 3.3% growth in employment for the UK as a whole.

In addition, central London is seen as a safe haven for overseas buyers, in terms of political and fiscal stability and investment security. Education is also a significant draw.

Some of our hotspots will perform strongly as demand for prime property radiates outwards, extending the area covered by prime central London, which we refer to as the 'prime ribbon'. In some cases this will coincide with developments which are being drawn up, such as that in Earls Court, which will revitalise a historically mixed-use area which suffered from a lack of cohesive identity.

The majority of areas achieve hotspot status because of new transport links, which will make them more accessible. Crossrail, the fast train service that will run across London from 2018, will further enhance the desirability of the areas around its stations in central London, and in particular the key transport hubs of Paddington, Farringdon and Liverpool Street.

Figure 1
London's future residential development 'hotspots'

Such trends have been evident in the past, residential prices in Canary Wharf and Tower Hamlets around the time of the Jubilee line extension in 1999 rose by more than 60% in the four years running up to the opening of the extension. While other factors, such as the wider rise in London prices and large-scale regeneration of the area clearly played a part, more than two-thirds of agents questioned in 2001 said that the extension had the biggest impact on the property market in the area since 1991.[1]

The remaining areas are hotspots because regeneration is leading to a wholesale change of identity, for example Nine Elms and Battersea Power Station on the riverside in South West London.

In this edition we have deliberately concentrated on central London. The impact and opportunity from the Olympics around Stratford and the Olympic village and the wider East London region will be explored in a later paper from Knight Frank.

As discussed in the final pages of the report, there are still questions lingering over the

1. Second Property Market Activity Study Final Report: Jubilee Line Extension Impact Study

planning regime as the government moves to introduce its vision for localism. However London has been sheltered from the worst of the confusion as the Mayor's London Plan is still seen as an overarching template for how the capital will develop. There is also evidence that some London boroughs are becoming more proactive in providing land for development, conscious that one way to boost their local economy is to create more capacity.

But despite this, as figure 3 on pages 6-7 shows, the capital faces a massive undersupply of housing over the coming years which is likely to support prices across London.

Methodology:

The chronic undersupply of housing in London, especially in central London (figure 3, pages 6-7) is set to continue. This factor, together with ongoing demand growth, will help to support prices for new residential developments. So there is a positive outlook for developers across London. But which areas and micro-markets will outperform?

In our analysis we have had regard for demographic and economic forecasts – but the critical elements in our assessment have been the factors which are likely to lead to the dynamics of a particular market area changing over time. So we have looked closely at new and proposed transport infrastructure, the spread of gentrification, current and potential pricing, and critically we have concentrated on areas where there is a real opportunity, either through refurbishment or redevelopment, for residential developers to enter the market and undertake schemes over the next five years.

Working with our London Residential Development team we have determined a final short-list of 13 'hotspots' across London where we believe there is (a) significant scope for development activity, (b) where the underlying market is undergoing improvements due to infrastructure investment or socio-demographic shifts and (c) where there is real potential for price growth over the next five years over and above our wider prime central London forecast for 30%.

HOTSPOTS

1. City of London and eastern fringe

Current value: £800 - £1,000 sq ft*
2016 forecast: £1,750 - £2,000 sq ft
118% rise

*City of London

The City of London has already seen an influx of wealthy residents in the last five years, with a more than 30% rise in the number of residents classed as "wealthy achievers" since 2005. The number of households in the Square Mile is also set to rise by nearly 70% in the next decade, far more than the London average of 10%. Developments such as The Heron, on the edge of the Barbican, and the forthcoming Four Seasons Hotel & Private Residences, London at Heron Plaza are lifting the City's residential profile. The Crossrail station at Whitechapel is likely to lead to demand rippling out from the City, boosting prices further east too.

ISSUES: Planners are concerned that residential development may be a future impediment to commercial redevelopment

2. City Road corridor

Current value: £625 - £775 sq ft
2016 forecast: £850 - £1,000 sq ft
36% rise

This area will be popular with City workers, who can not only walk into work but who can also take advantage of the nightlife in the nearby areas of Shoreditch, Clerkenwell and Angel. The area has also been designated as a technology hub by policymakers, stretching from Old Street to the Olympic Park in Stratford. Cisco, Intel and British Telecom have already pledged to invest in the area.

ISSUES: The technology hub may take a decade or more to become established, and there is a risk that it clusters in Stratford

Hotspots drivers

- Redevelopment
- Regeneration
- Transport
- Prime ribbon extension
- Planning

London's financial sector

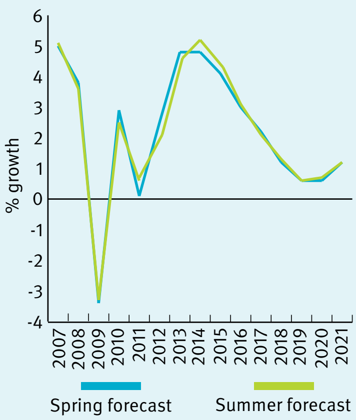
The tally of job cuts announced by major UK and European banks continues to climb. There are several key reasons why the banks are slimming down their workforces. Firstly, the UK's economic recovery has failed to materialise as strongly as expected. The global economic picture is also gloomy. In addition, banks are navigating a raft of new and more onerous regulations as well as adjusting to life after the initial £200 billion tranche of quantitative easing, which helped drive investment activity through most of 2009 and 2010.

The property market in London, and especially in prime central London, is fundamentally linked to the financial and business services sector, with many high-net-worth individuals from these sectors choosing to buy high-end property in the capital.

While the recent announcements of job cuts may act as a dampener on confidence in the coming months, we expect this to recover as the pace of employment growth picks up again. As shown below, in light of recent developments, Oxford Economics has revised down its forecast for growth in employment in the financial and business sector in London from 2.5% to 2.1% next year and 4.7% to 4.6% in 2013. But it then expects employment growth to pick up even faster in the following three years.

Figure 2

Employment growth: financial and business services in London



Source: Oxford Economics

3. Earls Court

Current value: £1,250 sq ft
2016 forecast: £2,000 sq ft
60% rise

Once it has hosted the Volleyball Olympic finals next summer, the Earls Court Exhibition Centre site will be redeveloped. Under the current proposals, the large-scale regeneration of the surrounding area will create 7,500 new homes in four 'villages' close to a new park. We believe that a high quality approach to development could see this area becoming a part of the prime central London market.

ISSUES: Minimal

4. Farringdon

Current value: £850 sq ft
2016 forecast: £1,300 sq ft
52% rise

This is one of the key areas where values will be boosted by the travel links provided by the new Crossrail line. Farringdon will become a major interchange for Crossrail and other overland services, providing workers and residents with direct access to three London airports. The journey to Canary Wharf will take less than 10 minutes.

Clerkenwell, the area that includes Farringdon, has already seen some regeneration and an improvement in retail and amenities over the last 15 years, but prices could climb higher in the central area and demand could also filter out further north and east than is currently the case.

ISSUES: Minimal

5. Hammersmith

Current value: £700 sq ft
2016 forecast: £1,250 sq ft
78% rise

Hammersmith's planning regime has become markedly more accommodating in recent years. There has been a recognition that developers need to negotiate over the type and number of affordable homes within schemes, which should help boost supply of new homes. The area is very well served in terms of transport links, and is within easy reach of Heathrow. It represents the logical overflow for the westward spread of prime central London demand.

ISSUES: Minimal

6. King's Cross

Current value: £650 - £1,000 sq ft
2016 forecast: £900 - £1,400 sq ft
38% rise

The regeneration around the station and St Pancras has already created interest among buyers. As more schemes complete, the area's superb transport links, including the Eurostar train to Europe as well as overland UK train and London underground connections, will only increase its desirability. This will be enhanced by attractive public realm planned by developers. Residents will also benefit from owning a property on an estate managed by a singe landlord, as well being in London's newest post code: NC1.

ISSUES: Minimal

7. Marylebone/Fitzrovia

Current value : £1,500 sq ft
2016 forecast: £2,500 sq ft
66% rise

High-quality properties and former office premises are being redeveloped for residential use in this area, which is tantalisingly close to Mayfair. The lure of better value prices has already attracted some wealthy buyers to the area. Buyers will benefit from being within walking distance of both Bond Street and Tottenham Court Road Crossrail stations when the service opens.

ISSUES: Site assembly for new developments could be more difficult than in some other areas of the capital

8. Midtown

Current value: £1,500 sq ft
2016 forecast: £2,250 sq ft
50% rise

This is the perfectly placed junction between the West End and the City, as well as being near the river with easy access to the popular South Bank area. It is currently largely made up of commercial buildings, but there is scope for these to be granted 'change of use' by planners to residential or hotels or shops. The number of households in this area is forecast to rise by nearly 20% over the next decade, double the 10% average across London.

ISSUES: The area needs a wider range of amenities

9. Nine Elms

Current value: £750 sq ft
2016 forecast: £1,800 sq ft
140% rise

This area is set to undergo a complete change of identity as regeneration takes place. Tideway Wharf and Battersea Power station will boast hundreds of apartments, and Nine Elms Parkside, which is yet to be granted planning permission, would create an additional 2,000 residential units.

Key to this area's success will be the extension of the Northern Line. Under current plans, two extra stops are planned at Nine Elms and Battersea. If this goes ahead, the area would have direct links to Covent Garden, Soho and Fitzrovia, as well as South London. The potential of this site has already been spotted by the US State Department, their new style campus embassy will open in 2017.

ISSUES: The volume of development could cause some congestion, and there is a lack of certainty over the tube extension

10. Paddington/Bayswater

Current value: £1,650 sq ft
2016 forecast: £2,500 sq ft
51% rise

Bayswater has lagged behind the neighbouring areas of Notting Hill and Holland Park over the past decade, and the proximity of Hyde Park has never been adequately priced into properties in the area. The opening of Crossrail at Paddington is likely to give the immediate area surrounding Paddington and Bayswater a boost, with travel time to the City being cut to just 11 minutes. Household growth in this area is set to outstrip the London average over the next ten years, rising by 19%.

ISSUES: Minimal

11. South Bank/Blackfriars

Current value: £1,250 sq ft
2016 forecast: £1,800 sq ft
44% rise

The wholesale makeover of Blackfriars station and London Bridge station as part of the upgrading of the Thameslink train service will boost the image and desirability of these areas. London Bridge has been named as a London opportunity area in the London plan. There is an appetite for riverside housing from those who also want to be close to the City and Canary Wharf. Its proximity to the West End also makes it an alluring location. But this lift in value will only extend as far back as Tooley Street – this is a riverside only story.

ISSUES: Minimal

12. Victoria

Current value: £1,350 sq ft
2016 forecast: £2,000 sq ft
48% rise

The redevelopment of Victoria underground station and the new Victoria Transport Interchange development will give the area a well-needed facelift, and engender more interest from buyers keen to take advantage of the area's proximity both to the West End and West London. International commuters can reach Gatwick in 30 minutes from the train station. Prices in the area will not catch up with those in neighbouring Belgravia, but they could see a significant bounce.

ISSUES: Minimal

13. White City/Westfield

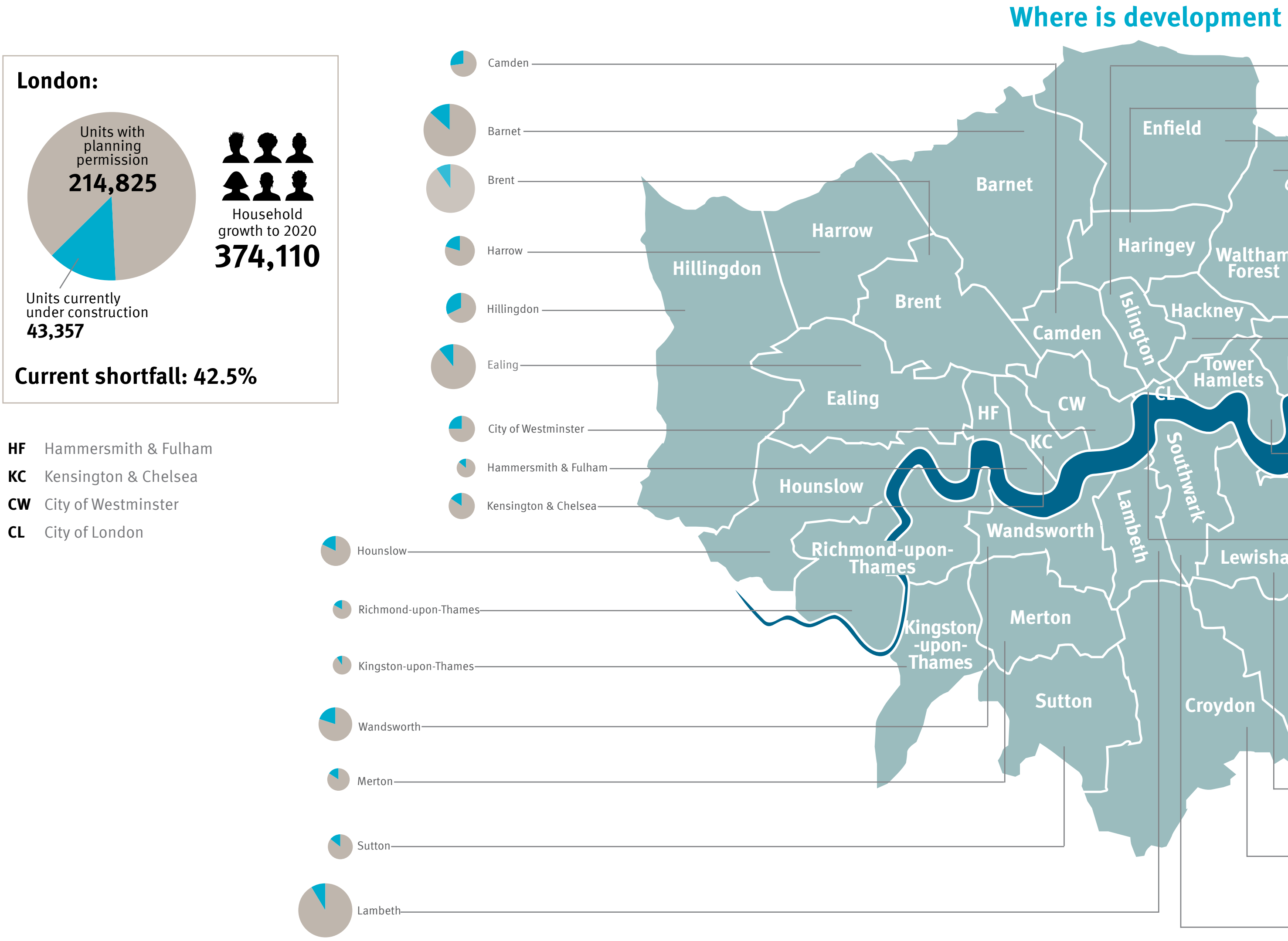
Current value: £900 sq ft
2016 forecast: £1,400 sq ft
55% rise

The new Westfield shopping centre has provided the impetus for an overhaul of the identity of White City in West London. The retail centre has boosted residential demand. There is also demand rippling out from the neighbouring, and higher-priced, Holland Park. Development plans are being drawn up for an extension to Westfield, as well as 1,700 new homes. The local borough and Mayor of London want to build a total of 4,500 new homes in the area.

ISSUES: Minimal

Figure 3

London's housing shortage



PLANNING AND DEVELOPMENT

Housebuilding in London has picked up sharply since the financial crisis, but there is still a huge backlog of development projects that have yet to start.

Around two-thirds of pipeline developments with planning permission have stalled, in many cases because of further wrangling over planning or because of a lack of finance.

As our graphic shows, even if these projects get off the ground, there will still be a significant shortfall in housing. Across the capital, planning has been granted for 214,825 units, but it is estimated that 374,111 households will have been created or moved into the capital by 2020. Even if there is a sharp pick up in planning schemes granted, and a surge in building activity, developers will struggle to eradicate the current implied 42% shortfall in housing.

As figure 5 shows, the largest shortfall in housing is in Kingston-upon-Thames, where only 10% of the forecast housing needs by 2020 will be met under current plans.

All boroughs in central London have a shortfall in supply, including the City and Westminster (shown in the table). Kensington & Chelsea and Southwark both have a 59% shortfall, while Lambeth has a 30% shortfall. Islington has a less pronounced 5% shortfall and Hammersmith & Fulham has a 15% shortfall under the current forecasts for household growth.

But if we look at the number of developments that are actually under construction, the picture is even more stark.

Around 43,000 units are being built at present, less than a quarter of the total number of units which have planning permission. Stripping out social housing, the number of private residential units under construction is even smaller.

There are several key reasons for this backlog of developments with planning that are awaiting construction, not least of which is affordable housing targets.

happening?

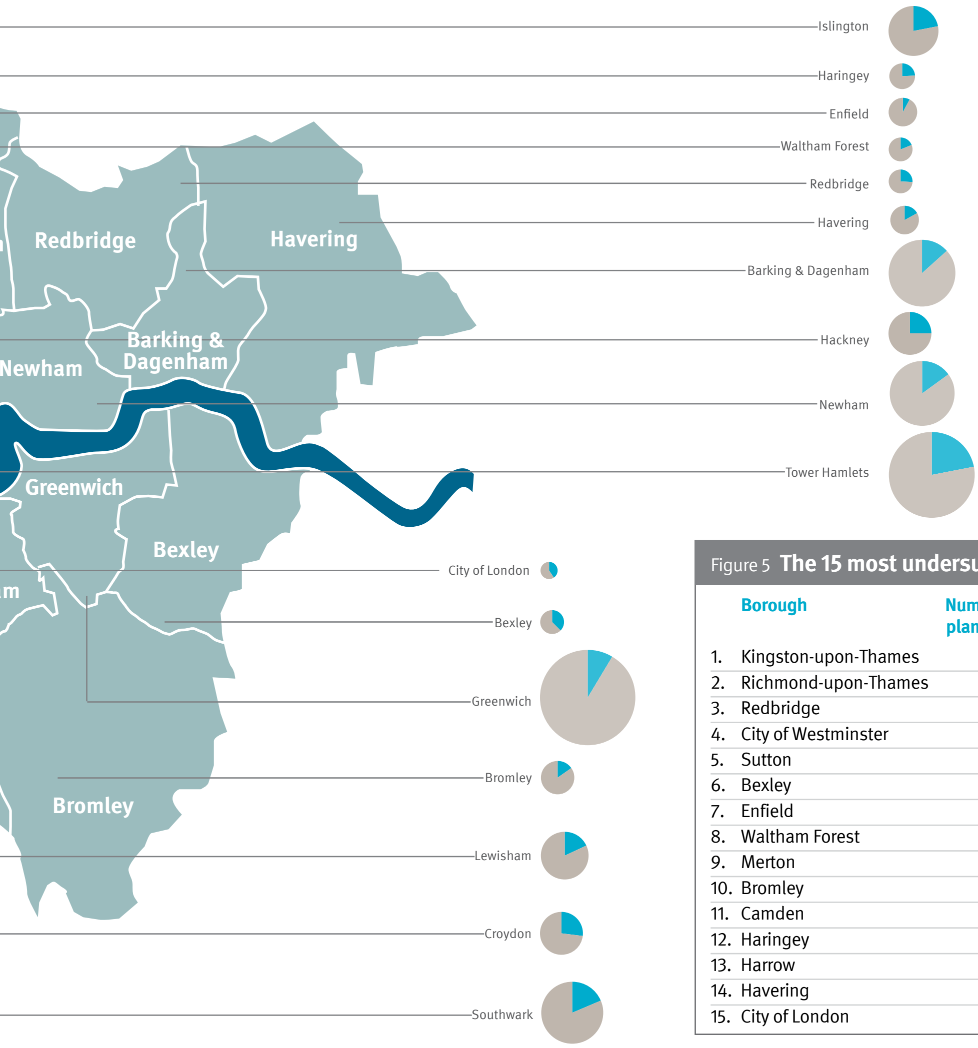
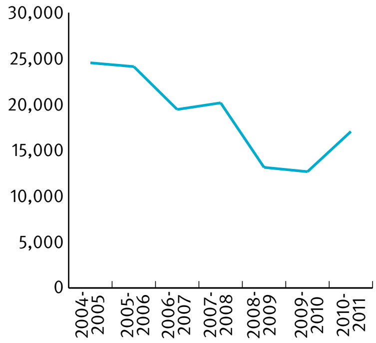


Figure 4
Housing starts in London



Source: DCLG

Figure 5 **The 15 most undersupplied boroughs in London**

	Borough	Number of units with planning permission	Household growth to 2020	Indicative 'undersupply' %
1.	Kingston-upon-Thames	1,234	12,009	90
2.	Richmond-upon-Thames	1,519	12,591	88
3.	Redbridge	1,868	13,591	86
4.	City of Westminster	3,578	22,280	84
5.	Sutton	2,148	12,006	82
6.	Bexley	1,487	9,002	83
7.	Enfield	2,379	12,592	81
8.	Waltham Forest	1,102	5,594	80
9.	Merton	2,899	14,009	79
10.	Bromley	3,556	15,768	77
11.	Camden	3,435	14,423	76
12.	Haringey	2,370	8,593	72
13.	Harrow	4,061	13,591	70
14.	Havering	2,919	9,592	70
15.	City of London	613	2,003	69

In the wake of the financial crisis and the economic slowdown – events which fundamentally changed the landscape of the housing market – developers have had to re-think their previous plans for affordable housing. Many schemes gained consent when the economics of house building were very different.

The need for a new approach has been compounded by the dramatic reduction of the Capital Grant by the Homes and Communities Agency. The drop in available grant, which provided more than £8 billion in top-up funds for developers building affordable homes between 2008 and 2011, has forced many developers and landowners to make new planning applications with fewer affordable homes.

The situation is further complicated by the confusion over the value of affordable housing because of a lack of clarity over the rents that can be charged. Plans have been mooted by ministers that affordable rents should be higher than current social rents, possibly up to 80% of market rents.

But in London, this would make the properties unaffordable for most, so local councils are still calculating what they should charge. These decisions are unlikely to be finalised before the end of the year.

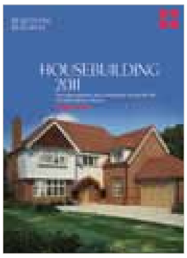
The loss of grant funding combined with this lack of clarity has further complicated the issue for developers and planners, and has resulted in prolonged negotiations in some cases.

Meanwhile financing, especially among smaller housebuilders and developers, remains a critical issue as funding constraints have eased only moderately since the financial crisis.

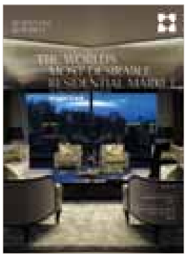
In conclusion, while there have been some small improvements in the planning landscape, such as signs of more flexibility towards the affordable housing requirements, London is still hugely undersupplied and will remain so for the foreseeable future. For developers with access to cash in the capital, this offers a very attractive proposition.

RESIDENTIAL RESEARCH

Recent market-leading research publications

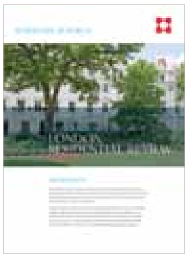


Housebuilding 2011

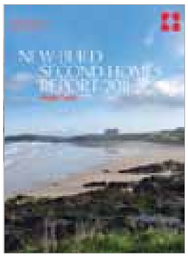


Super-prime London Report 2011

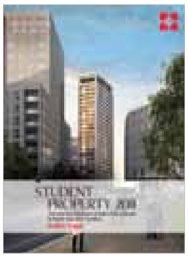
The Wealth Report 2011



The London Review Autumn 2011



Second Homes Report 2011



Student Property 2011

Knight Frank Research Reports are available at
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