HURFORD SALVI CARR

research

from Hurford Salvi Carr

CITY AND DOCKLANDS

RESIDENTIAL REVIEW 2006

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 2500 new homes in over 150 developments, the majority created from former commercial premises, and we have played a pivotal role in the repopulation of Clerkenwell and the City fringes.

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

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

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

HURFORD SALVI CARR

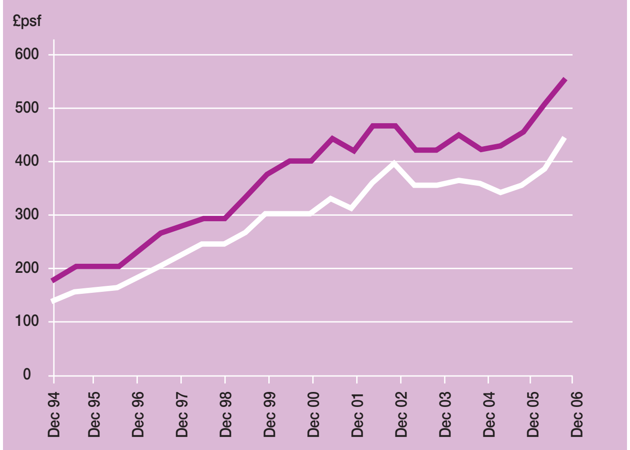
market *overview*

STOCK SHORTAGES AS PRICES HIT RECORD HIGHS

In 2006 the City and Docklands residential market experienced the highest rate of price increases since the dot.com boom of 1999-2000, with prices up by 22% in the City and 26% in Docklands (Figure 1), compared to a national average rate of around 9%. This built on growth in 2005, such that prices rose by a remarkable 30% in just two years.

Figure 1 illustrates that between 2000 and 2005 residential prices changes in the City and Docklands were unremarkable, but moved within a narrow range of +/- 10% in response to housing market factors and external economic and political stimuli. In 2006 the market made a definitive move outside that five-year range, taking prices in the City and Docklands, along with other parts of central London, into un-chartered territory, as we predicted in our end of year Residential Review 2005.

FIGURE 1 : THE HURFORD SALVI CARR PRICE INDEX



Source: Hurford Salvi Carr, CCR

Rising house prices combined with high rates of employment growth in the City and West End also increased demand for rented accommodation, with an 18% rise in rents in 2006 taking rents to record levels. Rents have now been on a rising trend for three and a half years from mid-2003. Hurford Salvi Carr, alongside the majority of estate agents in London, experienced a trend towards transacting more leases than sales in 2006, illustrating the growing importance of rental property in the City and Docklands, where a fluid labour market continually attracts new, often young, workers.

This major market trend is set to continue as fewer properties will be offered for sale for the following reasons:

- Many developers are now undertaking "build-to-let" schemes, retaining new homes for their own investment portfolios. If these properties are eventually sold, it is likely that they will be sold to other investors rather than broken up for sale to owner occupiers.
- In turn, a very significant proportion of new homes that are not retained by developers are being sold to all categories of investor, from individual buy-to-lets to discounted bulk sales. Investors, for example, are typically able to out-bid first time buyers.
- In the second-hand market, there is a growing trend for owner-occupiers to retain their existing properties when trading up, in order to establish or enhance a property investment portfolio.

Aside from price and rent increases, the distinguishing feature of the market in 2006 was the speed of sales and lettings of individual properties. Consequently, there was a shortage of choice of accommodation for sale or letting at any one time. The absence of an extensive number of properties for sale, however, did not imply low rates of turnover. The imbalance of supply and demand meant that sales negotiators were able to put newly available properties to a large list of applicants, with the internet and email the marketing vehicles of choice, although in the two weeks it takes to list a property on a web site, many had already been sold. Advertising in the property supplements thinned, with the bellwether Evening Standard New Homes section carrying fewer advertisements than normal, with the majority being offered outside London.

The market "paused for breath" in May and June 2006, as reported in our 1st Half Residential Review, but by every measure the market has been "hot" in the second half. London's economic mini-boom and accompanying house price growth, and its spread into the wider south east, was one factor behind the Bank of England Monetary Policy Committee's decisions to raise the base rate to 4.75% on 3rd August 2006 and to a five year high of 5% on 9th November 2006. The first increase evidently had no impact on the City and Docklands market, where the drivers of employment growth, pay rates and annual bonuses were not dented by a quarter point increase. Nor did the November increase in itself have an immediate impact, given the imminent payment of City bonuses and general level of confidence founded upon a strong economic outlook.

Confidence, rising prices and rising rents can be attributed to a number of key factors:

London employment boom – The Purchasing Managers Index (PMI)/Royal Bank of Scotland monthly survey shows that London firms added to employment consistently from the beginning of 2004, with a strongly rising trend from mid-2005 onwards. The Centre for Economics and Business Research (CEBR) reported in August 2006 that City jobs growth of 4% in 2006 to 335,700, would take the number employed past the previous peak in 2000 of 324,100.

Stock market – One of the factors that took the heat out of the housing market mid-2006, was a sharp 10% fall in the FTSE 100 index from 6,100 to 5,500 points in May. Since then the index recovered those losses rising to 6,256.8 points on 16th November 2006, a gain of over 10% on the start of 2006.

City bonuses - Within London, the City's financial and business services are growing very strongly, backed by high volumes of share trading, merger & acquisitions activity, trading in derivatives and hedge funds. According to recruitment consultant Morgan McKinley (September 2006), most City workers expected their bonuses to be 50% higher than last year, with almost a quarter expecting them to double.

Stock shortages – Our research shows that the majority of estate agents in the City and Docklands typically had under ten properties available for sale at any one time at the end of 2006, compared with 15-20 at the start of the year. In EC1, only 72 properties were for sale at the end of November in an area covered by 25 estate agents. This is an indicator, given that transaction levels are still high, that properties are not even reaching web sites and that supply has been affected at all levels of the market. Estate agents are using old fashioned techniques like the telephone to sell properties!

High prices – In the sales market high and rising prices became a self-fulfilling prophecy in 2006. The high entry prices for one and two bedroom flats, at £330,000 and £425,000 in the City, reinforced demand for rented property and contributed to rising rents, which in turn supported capital values in a market where investors form a high proportion of buyers.

Taken together, the above factors created a "virtuous circle" with economics, employment, supply constraints and confidence mutually reinforcing the market. No doubt there are some who will see the latest data from 2006 as evidence of over-exuberance and an asset price bubble in the making. Such theories must not be dismissed out of hand. The fact is, however, that the City and Docklands market is underpinned by the highest paid workforce in Europe, a workforce that is currently riding the up-cycle of a cyclical wave. It would take a major external economic shock to prematurely dampen that wave.

In addition, there is the added comfort that while UK house prices rose above trend for most of the early 2000s, in London there was a much lower rate of growth (Figure 1). We would argue that London, including City and Docklands, is now "catching up" after a five year period when housing became increasingly affordable.

Our forecast for 2007 is that sales prices in the City and Docklands will increase at a rate of 10%, with the majority of the growth in the first half of the year. We consider that the rental market will perform strongly in response to continued employment growth and the high entry price of owner-occupation, and we forecast an increase in residential rents of 15% for 2007.

the *sales* market

PRICES RISE UP 26% IN 2006 AS DEMAND EXCEEDS SUPPLY

In the second half of 2006, the sales market continued to display the characteristics evident in the first half of the year, with prices rising rapidly. Average prices in the sales market were up 26% in Docklands and 22% in the City during the year. A significant proportion of properties sold in the second half of 2006 across the City and Docklands went to best bids.

After a quieter period in May and June following the stock market's 10% tumble, the second half of the year saw unremitting price growth with the market shrugging off the quarter point increases in lending rates in August and November. In September and October, the market accelerated after the August holiday period and this is a time when the market is swelled by first-jobbers and better-off students. By November, City bonuses once again emerged as a dominant market force with expectant recipients scouring the limited number of available properties either to enhance their primary residence or to undertake some direct investment in the local housing market.

Other sources of demand included a steady build up of renters, who at regular intervals examine the sales market to see if they can shift from the rented to owner-occupier sector. High and rising prices made it easier to sell "problem" properties (e.g. with minor structural problems, high service charges, live-work use) that tend to stick in stable or falling markets, giving owners a one-off opportunity of trading up or out of the local market.

The speed with which individual transactions took place, meant that there was a very low number of properties for sale at any one time. Our data indicates that over two years from December 2004, the price of one bedroom flats has risen by almost £100,000, or 38% (Table 1). Two-thirds of that growth occurred in 2006, with an increase of 26%, a figure that closely mirrors overall £psf increases recorded in the Hurford Salvi Carr price index of 22% in the City and 26% in Docklands.

The imbalance in the market is a direct result of the growing importance of residential property as an investment medium, meaning that a higher proportion of property is available for letting rather than for sale. This we attribute to three main factors: the increasing number of vendors who retain their "old" property as a rental investment; developers who are building units to retain in their investment portfolio; and investment buyers out-bidding first-time buyers.

TABLE 1: ILLUSTRATED PRICE CHANGES FOR ONE-BEDROOM FLAT 1998-2006 IN THE 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

Source: Hurford Salvi Carr, CCR

new homes market

RESTRICTED SUPPLY ENCOURAGES OFF-PLAN SALES

Judging by the number of new homes being advertised for sale, on the face of it one might think that not much is being built in the City and Docklands. This is far from the case. Although in core locations housing construction has been curtailed by the rise of the office market, across the whole of our area the amount of new homes being built continues at a similar rate to that seen since the late 1990s (Table 2). The reality, however, is that a very significant proportion of schemes are being sold off-plan, largely to investors, leaving a reduced choice of property for owner occupiers, who typically buy at completion. In a tight market, however, owner-occupiers purchasing during construction has become more common.

Almost 2,700 housing units were completed in the City and Docklands during 2006 in 101 schemes in the 12 post codes that encompass our market area. By the end of the year only 17% were available for sale – just 455 new units across a very large part of central London from Covent Garden in the west to the River Lea in the east, and from Highbury Corner in the north to Elephant & Castle in the south. Note that 63% of available units were located in SE1 and E14, leaving just 166 new homes available in the rest of the City and Docklands market. In EC1 there were only 22 new homes still available from 2006 completions at the end of 2006. As a result of a lack of supply in schemes already underway, at the end of 2006 our New Homes department was busy selling units in schemes due for completion in 2008 and 2009.

TABLE 2: SALES PROGRESS IN NEW HOMES IN THE CITY AND DOCKLANDS SCHEMES COMPLETED IN 2006

Post Code	Number of Private Schemes	Total Private Units	Total Units Available at November 2006	% Units Available
E1	13	234	48	20
E2	7	81	7	9
E14	10	629	158	25
EC1	12	245	22	9
EC2	2	34	13	38
EC3	1	15	0	0
EC4	2	33	4	12
N1	16	316	59	19
SE1	29	1,004	131	13
SE16	4	52	0	0
WC1	4	37	13	35
WC2	1	7	0	0
Total	101	2,687	455	17

Source: Hurford Salvi Carr, LRR, CCR

As an illustration of this trend, Hurford Salvi Carr marketed 74 apartments off-plan on behalf of Mount Anvil in July 2006, at Angel Wharf, 166-168 Shepherdess Walk, N1, a new development on the Regent's Canal that will also include 34 social housing units and 30,000 sq ft of commercial space, mostly offices. There were a number of interesting points about this forward sale:

- 80% of the units were sold in a launch on 20th July 2006, the vast majority to individual investors, illustrating the strength of the investment market.
- The launch did not target or include bulk investors and as a result there was no need for the developer to offer discounted prices.
- Aside from a single editorial piece in the Evening Standard, the marketing of the scheme was exclusively via the internet, resulting in a queue around the block on the launch day.

In October 2006, we undertook a similar approach when marketing 14 units under construction in an office to residential conversion at 131 Aldersgate Street, EC1, north of Barbican station, due for completion in spring 2007. As a result of a limited marketing campaign, 12 of the 14 units offered for sale were sold within a month, at an average price of £700 psf. For the new homes market in and around the City, it appears that £700 psf is emerging as a new benchmark pricing level.

The number of new homes due to be completed in 2007 in the City and Docklands is likely to be 10% lower than in 2006 (LRR), and as a result the supply and demand imbalance will not be corrected and additional value will be created by developers, provided that the correct specification and marketing are adopted.

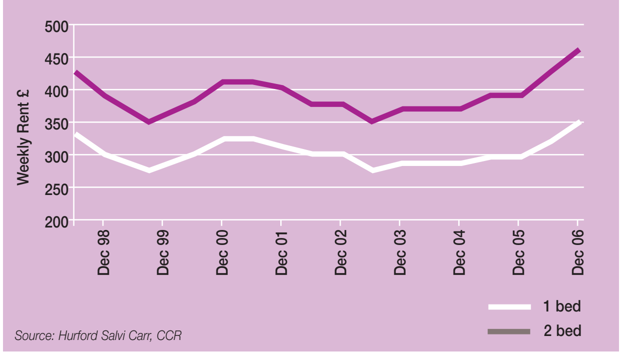
the *rental* market

HIGH RENEWAL RATES REDUCE VOIDS

Ten years ago there was virtually no private housing stock in many parts of our market area. In 2006, in a sign of the growing maturity of the market, we transacted a greater number of leases than sales for the first time in our ten year history.

The performance of the rental market in the City and Docklands in 2006 was exceptional, with rents increasing by almost 20% during the year (Figure 2). This built on more modest increases since mid-2003, illustrating that demand for rental property in the City and Docklands is growing in line with the buoyancy of local labour markets. As a corollary, when London lost jobs in the early 2000s recession, residential rents reduced. Typical market rents for one and two bedroom units in the City and Docklands stood at £350 and £460 per week respectively at the end of 2006, the highest levels in current prices since our survey began in 1998.

FIGURE 2 : WEEKLY OPEN MARKET RENTS IN THE CITY AND DOCKLANDS 1998-2006



Source: Hurford Salvi Carr, CCR

Following an established pattern, the third quarter was particularly active with an influx of corporate lettings, high net worth individuals, "milk round" employees and the usual crop of parent-supported third level students. In addition, the level of renewals of existing tenancies was higher than normal, reflecting the ever-rising entry price for first-time buyers in the sales market, with one and two bedroom units going up by £30-50,000 every six months. Some prospective purchasers were priced out of the market and renewed their tenancies, often at a new rent level based in part on the growth of the Retail Price Index. With the average age of purchase in central London in the early to mid 30s, occupiers could well be in the rental market for over ten years – in high quality spaces a world away from the image of private rented accommodation to a previous generation. In other words, low quality rented stock is no longer a factor pushing renters to buy.

Another factor influencing the demand for rented accommodation has been the influx of migrants from the 2004 European Union accession states, adding to already established migration into London from the rest of the UK and established EU countries. This reduces stock levels generally and encourages competition for the between employees for locations close to the City and Canary Wharf.

INVESTMENT ACTIVITY

Although there was a significant increase in rent levels in the City and Docklands in 2006, this had little impact on yields as capital values grew in tandem. In the second half of 2006 the typical gross initial yield for a one bedroom flat was maintained at 5.4% (Table 3).

Interest rates rose twice in the second half of 2006 by a total of half a percentage point, and there were some indications of weakness in the UK buy-to-let market, with auctioneers reporting that around 50% of repossessions sold at auction were buy-to-let. Repossessions reflect both rising interest rates and the fact that past-buyers are now coming to the end of fixed rate deals, and new fixes or variable rates (plus the inflation of other costs) have led to arrears in a limited but growing number of cases. Repossessions, however, feature neither in the City and Docklands nor in the wider London investment market. In the case of London investments, any increase in mortgage costs has been matched by rising rents, giving buy-to-let investors confidence in the market over the short to medium term.

The following transactions illustrate the areas of activity of our investment department during 2006.

Sale of a tenanted investment portfolio of 29 flats and 6 parking spaces in a luxury development in Clerkenwell, EC1, for £10.5 million to an Irish investment consortium.

80% of sales at a new block of 102 apartments developed by Bellway Homes at Zenith, Limehouse Basin, E14, to buy-to-let investors at an average price of £444 psf.

Sale of a portfolio of 9 new apartments developed by Buxton Homes at a development in Eagle Court, EC1, achieving £2.75 million.

Following the sale of 12 apartments off-plan at Saffron Heights, Farringdon Road, EC1, negotiation of a ten year lease to a serviced flats operator with annual rent in excess of £200,000.

TABLE 3: ILLUSTRATED INITIAL YIELDS FOR 1 BEDROOM FLAT IN THE CITY AND DOCKLANDS 1998 TO 2006

	Dec 1998	Dec 1999	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2005	June 2006	Dec 2006
Gross Annual Income £	15,600	14,300	16,900	16,120	15,600	14,820	14,820	15,340	16,640	18,200
Capital Value £	150,000	189,000	210,000	230,000	260,000	245,000	246,000	270,000	310,000	340,000
Gross Initial Yield %	10.4	7.6	8.0	7.0	6.0	6.0	6.0	5.7	5.4	5.4

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

Source: Hurford Salvi Carr, CCR

market *prospects*

The immediate prospects for the City and Docklands market in 2007 are "more of the same", but the exuberance of the market witnessed in 2006 could be tempered by mid-2007. The factors supporting confidence in the market include:

- **Lack of stock** – the underlying shortage of property for sale will continue to have the effect of limiting the opportunity to buy and this will lend support to further price increases. This is the most significant factor affecting the both sales and rental markets in the City and Docklands.
- **Security of employment** – there were at the end of 2006 no signs on the horizon of an economic shock that would be sufficient to lead to mass redundancies in the City, last seen in 2002.
- **Growth in employment** – data from economists, recruitment consultants, the London office market and private sector surveys support the view that central London employment has grown over the past few years, accelerating in 2006, and will continue to increase at least in the short-term.
- **Remuneration rates** – pay reviews and bonuses will bolster the already record level of compensation paid to central London bankers and professionals, with City bonuses due to be paid early in 2007 crystallising demand for housing that was evident in the market in the fourth quarter of 2006. Economist CEBR has predicted that London will be the beneficiary of £8.8 billion of City bonuses in early 2007, up from £7.5 billion in 2006.

Factors that might temper the market in the second half of 2007 include:

- **Interest rate rises** – the market has already factored in a further quarter point rise during the first quarter of 2007. Any further increases beyond 5.25% ought to have the effect of dampening demand.
- **Bonus factor fades** – the "once-a-year" boost to demand from high bonuses paid from January 2007 will have reduced by mid-2007.
- **Labour leadership** – although Gordon Brown's position as the next Labour leader and Prime Minister strengthened during November 2006, until he is formally elected by the Party, there will be uncertainty over the future direction of economic policy. Markets respond to this type of political uncertainty with quiescence, at best, so there may be a quieter period in the second quarter of 2007.

Our projection for 2007 is that overall prices will increase in the order of 10%. The majority of the growth will be seen in the first half of 2007 and we believe there will be a slowdown over the summer. We also consider that residential rents will rise by 15% in 2007, reflecting continuing low void rates and high rates of demand for rentals given that rising sale prices will price some potential buyers out of the sales market. Looking further ahead, we would expect to see the sales price inflation rate reduced to single figures during 2008.

Predictions of a housing "bust" are common currency when the market is exuberant, and because the last one in the UK was in the early 1990s and house prices have been rising steadily in the UK since 1996, economists are going to be right one day. On the other hand, it appears for the moment at least that the level of growth projected in the London Plan, which envisaged a 10% increase in London's population and jobs over the next twenty years, is being achieved. With supply limited, that will tend to support house prices.

Aside from the economic cycle, one of the major limiting factors for employment and population growth is the capacity of London's transport infrastructure. The guaranteed delivery of the East London Line Extension Phase 1 by 2010 is a welcome first step, but a guaranteed delivery date for CrossRail is imperative if London is to fulfil its growth potential.

TOWERS POINT TO RENAISSANCE OF CITY ROAD

The London skyline is set to be radically transformed over the coming decade by the construction of a new generation of residential towers. Strongly supported by London Mayor Ken Livingstone, these schemes will also provide significant amounts of affordable housing (including shared equity) as well as commercial uses such as offices, retail and leisure. Towers are popular with buyers and renters, and developers are bringing forward many new schemes, not least because high density living (and working) chimes in with planning policies for sustainable development to accommodate London's projected growth. In 2006 the Mayor raised the target for new homes completions for London from 23,000 to 31,090 per annum, and towers could make a significant contribution in boroughs seeking to meet these targets.

One location close to the City that looks set to benefit from this process is City Road. City Road forms part of London's Inner Ring Road and is the boundary of central London as far as the congestion charge zone is concerned. It connects Angel with Old Street, but lacks a coherent sense of identity as a "place". Until the early 1800s this area was outside London, but after the Regent's Canal was built between 1814 and 1820 the land between the canal and the city was gradually filled with warehouses and factories serviced by long canal basins, including City Road Basin and Wenlock Basin.

The introduction of residential use into this former industrial zone is nothing short of a revolution in land use planning, exemplified by proposals for three residential towers approved in 2005 and 2006 by Islington and Hackney councils. This followed the approval of a master plan for City Road Basin drawn up by Islington and landowners and approved in May 2004. If implemented, the towers will provide a contemporary reflection of the triple towers of the Barbican, just half a mile to the south, which proved the benefits of high-rise living even during the 1970s and 1980s - when towers had a bad name.

The three tower sites, working from west to east, are:

261 City Road, EC1. This former London Electricity site is on the south west corner of the City Road Basin, where permission was granted by Islington in 2005 to Fidelity Investments subsidiary Pembroke Real Estate for a 36 storey tower with 308 flats.

259 City Road, EC1. This is on the south east corner of the City Road Basin, on the former Access Storage site, and with 261 (above) will frame the basin. This proposal from City Road Basin Ltd (British Waterways and Miller Developments) and local specialist Groveworld, is for a 29 storey tower with 295 homes and was approved by Islington in 2006.

Eagle House, 158-189 City Road, EC1. This scheme, on the site of an office building and open car park a few hundred yards to the east of City Road Basin, was approved in 2006, following an application from Morley and Groveworld, for a 27 storey tower with 276 flats. In December 2006, the freehold of the site was on the market.

Wenlock Basin is also undergoing change, with the latest development being 50-60 Wharf Road, N1, by developer United House on the north-west corner of the basin, close to the Regent's Canal. This is a ten storey scheme with 55 private flats, 27 affordable units (including seven shared equity) and 50,000 sq ft net offices. Permission for the scheme was approved in October 2006 and after demolition is completed, Hurford Salvi Carr is set to launch the private flats off-plan in 2007.

City Road, centred on the revitalised canal basins, has the opportunity to develop its own identity as a modern waterside residential quarter, linking the established and elegant period squares of Islington with the more muscular industrial loft quarter of Shoreditch.

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TABLE 1: ILLU

Year End	
	Pric
	On
1998	NA
1999	+26
2000	+11
2001	+10
2002	+13
2003	-6%
2004	+0.
2005	+10
2006	+26

Source: Hurfor

new homes ma

TABLE 2: SALE

Post Code	Nu
E1	13
E2	7
E14	10
EC1	12
EC2	2
EC3	1
EC4	2
N1	16
SE1	29
SE16	4
WC1	4
WC2	1
Total	10

Source: Hurfor

the rental mark

Table 3: Illustra

	Dec
1998	Dec
1999	Dec
2000	Dec
2001	Dec
2002	Dec
2004	Dec
2005	Jun
2006	Dec

Gross Annual I
Capital Value £
Gross Initial Yie
Note: gross yie