Prime central London property prices inflate bubble fears

Overseas buyers are stifling traditional market mechanics, driving up rents and leaving some areas bereft of residents. Even estate agents are beginning to worry

The average asking price of a property in London has increased by more than £30,000 since the start of 2013, according to figures from property website Rightmove, and is now comfortably through the half-a-million pound mark, at £515,243. It sounds a lot, but in some parts of the capital it is small change.

Land Registry figures show the most expensive areas of the country - and those that have seen some of the biggest increases in prices - are the neighbourhoods that estate agents like to call "prime central London".

The property boom in these places – primarily Mayfair, Knightsbridge, the West End, Kensington & Chelsea, and Holland Park – has been extraordinary. The average price of a PCL home is now £1.53m, with the dearest deal done so far in 2013 believed to have been for a flat at One Hyde Park, sold for £29.35m.

It may seem that the only way is up, but politicians, retailers and even estate agents are warning that expensive homes are creating soaring rents, an exodus of small shops and a ghost town atmosphere, and that the market could turn out to be a bubble.

Silent streets

One big concern about the PCL boom is that it is leading to streets where nobody actually lives. "More and more stats and anecdotes indicate that 'Fortress Central London' is emptying of residents," says Ed Mead of Douglas & Gordon, an estate agency with 11 branches across the capital.

He says many overseas buyers own multiple homes around the world and rarely spend time in any one, however much it cost. As a result, parts of PCL fail the neighbourhood test of having milk and newspapers on sale within a short walk of where people live. "Why should owners care? They're never here to need them," Mead says.
Aldo Zilli - Chef Chef Aldo Zilli moved his restaurants out of Soho in 2012. Photograph: ITV/Rex Features

In 2012, of 7,000 new-build homes sold in PCL, more than 5,000 went to overseas buyers, and the estate agency Knight Frank says buyers from just two countries, China and Singapore, bought 40% of them. Savills, another agency, says fewer than half of PCL buyers treat their purchase as their main home, the rest are just investments.

"Some of the richest people in the world are buying property as an investment. They live here for a fortnight in the summer but the rest of the year they are contributing nothing to the local economy," says Paul Dimoldenberg, leader of Westminster council Labour group.

One of the reasons so many homes lie empty is that house prices have been rising rapidly, meaning capital appreciation is so high there is little incentive for some investors to let their property.

"Take a flat worth about £850,000 a year ago. That's worth £950,000 now," Mead says. "The capital growth alone is equivalent to almost £2,000 a week and there's no wear and tear." He believes some investors purchase new-build apartments only to "bubble wrap and sell in pristine condition at some point in the future".

This may account for why Knight Frank, which had expected no growth in PCL rents in 2013 on the back of City of London job losses, has now reported spring increases in rents in St John's Wood, Kensington, Marylebone, Belgravia and Knightsbridge.

Not only have residential prices and rents rocketed, excluding many London buyers and tenants, but commercial rents have soared as chains have outbid long-standing local shops in a bid to attract wealthier homeowners.

Aldo Zilli shut his two Soho restaurants in 2012 claiming "Soho's not the same as 35 years ago when I moved in", and that the influx of chains that could pay high rents meant the area was "becoming like Dubai". Roe & Moore's art shop next to the British Museum has closed, citing soaring rents as a main problem. Meanwhile, the Heygate, a former council estate in Southwark – an area on the edge of PCL but identified as a growth area by estate agents – is being demolished, but only 79 of the 2,535 projected homes on the site will be offered to renters as social housing.

Closed market

Another issue raised by commentators is the shortage of homes for sale in PCL. Many existing overseas owners are not reselling on the open market; instead they sell or pass them on to members of their families, or advertise them through agents in their own countries.

"As a result there is less stock available and prices rise still further, narrowing the type of buyer who can afford to purchase," says David Adams of John Taylor, a high-end estate agency.

"British buyers traditionally used to trade up, even in central London. They would buy a flat, do it up, move to a terrace, then move out of the centre when a family came. That buyer doesn't exist in central London anymore, so turnover is much reduced."

Hamptons International, another high-end agency, says there is now "an acute shortage" of stock. The firm's head of sales, Marc Goldberg, says PCL stock is "45% lower compared with the bottom of the market in 2008 and 17% below 2012."

Even if they are sold, many PCL homes are put on a private grey market where "property is traded out of sight of the internet and done by email and telephone instruction," according to Henry Pryor, a buying agent locating homes for wealthy clients.

When central London apartments and houses wanted by these buyers become available, details are sent electronically to agents who then inform their exclusive clients. Typically there will be no hard-copy brochures in order to ensure confidentiality for the seller and deter would-be buyers who are not cash-rich and able to buy without a mortgage.

Currency concerns

A big problem for PCL is its vulnerability to currency exchange rates, international financial crises and fiscal volatility.

Knight Frank says buyers using US dollars will find PCL properties 7% cheaper than in 2008 thanks to sterling's slide, while buyers using pounds pay 17% more. By contrast, a collapse of the dollar or of Asian currencies which have shown similar strength against sterling could badly damage demand for London homes.

On top of this, Adams warns that trigger events – a second international banking collapse or the introduction of higher UK property tax – "could expose PCL as being nothing more than a bubble."

"It is easy to see a failed bank or a heavy duty mansion tax completely changing the perception among international buyers," Adams says. "You could see 20% wiped off prices overnight. It would be the end of PCL as we know it."

Although that prospect may not bring tears to most people's eyes, it is worth remembering that just as booming prices have had a knock-on effect on other areas, so would a crash. The ripples of a substantial fall in prices could be felt throughout London, while a return to negative numbers in house price reports could damage sentiment beyond the capital. While PCL's relentless rise has its problems, so too would a fall.