A Tale of Two Cities: A Snapshot of the London and Paris Residential Property Markets

CHESTERTONS

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Introduction

The expansion of the world's population of high-net-worth individuals is triggering increasing investment in international residential property. London and Paris are the two largest residential property markets in western Europe, and are highly sought-after by international investors and lifestyle purchasers alike. This report analyses the two markets in terms of their size and performance and examines their short-term future prospects.

London

Geography

London is both a city and a region comprising 33 boroughs and covering a total area of 1,572km2. Inner London, which contains most of the capital's prime residential property, consists of 14 boroughs covering 319km2 and Outer London encompasses 19 boroughs covering 1,253km2.

Figure 1: London map

Source: DMAG Focus on London 2008, ONS

Demographics

At just over 8.6 million inhabitants, London is by far the UK's largest city and represents 13.6% of the national population. The population reached a record high this year after growing at its fastest ever rate. The mid-scenario forecast is that it will increase to just under 10 million by 2035. Around 39.5% of the population lives in Inner London, which is forecast to grow at a slightly slower rate than Outer London and London as a whole over the next two decades.

Figure 2: London population forecasts

Population forecast	2015	2020	2035	Change (%)
London	8,615,246	9,032,571	9,983,766	15.80%
Outer London	5,210,501	5,467,307	6,087,340	16.80%
Inner London	3,404,745	3,565,263	3,896,426	14.40%

Source: DCLG/GLA

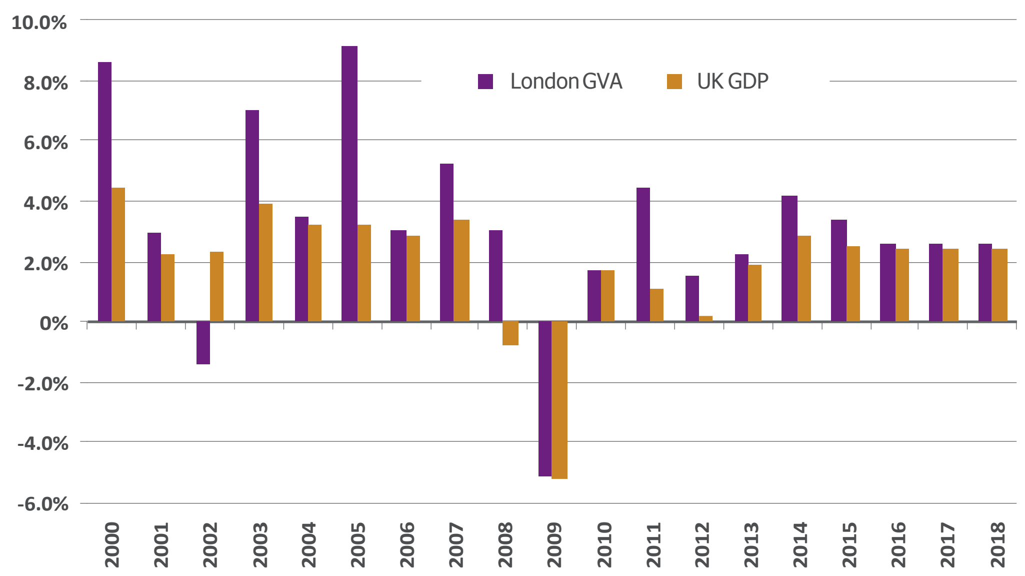
Economy

London is a global city and the economic heart of the UK. It accounts for 22.2% of national economic output and is a similar size to the entire economy of Sweden. Just under a fifth of London's gross value added (GVA) is generated by the financial services and insurance industry, which accounts for half of the UK's total GVA in the sector and 4.1% of the UK's total GVA. London also has one of Europe's fastest growing technology sectors, with a 75% increase in the number of Information and Communication Technology (ICT) companies investing from overseas since 2010. The Technology, Media and Telecommunications (TMT) sector in London accounts for £125 billion (8%) of economic activity across the UK and one in ten jobs in the capital.

The economic climate in London is positive. The May 2015 Purchasing Managers Index (PMI) survey reported continuing expansion in business activity, new orders and employment while consumer confidence in London stands at a post-recession high.

The unemployment rate in London decreased from 6.5% in Q4 2014 to 6.2% in February 2015. The prospects for London's economy are also healthy, with growth set to outperform the national average over the next five years.

Figure 3: UK & London economic growth



Source: ONS, Treasury Forecast Panel, GLA, CEBR

Quality of Life

The Mercer Quality of Living Report ranks London as the 40th best city in the world in which to live. As befits a city of its size, there is as wide a choice of entertainment and cuisine as one could wish for and it is one of the world's most cosmopolitan cities with over 300 languages spoken – more than in any other city.

There are large expatriate communities across the capital and the French consulate in London estimates that between 300,000 and 400,000 French citizens are now living here.

There is a rich heritage of buildings and monuments: three of the top ten museums and galleries in the world are in London and in total there are no fewer than 857 art galleries and over 170 museums. There are additionally four UNESCO World Heritage Sites: the Tower of London, Maritime Greenwich, The Palace of Westminster (including the Houses of Parliament and Big Ben, St Margaret's Westminster and Westminster Abbey) and the Royal Botanic Gardens at Kew. There are also 250 festivals that take place annually, including the Notting Hill Carnival which is Europe's largest street carnival attracting approximately one million people.

Transport Infrastructure

London's infrastructure is crucial to maintaining its status as a world-class city. It is well-serviced by regular international flights, with a choice of five airports (Heathrow, Luton, Gatwick, London City and Stansted), which between them transport approximately 135m passengers annually. London also benefits from the high-speed Eurotunnel rail services connecting London with the Continent, including Paris.

Within the capital itself, the extensive underground system transports around 1.3 billion people annually, while London buses make about 2.4 billion journeys each year. A bike sharing scheme, introduced in 2010, has been growing year on year to reach nearly 10 million users, while the Mayor has set a target of 12 million passengers to be carried annually by the London river taxi services by 2020.

A number of infrastructure improvements, most notably the Crossrail project, will further facilitate travel within the capital and will enhance property values in adjacent locations. Total planned public infrastructure expenditure in the capital stands at £35.8 billion, of which £28.3 billion is allocated to transport projects. The Mayor has also commissioned work to create the capital's first Long Term Infrastructure Investment Plan in order to ensure that London has the necessary infrastructure needed to cope with the projected population growth up to 2050.

The most significant projects planned or underway are Crossrail (£14.8 billion), which is due to commence operations in late 2018, and the Northern Line Extension to Battersea Power Station (£1 billion). The impact of both projects will be felt in terms of new development with Crossrail and the Northern Line Extension estimated to support the delivery of, respectively, up to 55,000 and 16,000 new homes.

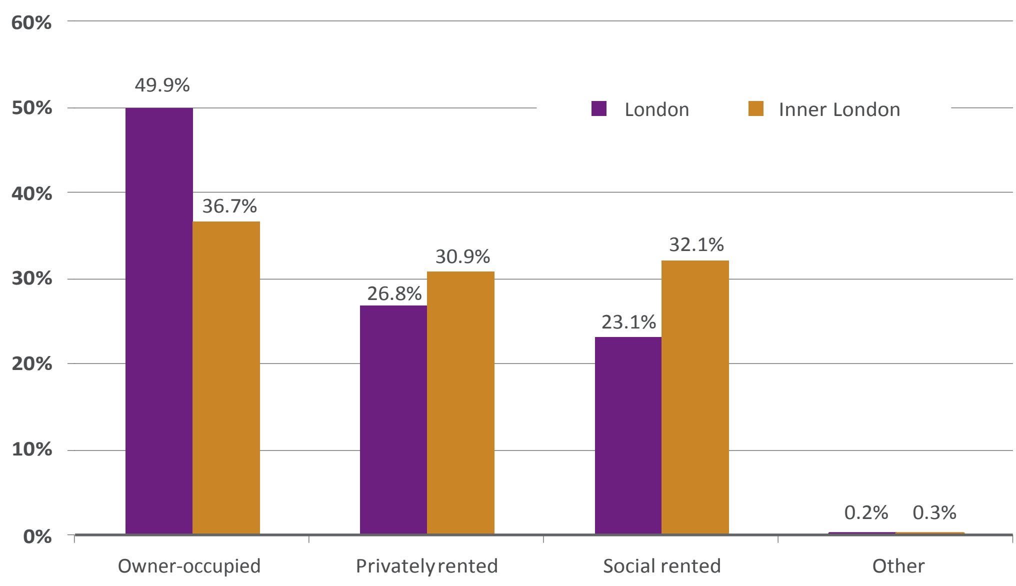
Residential Market

Market Size & Tenure

London is the UK's largest and wealthiest housing market and has expanded rapidly in recent years. The number of households in London has grown since 1991 from 2.8 million to over 3.3 million. Over the same time period, the number of Inner London households has risen from 1.1 million to 1.4 million. The housing stock has risen from 3.1 million dwellings in 2001 to 3.4 million in 2014 – an 11% increase.

Tenure trends have changed dramatically in London since the beginning of the noughties. Owner occupation has fallen from 56.5% of households in 2001 to 49.9% in 2014 while the private rented sector has expanded from 15.5% to 26.8% over the same period. The change has been even more pronounced in Inner London where currently 36.7% of households own their property and 30.9% rent privately.

Figure 4: London housing tenure (2014)



Source: GLA

House Building

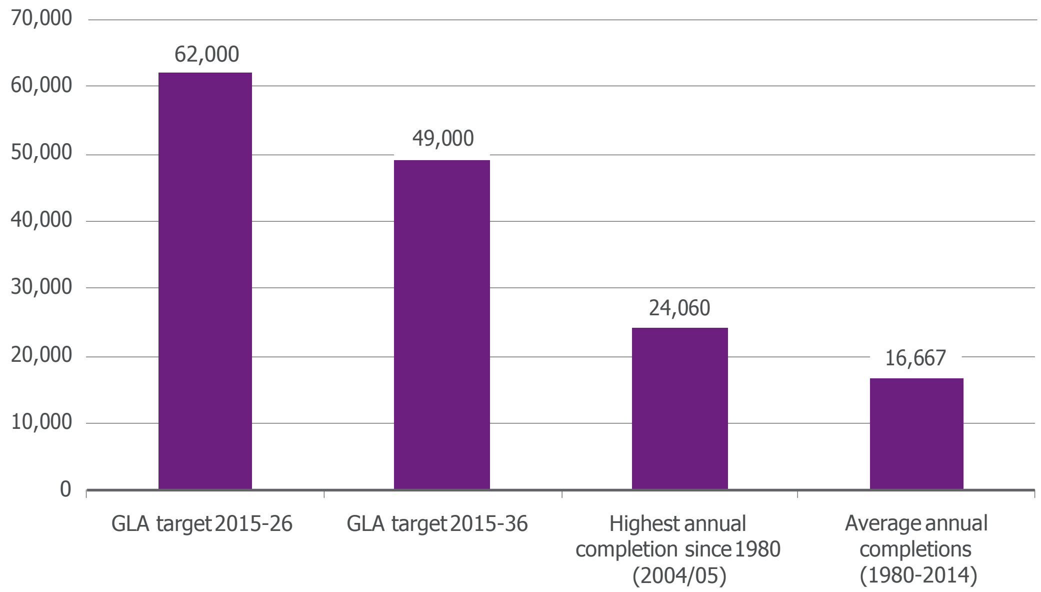
London suffers from a chronic shortage of housing relative to demand, as a result of insufficient levels of new construction and a rising population. The consequence of this imbalance is that house prices have become increasingly unaffordable for many households despite the favourable mortgage lending environment and record low interest rates. The problem is exacerbated by the fact that renting has also become unaffordable for a growing number of people.

The number of private sector new build homes registered in London during 2014 was 28,733 according to the National House Building Council (NHBC), which is a 10% increase from the previous year but still falls short of what is needed. The planned annual housing targets from the Greater London Authority (GLA) (2015-26 is 62,000 p.a. and 2015-36 is 49,000 p.a.) are both more than twice the highest average number of annual completions achieved since 1980 (16,667), while the highest annual completions number was only 24,000 in 2004.

In an attempt to increase the housing stock, designated Housing Zones are being established to fast-track housing development and the use of brownfield sites wherever they are located is being encouraged. In addition, in May 2013 the Government introduced temporary (until May 2016) permitted development rights (PDR) for office-to-residential conversions, which rose to a 10-year high in 2014.

London suffers from a chronic shortage of housing relative to demand, as a result of insufficient levels of new construction and a rising population

Figure 5: GLA annual housing target v historic completions



Source: GLA/DCLG

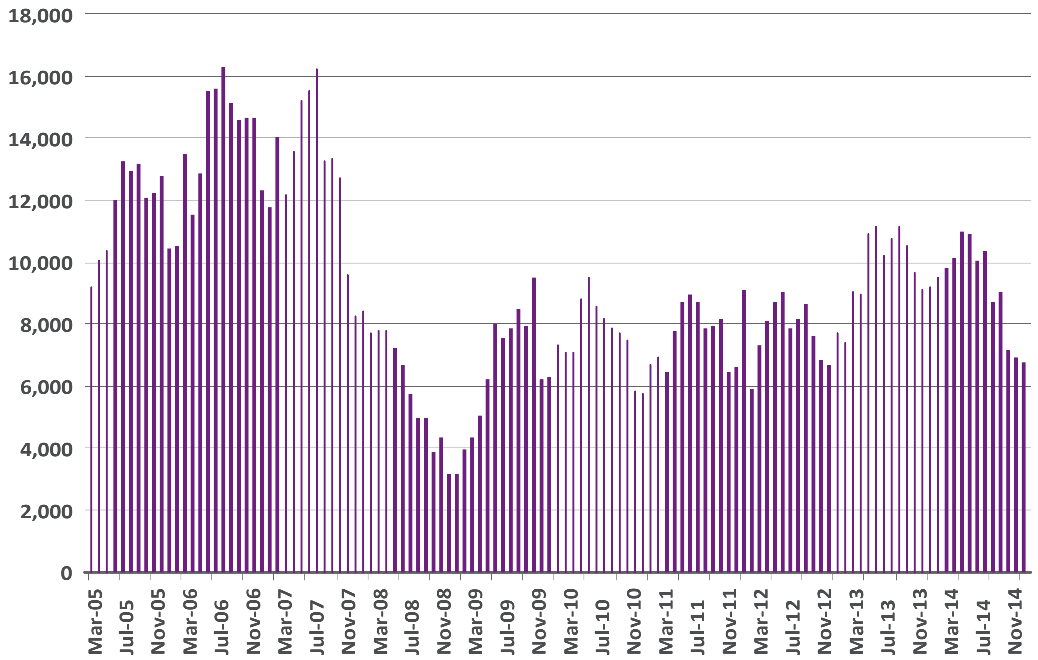
Demand

The global financial crisis of 2007/8 depressed housing demand for several years and it was not until 2010 that a tentative recovery began. However, this turned out to be the first of several false dawns and it was only from the beginning of 2013 that a sustained recovery took hold. This has been supported by a favourable mortgage environment, notably falling lending rates which reached a record low of 3.01% in Q1 2015, and rising activity from buy-to-let investors and overseas buyers. Coupled with an increasingly buoyant national and local economy, this boosted residential sale transactions up until autumn 2014, since when transaction volumes have trended downwards. This trend became more pronounced in the first quarter of this year when sales declined by just over 23% compared to Q1 2014 according to provisional data from the Land Registry.

The recent drop in sales is the result of a combination of factors. Despite low mortgage interest rates and Government programmes to facilitate home ownership such as Help-to-Buy, for many households affordability remains an issue both in terms of monthly mortgage payments and in raising a deposit. In the prime sector and for investors generally, the build-up to the 2015 General Election exerted a negative influence on buyer confidence, especially with regard to the possible introduction of a Mansion Tax and rent controls. The revision of the Stamp Duty Land Tax (SDLT) system was an additional contributory factor at the higher end of the market as was a shortage of available properties for sale.

Non-residents were additionally concerned about the introduction of Capital Gains Tax from April 2015, which triggered a spate of valuations from existing owners although few actual sales. Foreign buyers have long been an important element of the London residential market, which is viewed as both a safe haven and a market with good long-term performance prospects, and their presence increases proportionately with price – within some prime central London locations, they are estimated to account for over 50% of sales, a figure which can go above 75% in some micro-markets, notably some luxury new home developments. In 2014, 25 of London's 33 Boroughs had more than 30% of residents born outside of the UK, with the ratio in Westminster and Kensington & Chelsea rising to over 50%.

Figure 6: Residential sale transactions in London Mar 2005 - Mar 2015



Source: Land Registry

With the uncertainties of the General Election behind us, there has been a noticeable improvement in consumer confidence although the impact on sales volumes has so far been minimal. However, the market is expected to pick up steadily over the remainder of the year and into next year provided interest rates remain low and there are no further major economic shocks.

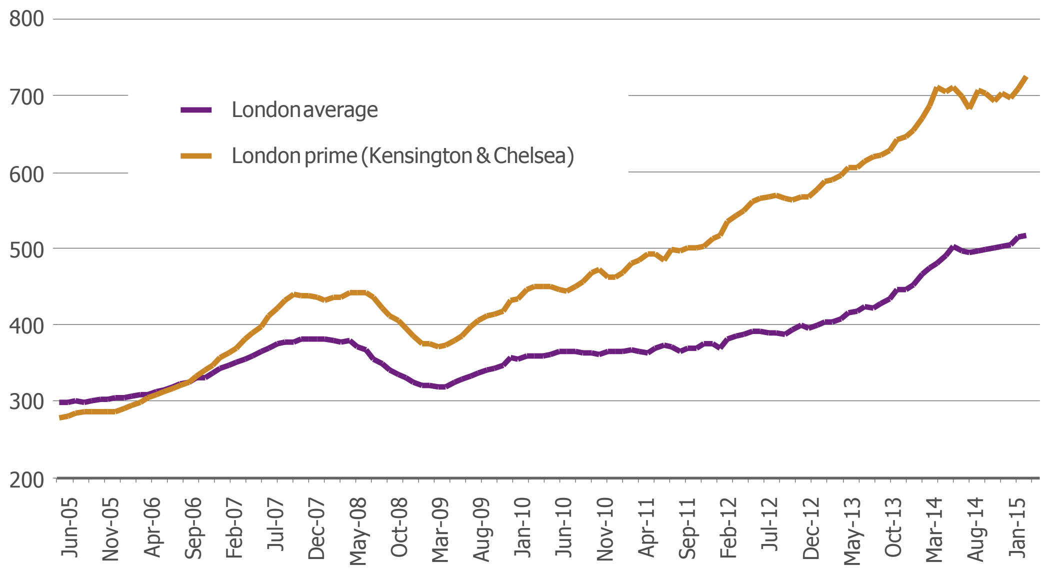
Capital Values

Although transaction volumes took several years to recover following the global recession, average house prices have been trending upwards since the summer of 2009 driven largely by the imbalance between supply and demand. According to Land Registry data, as at May this year, average values were 63% higher than the post-recession trough in April 2009 and 36% higher than the pre-recession peak in February 2008.

However, the particularly strong growth seen during most of the first three quarters of 2014 has proved unsustainable and annualised price growth has been slowing since then, from the high double-digit territory for much of last year to single figures for the first three months of 2015, according to Land Registry data. April saw an acceleration up to 11% although the May figure fell back to 9.1%.

The post-election confidence boost, combined with pent-up demand, is likely to exert upwards pressure on prices when sales pick up again. However, prices are more likely to enter a period of moderate growth over the next couple of years rather than return to growth levels seen in much of last year. Mortgages will become more heavily regulated in the wake of imminent new legislation, interest rates are expected to rise from next year and ongoing affordability issues will all act to subdue buyer demand.

Figure 7: Average v prime London house prices (Index: Jan 1995 = 100)



Source: Land Registry

Values in the prime sector peaked in mid-2008, a couple of months after the wider London market. The global recession induced decline in prime values was slightly less severe than that experienced in the wider market (around 16% compared to just under 17%) and lasted for approximately one year. From mid-2009, prime values began to recover and soon outpaced the rate of growth in the wider market before peaking in the first quarter of 2014.

Since then, values have flattened and in some prime locations have seen a slight decline. This reflects a combination of buyer resistance to asking prices, the impact of the changes to Stamp Duty and Eurozone buyers retreating as the euro has weakened. Prime values should stabilise over the summer as the wave of price reductions is absorbed and buyers are tempted back to the market. Thereafter, achieved values should see a return to growth, although growth rates are likely to be modest in comparison to the last upwards cycle.

The most expensive submarkets are situated in the prime central locations including Mayfair, where capital values average £2,500-£3,000/ sq ft but have recently exceeded £5,000 / sq ft on a new development close to Green Park, and Knightsbridge, where values average £3,000-£3,500 / sq ft but have famously exceeded £7,000 / sq ft at One Hyde Park.

From mid-2009, prime values began to recover and soon outpaced the rate of growth in the wider market before peaking in the first quarter of 2014

Figure 8: Selected prime capital values in London (at June 2015)

Submarket	Borough	Ave value £/ft2	Top value £/ft2
Mayfair	Westminster	2,500-3,000	5,000+
Knightsbridge	Kensington & Chelsea/Westminster	2,500-3,250	7,000+
Kensington	Kensington & Chelsea	1,500-1,700	4,500+
Chelsea	Kensington & Chelsea	1,700-2,000	3,500+
Hyde Park	Westminster	1,250-1,350	2,000+
St John's Wood	Westminster	1,100-1,400	3,000+
Hampstead	Camden	900-1,200	2,000+
Fulham	Hammersmith & Fulham	850-1,050	1,500+
Notting Hill	Kensington & Chelsea	1,200-2,000	3,000+
Islington	Islington	900-1,100	1,500+
Camden	Camden	800-1,500	2,000+
Little Venice	Westminster	1,200-1,500	2,000+
Westminster/ Pimlico	Westminster	1,300-1,400	1,700+
Canary Wharf	Tower Hamlets	600-700	1,000+

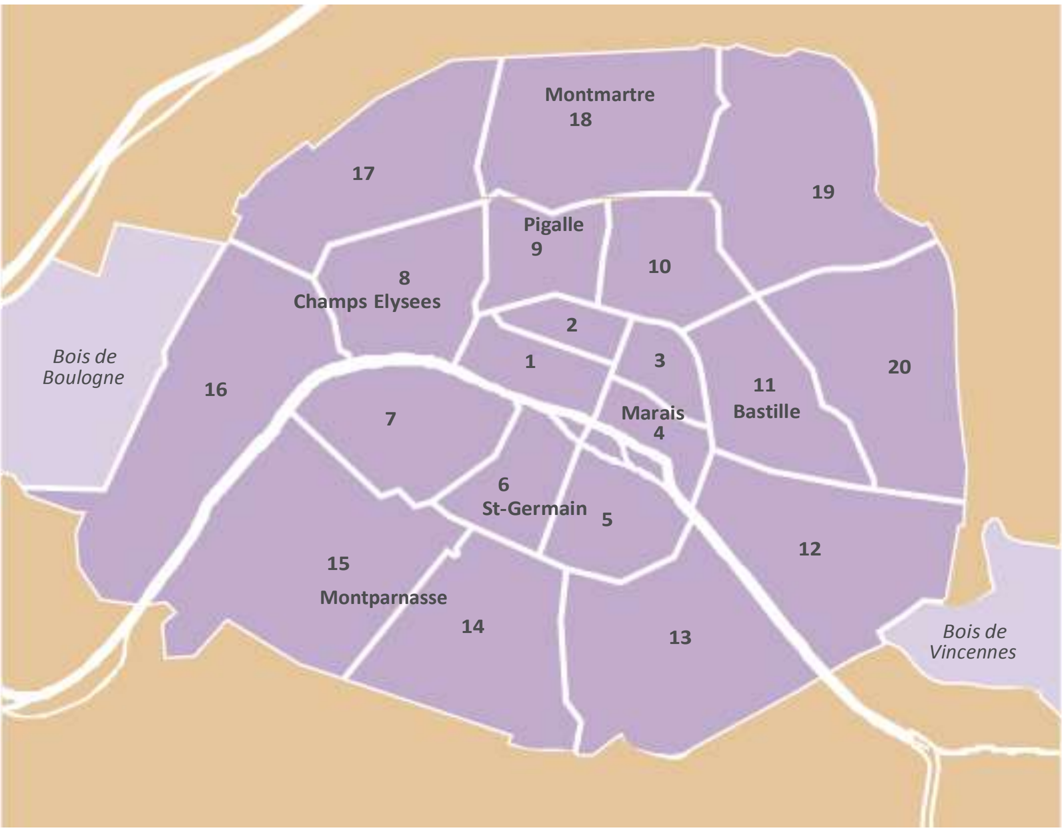
Source: Chestertons Research

Paris

Geography

Paris is the largest city in France and the economic and political centre of the country. Covering an area of 105 km2, it is one of eight administrative departments within the Île-de-France region and is subdivided into 20 arrondissements.

Figure 9: Paris arrondissements



Source: Chestertons Research

Demographics

The Île-de-France is home to just over 12 million people (18.2% of the national population) of which Paris accounts for 2.3 million. The regional population is relatively young – 50% are aged under 40 – and 12.6% of the inhabitants are from outside France. Both the region and Paris itself are forecast to see steady population growth between now and 2035 at 9.2% and 7.1% respectively.

Figure 10: Paris population forecasts

Population forecast	2014	2020	2035	Change (%)
Île-de-France	12,005,077	12,205,310	12,862,028	7.1%
Paris	2,241,346	2,323,615	2,448,640	9.2%

Source: INSEE

Economy

The Île-de-France region is the economic heartland of the country and accounts for around 31% of French GDP and 23% of national employment. The economy is dominated by the services sector, where employment represents 84.5% of the region's total, compared to 75% at national level. Other important industries in the region include electronics and ICT, agro-food, construction, automobiles, pharmaceuticals, culture and aerospace.

The region is also a major farming and food industry player, both at a national and a global level. Paris itself houses more than two-thirds of the headquarters of the country's major companies and a large share of senior management and research staff.

Economic activity in France has been sluggish for several years – GDP growth was only 0.4% in 2014 – however there are signs of improvement this year. French business confidence was at its highest for nearly three years in March on the back of lower oil prices and a weaker euro and the The Organisation for Economic Co-operation and Development (OECD) forecasts growth will accelerate to 1.1% this year and 1.7% in 2016. However, the unemployment rate has drifted upwards to reach 8.9% in the Ile-de-France and 8.3% in Paris at the end of 2014.

Looking ahead, the potential impact of Greece exiting the European Union is uncertain but would almost certainly exert downward pressure on the Euro making imports more expensive, but would also make French property cheaper for international buyers.

Quality of Life

The Mercer Quality of Living Report ranks Paris as the 27th best city in the world, ahead of London. Healthcare, infrastructure, and recreational facilities are generally of a very high standard, while political stability and relatively low crime levels provide a generally safe and secure environment for residents. Although the cost of living is higher than in other French cities, incomes are generally higher resulting in an overall higher standard of living.

From a leisure and tourism perspective there is plenty to see and do. Besides some of the world's most famous museums, Paris has a vibrant historic city centre, a beautiful riverscape and an extensive range of historic monuments. The city is also renowned for its café culture and cuisine as well as its vibrant nightlife, perhaps epitomised by the Moulin Rouge.

Transport infrastructure

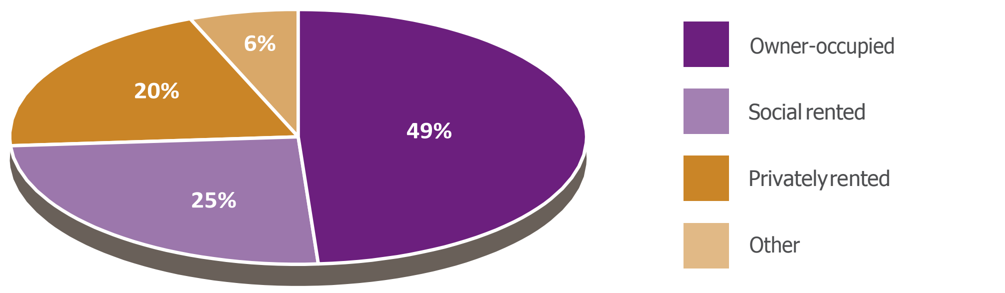
The transport network in Paris and its region is renowned for being one of the best in the world. The Île-de-France contains Europe's second largest airport hub, with two international airports (Charles de Gaulle and Orly) transporting 83.4 million passengers and 2.4 million tonnes of goods per annum, plus Beauvais-Tillé which is used mainly by budget airlines servicing Paris. The railway network encompasses six high-speed train stations, offering direct links to many of western Europe's major cities, including London.

Paris is contained within a ring road (the Périphérique) that stretches for 35km around the city. The Paris Metro is the second busiest metro system in Europe, carrying around 4.5 million passengers daily and is reputed to be one of the best transport systems in the world in terms of service density, frequency and safety.

A number of infrastructure improvements, most notably the Grand Paris Project, will further facilitate travel within the Île-de-France and will likely increase property values in neighbouring locations.

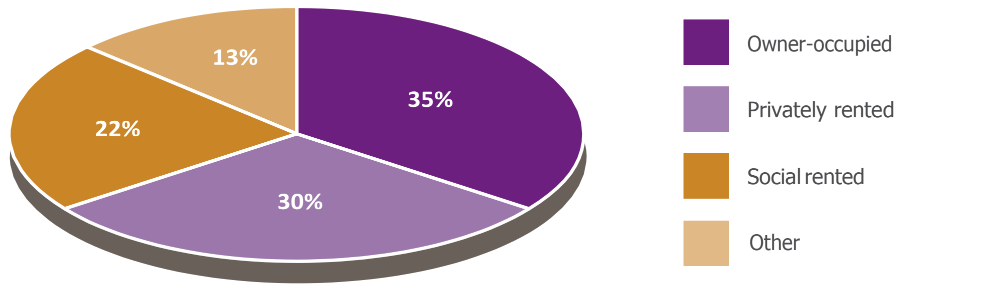
The Grand Paris project was first announced in 2007 and is forecast to be completed by 2030, at an estimated cost of €22.6 billion. It involves the construction of four new Metro lines around Paris and the expansion of two existing lines of the Paris Metro, which will deliver 205km of new rail network.

Figure 11: Île-de-France housing tenure



Source: INSEE

Figure 12: Paris housing tenure

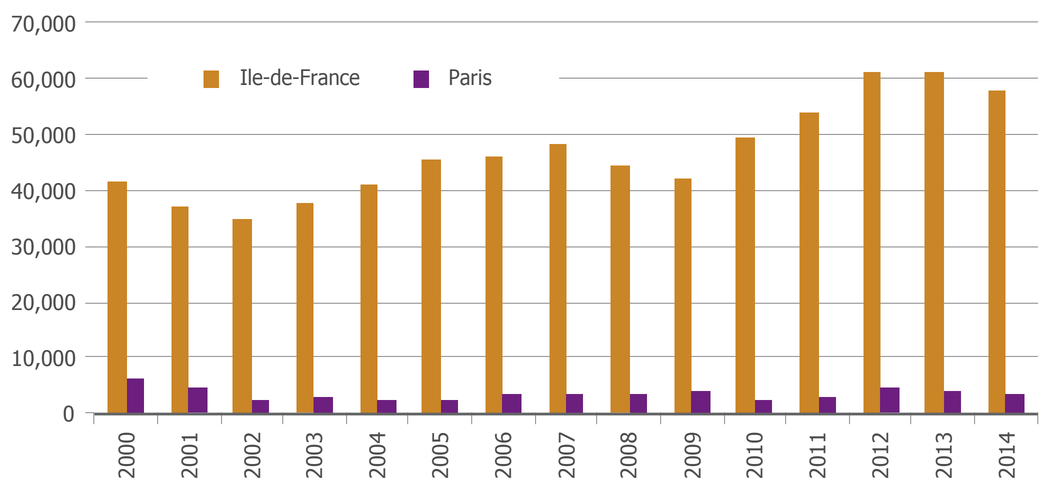


Source: INSEE

House building

As is the case in London, the Île-de-France suffers from a shortage of homes owing largely to poor housing construction rates, which are low given the size of the market. A strict planning approach, especially in Paris, is mainly to blame for this situation. Residential construction starts over the past decade have averaged just under 51,000 per annum in the Île-de-France and only a little over 3,500 per annum in Paris. Average construction rates have picked up in the Île-de-France in the current decade compared to the noughties (56,640 p.a. v 41,870 p.a.), but the corresponding improvement in Paris construction rates is modest: 3,700 p.a. v 3,620 p.a.

Figure 13: Île-de-France & Paris residential construction starts



Source: SOeS

As part of the policy to increase the housing stock, the Paris city administration is aiming to convert 250,000m2 of empty offices into housing by 2020, which is a key element of the strategy to provide more affordable homes and increase social diversity in the capital. French rail operator SNCF recently signed an agreement with the city authorities to build 14,200 housing units on disused railway land and through the conversion of obsolete office buildings. However, according to ORIE (the regional representative body for commercial property in the Île-de-France), French investors remain reluctant to put money into office-to-residential conversions despite the large volume of redundant space in the Paris region, as financial and legal constraints make it difficult to generate an adequate return on investment. This would suggest that the supply/demand imbalance is likely to persist for some time to come.

Demand

As is the case in London, demand for homes in Paris for both owner-occupation and investment far exceeds supply. However, affordability issues since the global recession have taken much of the steam out of the sales market.

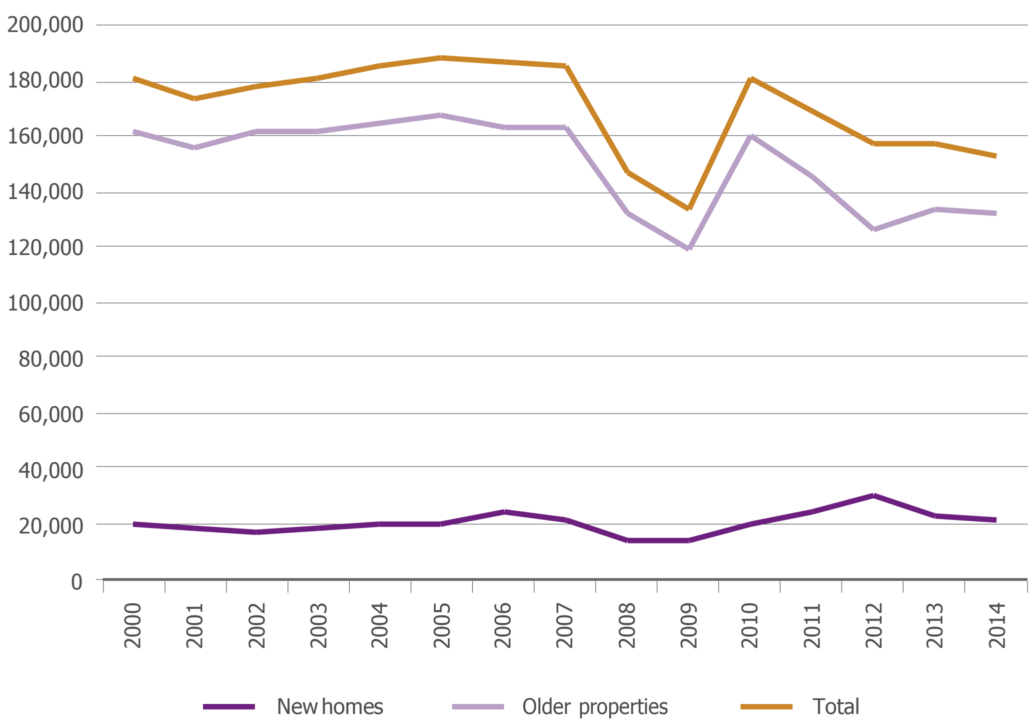
Residential sales growth has been fairly flat over the past few years and remains some way below pre-recession levels. Ten year average annual sales at the end of 2014 stood at just over 165,000 and 29,000 respectively in the Île-de-France and Paris according to official data.

Transaction numbers in 2014 in the Île-de-France were only 81.5% of the 10 year peak while in Paris they were just below 74%.

The new homes sector in the Île-de-France has experienced a similar trend, with annual sales declining over the past two years in both Paris and the wider Île-de-France region.

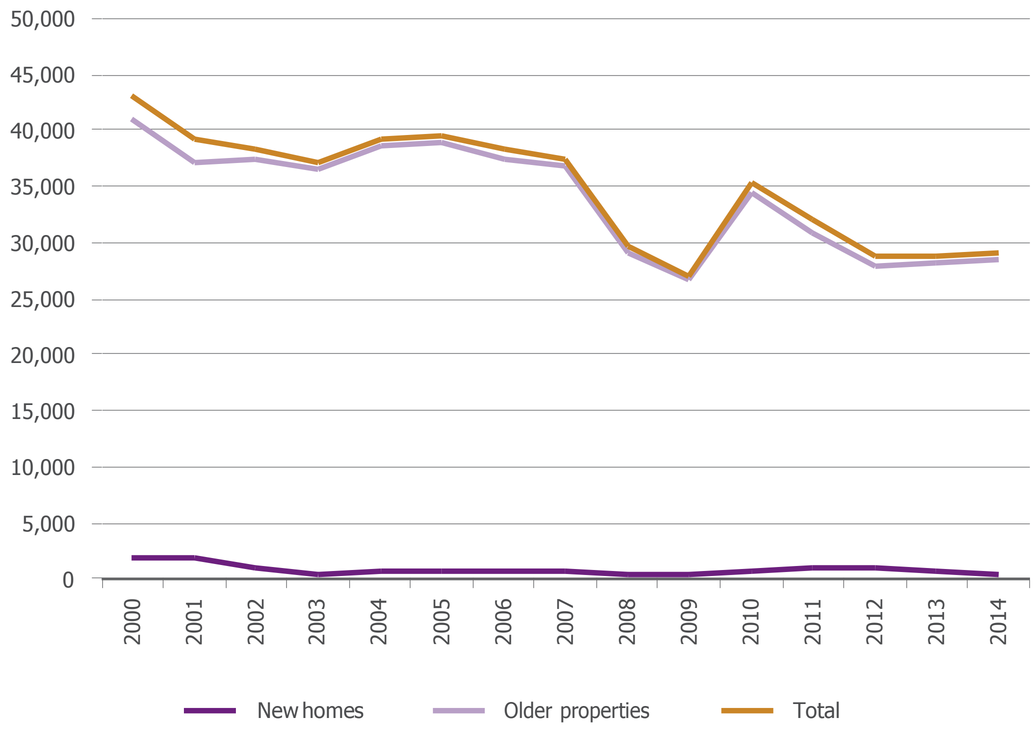
Over the past decade, sales of new homes have averaged 21,000 per annum in the Île-de-France and just 666 per annum in Paris.

Figure 14: Île-de-France residential sales



Source: CGEDD

Figure 15: Paris residential sales



Source: CGEDD

International buyers have become increasingly active since 2011 and, according to the Chambre des Notaires, currently account for 9.2% of apartment sales in Paris and 9.5% in the Île-de-France. In the 4th and 7th arrondissements the proportion of foreign buyers is significantly higher at around 17.5%.

The weakness of the Euro together with falling prices has made Paris property more attractive, although some eurozone countries are among the most prominent buyer nationalities, which include Italy, Portugal, China, Great Britain and French-speaking Arab countries, while US and Russian buyers are also prevalent.

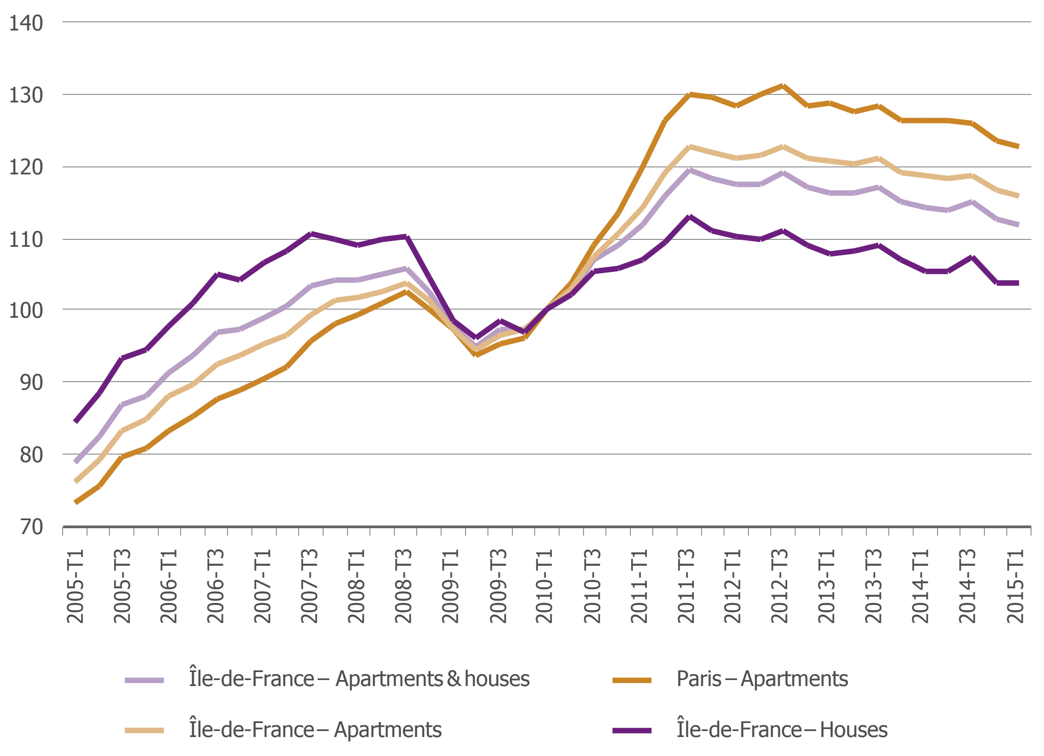
Capital values

Following the global-recession-induced market fall, residential values began to recover fairly quickly from the third quarter of 2009, though the return to growth was moderate and relatively short-lived. Residential property prices for both apartments and houses in older buildings have been falling or flat in the Île-de-France region, including Paris, since the third quarter of 2012.

A similar trend has been apparent in the new homes sector. According to Databiens, the higher segment of the market (above €1.5m) has seen the largest decline in values although all segments have been affected. Residential values in the Île-de-France in Q1 2015 were only 5.4% higher than their pre-global recession peak in Q3 2008 and just 17.5% above the post-recession low point in Q2 2009.

Data from the Notaires de Paris suggests average values in apartments in older buildings in Paris in Q1 this year stood at €7,910/m2, 2.9% lower than in the corresponding quarter in 2014. The most expensive locations were in the 6th and 7th arrondissements where the highest average values per m2 were €12,810 and €12,420 respectively.

Figure 16: Île-de-France & Paris house price indices (Q1 2010 = 100)



Source: Notaires de Paris

Residential values are expected to remain subdued over the next couple of years, however there is potential for more robust growth given the likely continued shortage of available property if demand picks up.

The most expensive properties are located in the 6th arrondissement comprising the prestigious quarters of St. Germain des Prés, la Monnaie, l'Odéon and Notre-Dame-des-Champs where prices currently can go as high as €25,000 per m2. Not far behind in value terms is the 7th arrondissement where values in the luxury quarters of St Thomas d'Aquin and Les Invalides can reach around €21,000 per m2. Other luxury districts include the Triangle d'Or (8th arrondissement) where value can reach over €21,000 per m2 and the Notre-Dame quarter (4th arrondissement) where values can approach €20,000 per m2.

Values outside Paris are noticeably cheaper. In Neuilly-sur-Seine to the west of the capital values currently range between €9,000 per m2 and €15,000 per m2, and drop to €7,000 - €11,500 per m2 in nearby Boulogne-Billancourt.

> ***The most expensive properties are located in the prestigious quarters of St. Germain des Prés, la Monnaie, l'Odéon and Notre-Dame-des-Champs***

Figure 17: Selected prime older apartment values in Paris (at June 2015)

Quartier	Arrondissement	Ave value €/m2	Top value €/m2
Rue de Rivoli	1st	€10,500	€16,000+
Place Vendôme	1st	€15,500	€17,500+
Avenue de L'Opéra	1st	€10,000	€16,000+
St Germain des Pres	6th & 7th	€14,000	€25,000+
Odeon	6th	€12,500	€20,000+
Rue de Passy	16th	€9,000	€16,000+
Avenue Victor Hugo	16th	€9,500	€16,000+
Les Invalides	7th	€12,500	€21,000+
Champs Elysées	8th	€10,000	€17,500+
Rue Saint-Sulpice	6th	€13,500	€16,500+
Triangle d'Or	8th	€13,000	€20,500+
Neuilly-sur-Seine	Hauts-de-Seine	€9,000	€15,000+
Levallois-Perret	Hauts-de-Seine	€7,500	€10,000+
Boulogne-Billancourt	Hauts-de-Seine	€7,000	€11,500+

Source: Chestertons Research

Contact

Chestertons is one of London's largest estate agencies and has a network of over 30 offices offering sales and lettings services, in addition to a further 35 offices worldwide including Dubai, Singapore, Monaco, Paris, Marbella, Barbados, St Tropez, Mallorca and Australia.

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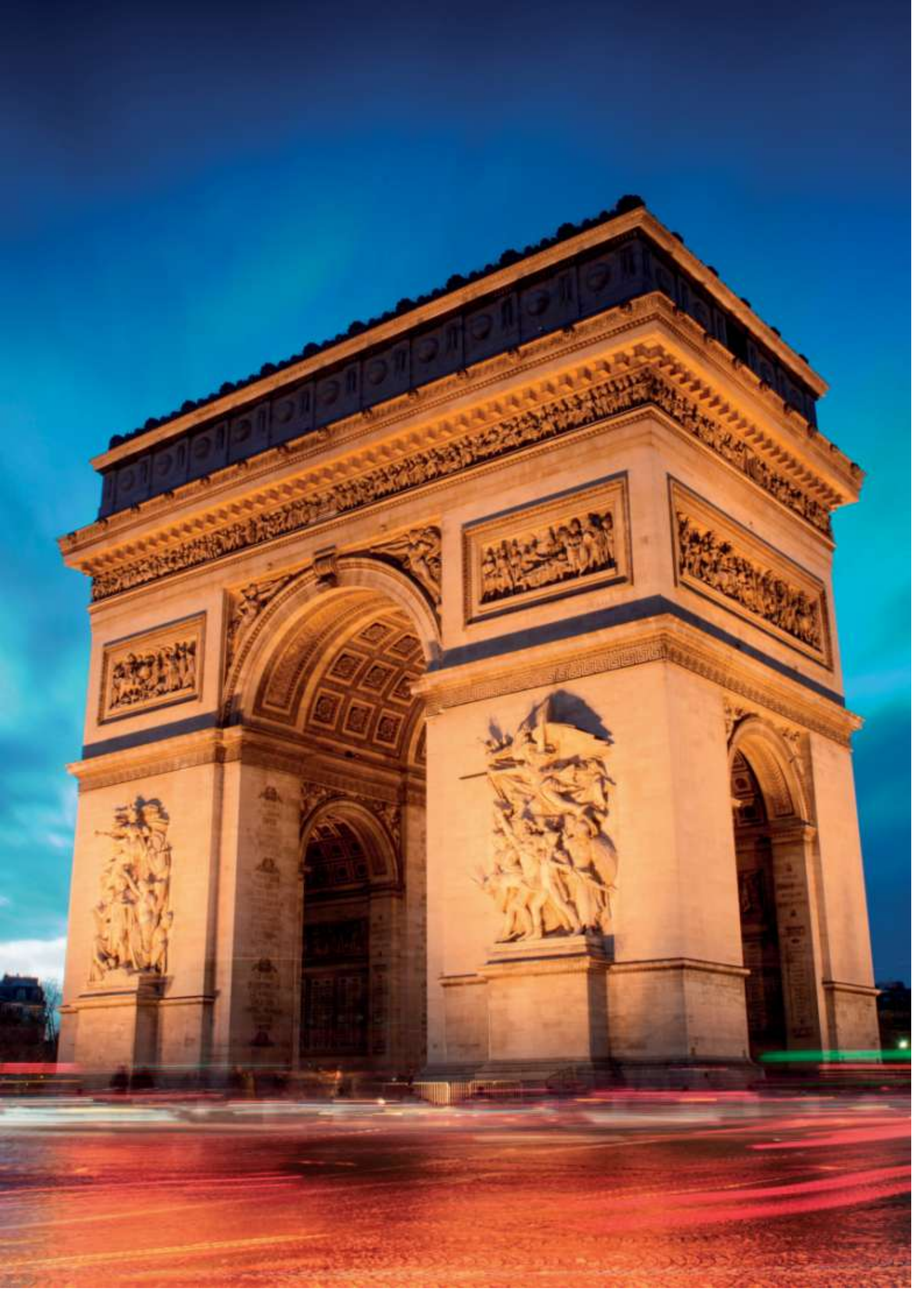

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