NINE ELMS

UNDERSTANDING THE VISION

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Misconceptions

Regeneration development at Nine Elms has attracted some negative attention based on a range of factors. Detractors object to many elements of the new residential development taking place on site, such as its scale, high prices, international ownership as well as elements of the design itself.

Some of the criticisms levelled at Nine Elms are valuable challenges to Central London's largest regeneration area. This is the only location in Central London that could absorb the development of such a huge volume of new offices, shops, hotels, homes and open space. However, much of the media comment on weakened price levels and sales rates – even prior to the Referendum – has been exaggerated and widely misinterpreted. To the extent that the residential market is heavily influenced by sentiment, it has the potential to become a self-fulfilling prophesy.

This short note is intended to address many of these issues head on, recognising that much of the press commentary to date is not entirely based on hard facts. In fairness, a reticence from some developers to provide a more transparent flow of information to journalists has not helped. As advisor and agent to many of the new residential schemes in the area, JLL clearly has its own interests, which we acknowledge up front. However, this privileged position also means we are among the best placed to provide vital facts behind the real story unfolding across the mixed use development at Nine Elms.

JLL RESIDENTIAL RESEARCH
ADAM CHALLIS

Understanding the Vision

It is worth reminding ourselves of the scale of the current transformation taking place. By 2025, across the whole of the Nine Elms area, Londoners will see a new high density town in the place of the last large-scale industrial estate in Zone 1. In real estate terms, this will include:

- 20,000 + new homes
- 3.2 M sq ft of new office space, including new US and Dutch embassies
- 2.3 M sq ft of new retail space
- 1,600 new hotel rooms
- 30 acre linear park
- Over 3 kms of riverside returned to public access and use
- Schools, nurseries & community spaces
- 2 new underground stations
- Foot bridge

> The last and greatest single prospect for regeneration in central London
>
> FORMER MAYOR OF LONDON
> BORIS JOHNSON

The Nine Elms riverside location is a legacy of the Thames' role in delivering goods in and out of the Capital, notably coal to fuel Battersea Power Station, Europe's largest and once most polluting brick building. Its Grade II listed status means that preservation and reuse, in some way, is of national importance.

The high costs associated with its repair, decontamination and conversion have confounded several previous attempts to redevelop the 13 acre site, which has not been in use for over three decades. The current owners, Malaysian developer SP Setia and Sime Darby alongside the Employees Provident Fund of Malaysia, were able to purchase the site from the Irish Government's National Asset Management Agency (NAMA). At the time in mid-2012 it was unclear whether any firm, anywhere in the globe, would be able to take on the enormous cost and risk of this multi-billion pound restoration and redevelopment. In real estate terms the site had a negative land value; in essence, it was worth less than zero in its current condition due to the high decontamination and restoration costs.

In order to create a viable scheme, it was crucial to improve accessibility to the location and to propose a high density scheme that could generate enough revenue to offset the associated costs and risks. Detailed inspections made clear that the four stacks, and possibly the whole building, would soon become unstable and need to be pulled down. The subsequent confirmation of a plan to extend the Northern Line, underpinned by a £1 billion Government loan and over £250 million from local developers was agreed by planners and Transport for London, alongside a wide range of local stakeholders. Direct Underground connections will provide a boost to accessibility across Nine Elms, improving the placemaking opportunity for the benefit of all future residents, workers and visitors. Construction on the extension has now started, ensuring that the last regeneration area in Zone 1 will be well-connected to the rest of London.

Residential Market Performance

Nine Elms is directly across the river from some of the world's most expensive real estate in Prime Central London. However, at the time of masterplanning Nine Elms, south side residential values were only one-third of those on the north side of the river.

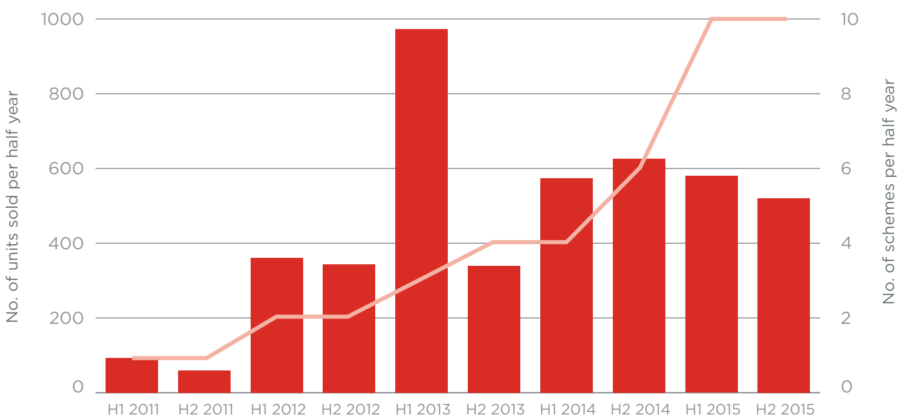
In market terms, regeneration sites can represent very strong opportunities for developers to drive value outperformance against the wider market. However, due to the nature of these sites, often with complex land assembly and contamination issues, they are also associated with much higher risk of failure. Indeed, the number of unsuccessful scheme proposals at Battersea Power Station over the past three decades is a testament to this challenge. As a collective, the developments across Nine Elms also have the burden of a highly complex and competitive market place in which to bring forward individual sites.

Regeneration across Nine Elms is also a very long-term commitment. From start to finish, construction will take place over at least two decades. Any development of that duration must also run the risk of changing market cycles; the residential market in London rarely runs smooth for long, with current softer conditions a testament to that point.

The strong post-downturn recovery of the Central London residential market has ensured that average values in Nine Elms, coming from the lowest base of any sub-market in Central London, have nearly doubled since Riverlight - the first residential scheme - launched in 2011. Across Nine Elms, average value growth for residential has been nearly 35% between 2011 and the end of 2015.

UNITS SOLD AND AVAILABLE SCHEMES

Based on sales data in the Vauxhall Nine Elms Battersea opportunity area



Source: JLL

As construction in Nine Elms progresses the area is transitioning from a building site to a high quality mixed use neighbourhood

JLL NINE ELMS SALES
HELEN PENFOLD

It is typical for price growth to occur in stages on large regeneration sites. Step changes are often evident when major planning permissions are announced, when construction work begins, at the point when new infrastructure commitments have been made, or towards the end of the scheme as the placemaking promises are in evidence. Due to the long duration of construction across Nine Elms, it is to be expected that the area will endure periods of relatively stronger and weaker price growth, occasionally diverging from trend with the wider residential markets across Central London. However, we would also expect it to outperform in value growth terms from inception to project completion.

Sales volumes across the area have broadly doubled year on year, with a modest tapering in 2015 in line with slower market activity for all Prime markets. Setting aside the particularly strong rate of sales in Q1 2013, including the record-breaking sales volumes of Battersea Power Station Phase 1 (Circus West), this rate of growth is correlated with the growing number of residential schemes now progressing into sales and marketing phases across Nine Elms.

From the launch of St James' Riverlight scheme in early 2011, the number of residential developments that are actively being promoted has continue to climb; residential units in 10 different schemes were for sale as of end H2 2015. Across Nine Elms, only the Riverlight scheme and Embassy Gardens Phase 1 have been completed, although Circus West at Battersea Power Station may complete in late 2016. This also means the area is beginning to welcome its first new residents; for example, Embassy Gardens Phase 1 is now over 90% occupied.

In this context, it is worth noting the delivery schedule across the regeneration area is expected to take up to two decades, which implies a sales rate of roughly 1,000 homes per annum. With current rates already ahead of this level, the risks of oversupply appear to be well-managed over the course of delivery in the area.

The relationship between sales rates and scheme availability is important in order to understand current market performance. Some commentators have rightly noted slowing sales rates, but this is generally in reference to specific schemes. However, as the graph makes clear, aggregate sales rates for Nine Elms continued to grow up to the end of 2015. This is important, as while sales rates improved they are being spread over a larger number of schemes, which has depressed the per scheme sales rate. It is also the case that, in line with wider Central London market conditions, a weaker demand profile has emerged, which is also impacting sales activity for high value properties.

The graphic below shows the minimum, average and maximum £psf values achieved in Nine Elms in both the first half of 2013 and during 2015. As can be seen, in contrast to much negative press comment, values showed strong improvement during this time. While the lower-end of average values by scheme remains remarkably steady, there has been strong growth in the average and upper-end values at end H2 2015. This is indicative of a broadening of choices for purchasers and a general upward trajectory in averages values over the two year period.

This graphic is important to highlight the influence that individual schemes can have on overall averages. While there is no question that more recent sales rates have slowed for higher value properties, there remains a solid level of confidence in the market for residential properties that represent good value. The £1,500 psf threshold is currently cited as the point where buyers become more concerned about supply and are subsequently becoming more sensitive to price. In contrast, recent transactions in the £950 psf to £1,200 psf range show continued strong demand and only modest discounting.

Ironically, some of this supply concern will dissipate across Central London as some scheme launches will be delayed. Developers can be very adept at adjusting to market conditions.

£PSF PER UNIT

Based on sales data in the Vauxhall Nine Elms Battersea opportunity area

	H1 2013	2015
MINIMUM	£725	£825
AVERAGE	£1,035	£1,423
MAXIMUM	£2,020	£2,950

Source: JLL

Reassignments, or 'Flipping'

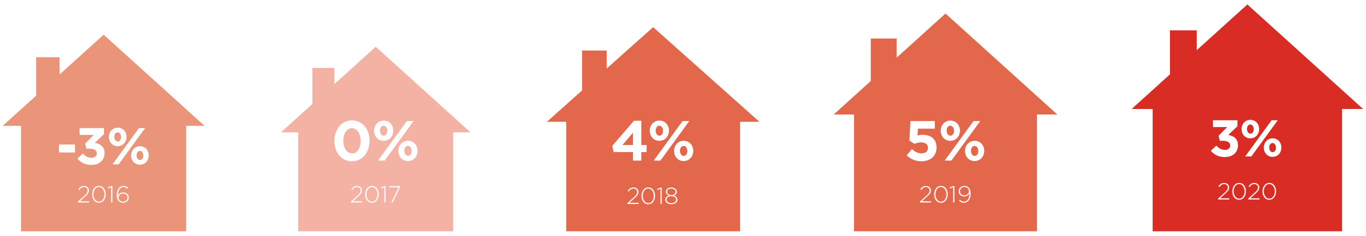
Reported discounts of up to 10% or 12% in the reassignment market are simply not reflective of conditions in the primary sales market, as has been occasionally portrayed in the popular press. The reassignment market, colloquially known as 'flipping', is when the original purchaser of an off-plan property agrees to sell the future rights to that property to a third-party. Where this occurs greater than six months prior to completion of the property, it is generally challenging to secure a mortgage. As a result, this purchaser is very likely to be an all-cash purchaser.

Many of the original off-plan purchasers will be progressing through three or possibly four deposit stage payments. At the same time, they will have seen their forward purchase commitment increase in value over the past few years (upwards of 25%-30% for many early purchasers). As a result, in order to crystallise these significant gains and to successfully transact with an all-cash purchaser under current, softer market conditions, it is often necessary to accept discounts in order to incentivise the purchaser.

What is often overlooked in reporting on these transactions is the significant gains that original purchasers will have made.

The reassignment market is a very important sub-market that enables development finance and liquidity for off-plan purchasers. However, it bears little resemblance to the primary new build sales market.

CENTRAL LONDON NEW BUILD FORECASTS



Future Prospects

Weaker market conditions through the end of 2015 and into 2016 forced JLL to restate price forecasts for Central London new build. Notably, changes to Stamp Duty alongside more recent changes to the global economic backdrop have slowed demand. Concerns over the impact of Brexit have also contributed to temporary downward price pressure, notably for Prime markets.

Against this backdrop, there a number of factors worth considering in the context of Nine Elms itself.

1. As the last regeneration area in a Zone 1 location, there is likely to be an accelerated capital growth trajectory in line with the realisation of the buildings and spaces that will make up this emerging area with its wide mix of uses. It is expected that price increases will occur as step changes in line with completion of larger sections of the masterplan, notably the US Embassy, Battersea Power Station main building and the Tube line extension.

2. This tract of Central London Thames riverside property is the last area to hold a wide price discount compared with adjacent markets on the north side. In comparison with the relative value parity at Southbank and the Strand, or Putney and Fulham, average house prices in Nine Elms are as much as 40% below current levels for Chelsea on the north side. This suggests a longer-term arbitrage potential for Nine Elms.

3. Despite persistent press headlines to the contrary, average new build values and sales rates have remained robust. There is widespread confusion regarding the release of newly completed stock or the sale of nomination rights (known as ‘flipping’) to the market as early investors look to crystallise the significant gains noted above, which is not reflective of activity in the broader new build market.

4. In line with current softer market conditions, value growth and sales momentum in Central London will remain below the long-term trajectory during 2016, with the Referendum result increasing uncertainty for Prime markets for a period. However, in Nine Elms the medium-term opportunity for residential outperformance in the last Zone 1 regeneration area remains very strong.

KEY CONTACTS

With over 350 professionals operating from a comprehensive network of UK regional offices, the Residential team at JLL is the most comprehensive full service advisor in the market.

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