# RESIDENTIAL MARKET UPDATE

# Feel-good factor boosted by return of first-time buyers and BOE's "forward guidance"

**Average house prices across the UK are showing sustained growth amid a significant increase in mortgage lending. Gráinne Gilmore examines the latest trends in the market.**

## Key facts – August

**Average UK house prices rose by 0.8% in July,** taking the annual increase to 3.9%

**Prime central London property values climbed by 0.5%,** taking the annual increase to 7%

**Average rents in prime central London fell again in July,** by 0.7%

**Optimism on house prices continues to rise** amid low interest rates and looser mortgage lending

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"Low mortgage rates and the "Help to Buy" effect are boosting confidence – and construction."

**Gráinne Gilmore,** Head of UK Residential Research

## UK housing market and economic overview

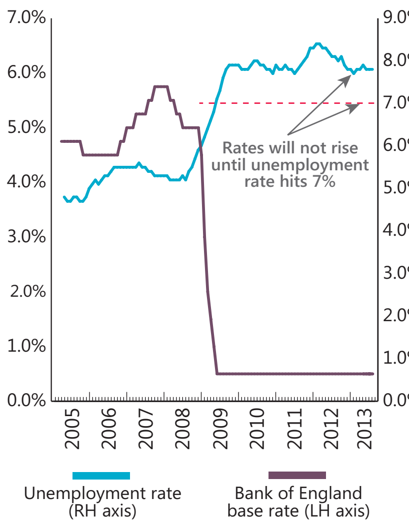
The mood music in the UK has become much more upbeat in recent months. There are signs that the economy is finally delivering convincing growth, with some top economists saying that it is approaching "escape velocity", the point at which the recovery could become self-sustaining. Even more encouragingly, it seems that the pick-up in economic activity is not purely based in the south, with a closely-watched indicator of business recently indicating that activity in the North West hit a record high during the summer. To cap it all, the Bank of England revised up its forecasts for economic growth in 2013 and 2014 to 1.4% and 2.5%, up from 1.2% and 1.7% respectively.

There have also been several positive developments for homeowners and potential buyers, not least Mark Carney's "forward guidance" on interest rates. The idea that Dr Carney, would issue some reassurance that interest rates would stay low for a year or two, had been trailed for quite a while. In the event, Dr Carney said that rates would not be raised until the unemployment rate fell to 7% (it is currently at 7.8%, see figure 1). Economists expect this to happen at some stage in mid-2016. However, one of the key caveats to this "7% threshold" is that if inflation looks as if it will rise above 2.5% over the 'medium-term', usually considered to be in 18 to 24 months' time, the Bank can step in to raise rates earlier.

Dr Carney also made an interesting observation on Help to Buy, the multi-billion pound government scheme designed to boost new housing construction, indicating that there may well have been some discussion about extending it beyond its initial 3-year term. Speaking during an interview in the wake of last week's Inflation Report, Dr Carney said: *"If the view at a point in time is that [Help to Buy] is contributing to an underlying vulnerability of risk to the UK economy, I would fully expect that the Financial Policy Committee would not expect to extend it, but that is a hypothetical."*

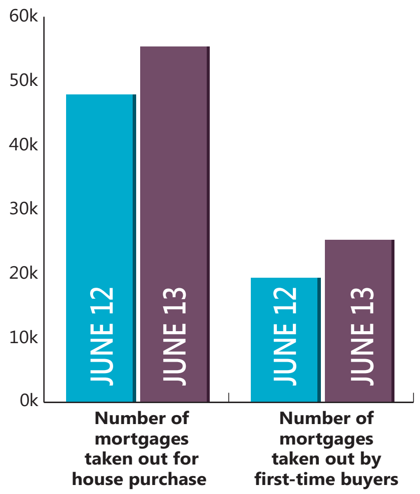
The first tranche of Help to Buy has been dubbed an "instant hit" by the housing

Figure 1
**Forward guidance**
**Unemployment rate vs. bank rate**




Source: Knight Frank Research / ONS / BOE

Figure 2
**Mortgage lending rises**
**Number of loans**




Source: CML

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> "THE BANK OF ENGLAND REVISED UP ITS FORECASTS FOR ECONOMIC GROWTH THIS YEAR AND NEXT TO 1.4% AND 2.5%, UP FROM 1.2% AND 1.7% RESPECTIVELY."

minister, with 10,000 new home reservations in first four months of the scheme.

Low mortgage rates and the "Help to Buy" effect, have certainly helped boost optimism over the outlook for house prices. Demand for home loans has picked up, and this is reflected in data from the Council of Mortgage Lenders (fig 2) showing the number of loans granted to first-time buyers in June this year rose by nearly a third compared to June 2012. House prices have also started to show some positive momentum, although it is worth noting that the average UK house price increase is more modest than the headline 3.9% annual rate once London prices are stripped out, perhaps closer to 1.5%-2%. Investment activity has also picked up, with some 40,000 mortgages advanced for buy-to-let house purchases in Q2 – the highest level since early 2008, although the number was still well below the highs of nearly 100,000 seen in Q3 2006.

Recent GDP data showed a significant 8.2% annual uptick in housing construction output between April and June, and new data from the DCLG shows that private housing starts picked up between April and June, rising by 7% compared to Q1. The increase demand for new homes is curbing the cost of capital for housebuilders, allowing development land values to rise by 1.8% outside London in the year to June.

## Prime market performance

Prices in prime central London rose by 0.5% in July, and are up 7% on an annual basis. Buyer interest remains strong for the best homes in the capital, with viewings in the year to date up 15% compared to the same period in 2012, and sales volumes up by more than 8%. Prices are being underpinned by the city's reputation as a safe-haven investment location, as well as the value of sterling. We recently raised our forecast for prime central London price growth for 2013 to 6%.

Prime country house prices in England rose by 0.4% during Q2 2013, but are still down 1.2% on an annual basis, while Scottish country home prices remained broadly stable in Q2.

## Rental market

Average rents across the UK remained unchanged in June. On an annual basis, rents are up 2.6%, below the current 2.9% rate of inflation. While rental activity is still strong, the re-ignition of the sales market, especially for first-time buyers, has put downward pressure on rents.

Prime central London rents slipped again in July, falling by 0.4%. They are now down 2.7% year on year, but are still more than 21% above the low point they reached in June 2009. The picture for rents across London's prime areas is mixed. While rents are down compared to the beginning of the year in St John's Wood, Mayfair and Notting Hill, rents are still rising in Kensington, Belgravia and Marylebone. Our view is that it will be 2014 before we see more widespread and robust rental growth, however this will necessitate a further improvement in job creation in London's financial sector.

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