February 2013

RESIDENTIAL RESEARCH

# RESIDENTIAL MARKET UPDATE

Knight Frank

# Increased lending boosts optimism in housing market

**Positive signs from the mortgage market have lifted optimism over house prices among UK homeowners in February. But, as the countdown to the Budget begins, 'mansion tax' is back on the news agenda, despite a pledge from the Chancellor not to introduce the levy.**

## Key facts

**Average UK house prices rose by 0.5% in January** but remained flat on an annual basis

**Optimism that house prices will rise in the next 12 months highest for two and a half years,** according to Knight Frank/Markit HPSI

**Prime central London prices climbed again in January,** by 0.4%. Prices are up 8.1% year-on-year

**Prime central London rents slipped by 0.1%** and are down 3.1% on an annual basis

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## UK housing market and economic overview

The news emerging from the UK economy has been as gloomy as the weather in recent weeks. While the closely watched PMI indicators of economic activity suggested a modest uplift in January, there was disappointment on the high street as several high profile chains entered administration. New data shows that UK retail sales nosedived in January to the lowest level in three years, exacerbating fears of a triple-dip recession.

Despite the wider economic concerns, some optimism has returned to the housing market with several factors combining to lift activity, albeit from very low levels.

Not least among these factors has been the signal from Mark Carney, the Canadian central banker who will take over as the next Governor of the Bank of England in July, that interest rates could remain pegged at the record low rate of 0.5% for some time yet. While there has always been an understanding that this will be the case given the weakness of the economy, Dr Carney has indicated that he is not averse to a public commitment to keep rates low for a certain period, removing any uncertainty, which will only serve to boost confidence among homebuyers.

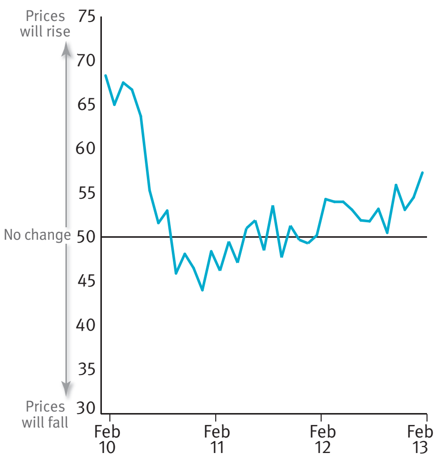
There is also some evidence that the Bank's Funding for Lending scheme has provided a fillip in the mortgage market. While the initial take-up on the 'cheap lending' scheme by high street banks was not overwhelming, there are signs that the existence of the scheme at least is encouraging more lending, which in turn has prompted fiercer competition between mortgage lenders – driving down interest rates and in some cases loosening lending criteria.

Recent data from the Council of Mortgage Lenders (CML) showed that the total number of loans advanced for house purchase rose by 6.2% in 2012 compared to 2011. Lending to first-time buyers climbed by 12%. While the total lending figures suggest that the market is still not functioning properly, the pick-up is a step in the right direction. It is also worth noting that some lenders are dipping their toes back in the market for higher loan-to-value loans, with one in 40 first-time buyers taking out a 95% mortgage in the final quarter of 2012, up from one in 100 in the same period of 2011.

Figure 1

**House price sentiment index**

**How will value of your home change over next 12 months?**

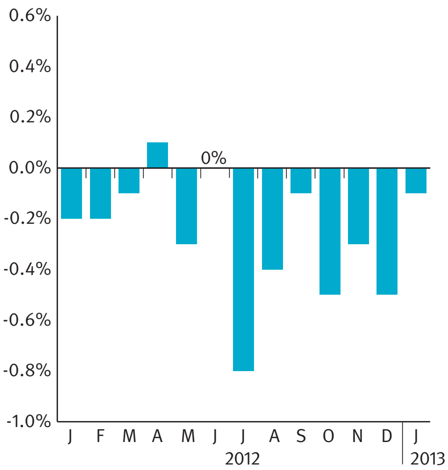



Source: Knight Frank/Markit

Figure 2

**PCL rents – monthly change**

**Prime central London average residential rental change**




Source: Knight Frank Residential Research

*Follow Gráinne on twitter at @ggilmorekf*

"Despite the wider economic concerns, there is a level of optimism in the housing market, with several factors combining to lift activity."

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

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The increased activity in the mortgage market has certainly had an impact on homeowners' optimism about prices across the UK. As Figure 1 shows, the Knight Frank/Markit future HPSI, a monthly monitor of what 1,500 households across the country think will happen to the value of their property over the next 12 months, rose to its highest level in more than two and a half years in February.

Turning to the prime market, the 'mansion tax' has reared its head again, with both the Liberal Democrats and Labour pledging to levy an annual tax on homes worth more than £2 million. It is perhaps no coincidence that talk of this tax has once again emerged in the weeks leading up the Chancellor's budget. There were similar discussions in the run-up to the Spring Budget and Autumn Statement last year. Boris Johnson, Mayor of London, has been vociferous in his opposition to the 'mansion tax' over the last week, labelling the plan "ill-thought-out, unjust and un-British". He added that it would be "colossally unfair on Londoners". The Chancellor has pledged not to introduce a 'mansion tax', but the scheme is a political hot potato within the Coalition Government.

> "INCREASED ACTIVITY IN THE MORTGAGE MARKET HAS CERTAINLY HAD AN IMPACT ON HOMEOWNERS' OPTIMISM ABOUT PRICES ACROSS THE UK."

## Prime market performance

Prices in prime central London continued to rise in January, with a further 0.4% increase in prices. On an annual basis, prices are up 8.1%, although this is down from the 8.7% increase seen in December last year. The international demand for prime central London property remained strong over the New Year, and the recent slide in sterling has further boosted the appeal of bricks and mortar in the capital to overseas buyers.

Prime English country house prices fell by 1.2% in the final quarter of 2012, and are down 3.8% year-on-year. The decline in prices seen over the last few years, combined with the weakness of sterling, has led to increased interest from overseas purchasers. Those buying in US dollars have effectively received a 35% discount on the asking price of a country home compared with the market peak in 2008. Prime property prices in Scotland fell by 2.7% in 2012, although prices in Edinburgh bucked the trend, edging up by 0.6% during the year.

## Rental market

Average rents across the UK fell for a third consecutive month in January, dipping by 0.3%. In prime central London, rents also fell in January and this marked a seventh consecutive monthly decline. Average rents for prime property in the capital are now down 3.1% year-on-year amid the weakening jobs market in the financial sector.

However there are increasing signs that the rise of the technology and media sectors in London will have a positive impact on the prime rental market. Applicant levels remain strong, especially in the sub-£1,000 a week band, indicating resilience in this sector of the market. Certainly, the allure of rental property to overseas tenants is undimmed, with Knight Frank agents agreeing deals with 77 different nationalities in 2012, a record high. We forecast that rents will stabilise this year, rising by 1% in 2013 and 3% in 2014.


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