RESIDENTIAL RESEARCH

UK RESIDENTIAL MARKET UPDATE

STEADY START TO 2015

Price growth continues to ease in most parts of the residential market as limited wage growth and mortgage constraints rein in the rise in values. Meanwhile in prime central London there are signs that the changes in stamp duty are starting to be absorbed. Gráinne Gilmore examines the latest data.

Key facts January 2015

UK house prices rose by 7.2% in 2014 – broadly in line with Knight Frank's 7% forecast

Prime central London prices rose by 5.1% in 2014, after a 0.1% decline in December

The value of prime country houses in England climbed by 3.4% in 2014, after a 3.1% rise in 2013

Knight Frank forecasts moderate price growth for the UK in 2015

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"Limited wage growth and funding issues mean affordability constraints remain in the mainstream market, especially in London and the South East."

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UK housing and economic overview

House price growth continued to slow in the last quarter of 2014, a process which is expected to continue this year. Knight Frank forecasts growth of 3.5% for UK house prices this year.

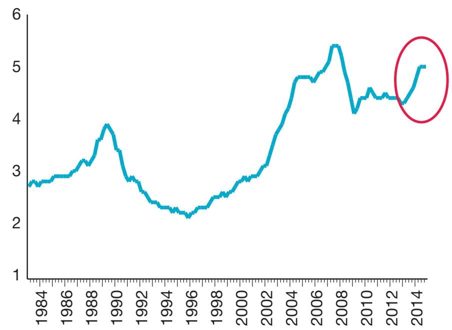
There are various factors at play in the market at present, not least the recent reform of stamp duty which has cut thousands of pounds off the cost of buying for many purchasers of homes worth less than £1 million. This could boost activity levels in the short-to-medium and, coupled with the relatively healthy jobs market, is likely to help underpin buyer sentiment.

The outlook for interest rate rises has also changed in recent months. Low inflation figures out this month, with CPI at 0.5%, against a target of 2% – largely as a result of falling fuel prices, mean that the likelihood of rate rises in the coming months is receding rather than growing, with some economists arguing that the central bank may not actually make their first move until 2016.

Mortgage rates have also fallen in recent months, with five-year fixed-rate deals at less than 2.4% available to some borrowers with a 40% deposit.

Despite the drop in mortgage rates, lenders are still requiring larger deposits, and the more onerous MMR mortgage rules are also making it more difficult for some to get a loan, especially if they have varying levels of income. This trend is certainly curbing any exuberance in the market. In addition, the strong performance of the UK economy in comparison to most other developed countries in 2014, wage growth has been minimal over the last few years. Average wages rose by 1.8% in the 12 months to April 2014, and is only forecast to rise to 2.1% in the next 12 months. While annual pay rises are eventually tipped to climb to 4%, this won't be until 2017-2018 according to the Office for Budget Responsibility.

FIGURE 1
First-time buyer affordability index
(Gross house price to earnings ratio)

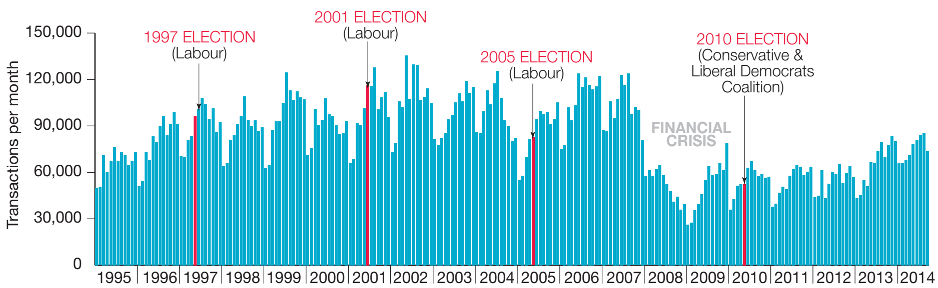


Source: Nationwide

Low inflation has helped keep household incomes relatively steady, but depressed wage growth means that affordability constraints remain, especially in markets in London and the South East.

The General Election could also impact some buyers' purchasing intentions. In past election years, transaction levels have not unduly deviated from their average levels in the months around polling day as shown in figure 2.

FIGURE 2 **Elections and monthly residential transactions (England & Wales)**



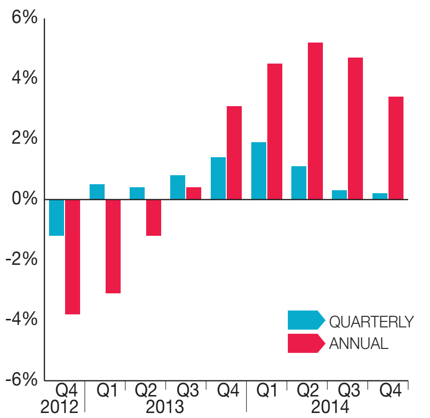
Source: Land Registry

However this year, the outcome of the election will have more significance for buyers towards the top end of the market, with Labour pledging to push ahead with an annual "mansion tax" on properties worth more than £2m, despite the recent reform of stamp duty which has increased the cost of buying a home worth more than £1m.

Prime markets

Prime Central London prices slipped for the second consecutive month in December, taking the annual change in prices to 5.1%. This is the lowest annual rate of growth since the end of 2009, but prices have risen by a cumulative 52% since that point. There is evidence that the market is already starting to absorb the higher rates of stamp duty introduced in December, although there have been tough negotiations on some transactions, and evidence of buyers and sellers agreeing to split the difference on the new, higher, stamp duty charge. There is still some uncertainty in the market however over the possible introduction of a mansion tax, and this is unlikely to abate until the Election is decided.

FIGURE 3 **Quarterly and annual prime country house price growth**



Source: Knight Frank Residential Research

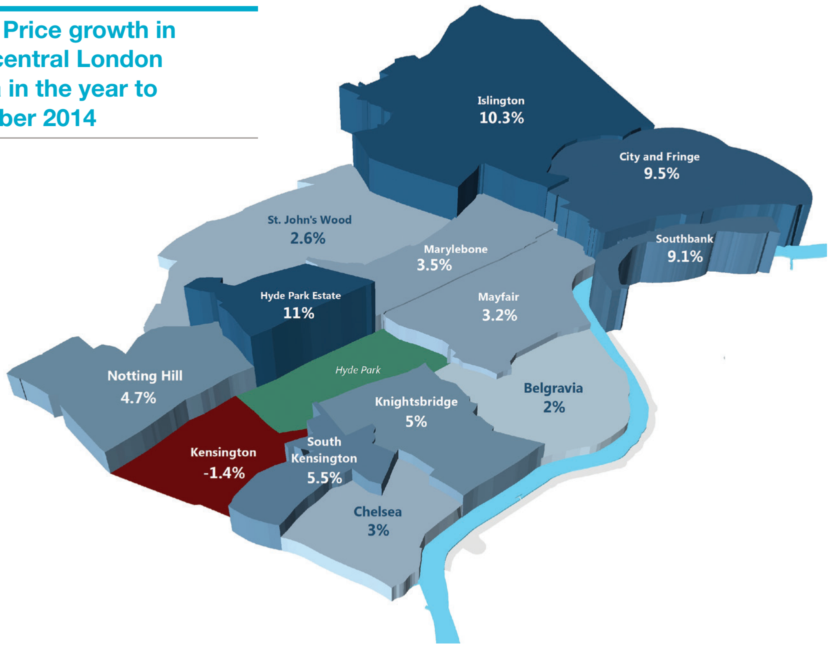
Rental growth in prime central London hit a three-year high at the end of 2014 as the uncertainty in the sales market boosted activity in the private rented sector. Rents rose by 3.3% last year, and are forecast to climb by 3.5% this year.

Average prices in the prime country house market rose by 3.4% during 2014, after a strong start to the year. This is broadly in line with our forecast for 3.5% growth in prices last year. Activity levels in this market have picked up strongly over the last two years, with transactions up 24% since 2012. There are signs that given the "relative discount" available on country properties compared to London, demand is set to remain strong.

Meanwhile in Scotland, prime country house values rose by 1% in the final quarter of 2014, after the political clarity provided by the result of the Referendum. However there are still hurdles ahead for the market in Scotland as the new Land and Buildings Tax, due to come into force in April, is much more onerous than the new stamp duty regime. Yet this could also mean a flurry of activity in the housing market between now and then.

The Edinburgh market continues to lead from the front, with a 0.5% rise in prices in the final quarter of 2014, taking the annual rate of price growth to 4.2%.

FIGURE 4 **Price growth in prime central London by area in the year to December 2014**



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