RESIDENTIAL RESEARCH

RESIDENTIAL MARKET UPDATE.

Knight Frank

JULY 2011
SUMMER STABILITY.

"The regional differences in the housing market were even more stark in June, with prime London property prices hitting a new record high while prices in the rest of the UK remained broadly flat. Rents in prime London also continued to climb, as the scarcity of mortgages boosted activity in this sector."

Gráinne Gilmore, Head of UK Residential Research, Knight Frank

"While the economic fragility is dampening buyer confidence, a lack of mortgage funding is also a major factor, with many first-time buyers unable to secure a home loan deal unless they have a large deposit."

UK housing market

Average house prices across the UK were unchanged last month, but there were wide regional variations, with London continuing to outperform the rest of the country.

Average prices of all London houses rose by 2.6% in the three months to June, while the average rise across the whole of the UK was just 0.3%.

Prices across the UK have slipped by 1% over the last year.

Property values are likely to remain broadly unchanged for the rest of the year, supported by low interest rates.

The base rate has been at a record low of 0.5% since March 2009 and economists forecast that it is unlikely to rise until the economic recovery is fully established. Recent data confirmed that the economy effectively stalled between September last year and March this year.

The economists' predictions about base rates were re-enforced in late June when Mervyn King, Governor of the Bank of England, indicated that rate rises were unlikely to be implemented until the economy was stronger and unemployment was falling rather than rising.

Official figures from the Office for National Statistics, published last month, showed that the number of people claiming jobseekers' allowance continued to climb in May, rising by 19,600 to hit a 13-month high of 1.49 million.

Meanwhile recent data from the manufacturing sector showed that activity grew at the slowest rate in 21 months in June, denting hopes that the desired 're-balancing' of the economy away from services and towards manufacturing was beginning to materialise.

Economists forecast that gross domestic product (GDP), the key measure of the economy's growth, will have risen by just 0.3% between April and June, a figure which will be far from enough to signal that the country is in a strong enough state to withstand a rise in interest rates.

Meanwhile inflation remains high, at 4.5% in May, putting increasing pressure on households as wage growth is muted.

While the economic fragility is dampening buyer confidence, a lack of mortgage funding is also a major factor, with many first-time buyers unable to secure a home loan deal unless they have a large deposit.

Banks, which are dealing with the fall-out from the financial crisis and the new financial regulations coming into force, have dramatically cut back on lending since 2007,

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and are cherry-picking the best applicants in many cases. They are also favouring applicants with large deposits, typically those who have already built up equity in a property, creating a gridlock in activity at the base of the housing ladder, which is having a knock-on effect on activity throughout the whole market.

Our forecast for a 6% drop in average house prices across the UK this year may prove too pessimistic if interest rates stay pegged at 0.5% for the rest of 2011, as low interest rates will help underpin prices. But if the rate rises are delayed until next year, the 6% bounce back we forecast in 2012 may be more modest.

Housing market activity

Estate agents reported that while new buyer enquiries fell slightly in May, newly agreed sales edged upwards, albeit at a very slow pace. There was also a rise in the number of new properties being put on the market, causing the sales-to-stock ratio to fall to around 20%, well below the long-run average of 33%.

But agents surveyed by RICS expect that the number of sales will continue to rise modestly in the next three months, although they also anticipate further falls in house prices.

Mortgage lending, another key indicator of activity in the market, also picked up during the month, with figures from the Council of Mortgage Lenders (CML) showing that gross mortgage lending totaled £11.3 billion in May, up 12% from April and 1% from May last year. But this is still well below typical lending rates seen before the financial crisis, and while it suggests a slight easing in the market, funding is still severely constrained.

In a further sign of the turbulence in the mortgage market, BNP Paribas' private banking arm, which specialises in high-value loans, last month withdrew from the market over concerns about its exposure to Greece given the turmoil in the country.

The CML recently revised down its forecasts for housing transactions this year by 20,000 to 840,000, which is well below the long-run average of 1.2 million transactions a year. But activity is expected to improve next year, with 900,000 transactions forecast.

Meanwhile the rental market continues to go from strength to strength as those unable to get on the property ladder are forced to live in rented accommodation.

Demand continues to outstrip supply in many areas of the country, which is pushing up rents.

Rents for prime London properties rose by 0.3% in June, taking the annual increase to 15.2%. Rents are now 26% higher than in June 2009.

Prime market performance

The demand for properties in prime central London locations continued unabated in June, with prices rising by 0.9% during the month. The contrast between London and the rest of the UK market was further underlined as prime prices reached a new record high. They are now 2% higher than the previous market peak in March 2008. Prices have risen by more than a third over the last two years.

Activity in this market shows little sign of slowing, as interest from domestic and overseas buyers remains strong. Viewing figures were up 8% on the year in June, and the volume of properties under offer in June was 52% higher last month than in June last year.

This rise in activity has, to some extent, been caused by a rise in supply to the market. Stock volumes rose by 12% in the year to June, but demand is still far greater, meaning that prices will continue to rise, although perhaps at a slightly slower pace in the second half of the year.

In light of this, Knight Frank has revised up its forecast for price growth in the prime London market from 3% to 9%, which also allows for a slight slowing in the pace of growth towards the end of the year.

Prices of prime country houses have remained broadly flat since the beginning of the year – slipping by 0.7% in the second quarter, which partly offset the 0.5% rise in the first three months of the year.

But the North-South regional divide was further highlighted by the Prime Country House Index data, which shows that while prices held up between April and June in the home counties, prices in the North of England edged down across the board.

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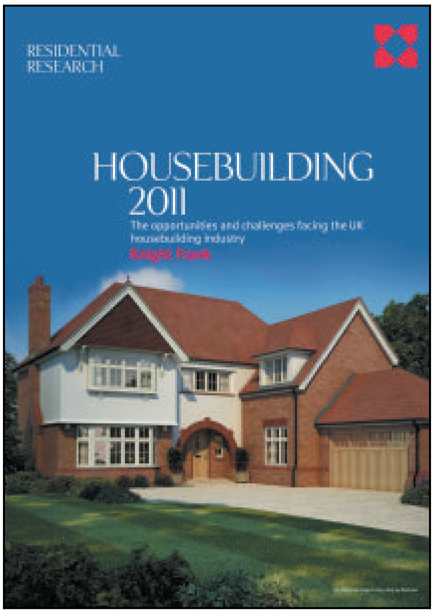

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