July 2012
RESIDENTIAL RESEARCH

RESIDENTIAL MARKET UPDATE

Knight Frank

The £100 billion mortgage question

The Bank of England unveils plans to boost mortgage lending by offering cheap loans to banks, but will it work? Meanwhile UK house prices continue to drift downwards in contrast to prices in prime central London, which have risen by 48% since March 2009

Key figures

Prime central London prices rose by 0.8% in June and are up by 10.5% year-on-year

Average UK house prices dipped by 0.6% in June, down 1.5% on an annual basis

Prime country house prices declined by 1.5% in Q2

Prime Scottish property prices fell by 0.9% in Q2, but Edinburgh prices climb by 0.6%

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UK housing market and economic overview

The Bank of England took decisive action to address the continued constraints in the mortgage market last month by pledging to deliver £100 billion in cheap loans to the UK's banks. Unlike quantitative easing, which has so far done little to boost bank lending, this 'funding for lending' pot must be 'ear-marked' by the banks for small business and mortgage lending.

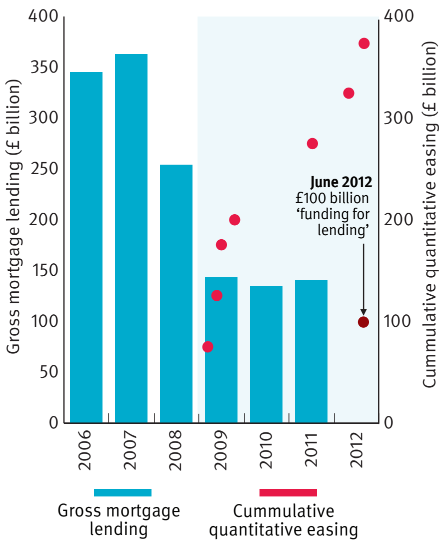
The effectiveness of such an approach remains to be seen. After all, there were expectations (not least at the Bank of England) that the money made available via quantitative easing could help lift mortgage lending – but that has yet to materialise, as shown in figure 1. The lack of mortgage funding is casting a long shadow over the UK housing market, with prices down 1.5% year-on-year and low transaction levels. Indeed the rental sector is gaining further momentum, 16.5% of all households are now in the private rented sector, up from 12.7% in 2007.

UK banks have been centre stage in recent weeks amid a new controversy around the pricing of Libor rates, the inter-bank lending rates upon which some mortgages and other financial instruments are based, before and during the height of the financial crisis.

This has taken the attention off the Eurozone somewhat, yet there has been progress by policymakers in the single-currency area. Leaders at the recent European summit agreed that the Eurozone's permanent bailout fund could directly fund banks in difficulty, without going through central governments.

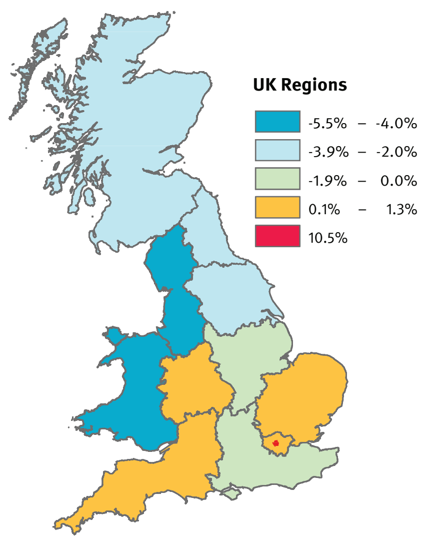
But there is no doubting the ongoing underlying weakness of the Eurozone economy. The closely watched purchasing managers index (PMI), which signals the strength of services firms, showed that the sector continued to shrink in June amid plunging business confidence. This is a headache for governments trying to plug the black hole in their finances, as lower business activity translates into lower tax receipts.

Figure 1
Mortgage lending still subdued despite QE



Source: CML, Knight Frank Residential Research

Figure 2
The patchwork effect
Regional annual house price growth Q2 2012



Source: Nationwide, Knight Frank Residential Research

"The lack of mortgage funding is casting a long shadow over the UK housing market."

Gráinne Gilmore, Head of UK Residential Research

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> PRIME CENTRAL LONDON PRICES CLIMBED AGAIN IN JUNE, FOR THE 20TH CONSECUTIVE MONTH, AND ARE NOW 48% HIGHER THAN THE TROUGH OF THE MARKET IN EARLY 2009.

This week French president Francois Hollande attempted to help balance his country's books with a raft of wealth and business taxes in his budget.

The UK economy is by no means shrugging off such challenges.

The country remains in recession, and the economic travails are reflected in the latest unemployment figures. While the overall number of unemployed people fell in June, the number claiming jobseeker's allowance rose, climbing to 1.6 million, up from around 840,000 back in 2007 before the financial crisis hit.

The outlook for employment to some extent informs the 'patchwork' nature of the property market in the UK, especially in areas heavily dependent on public sector jobs given the further public sector cuts in the pipeline. In contrast, prices in prime central London continue to shine.

Prime market performance

Prime central London prices climbed again in June, for the 20th consecutive month, and are now 48% higher than the trough of the market in early 2009. A £1 million investment in prime central London property in March 2009 would now be worth around £1.48 million – a growth of £12,400 a month.

But there are some initial signs of resistance from buyers to the ever climbing prices, with the percentage of asking prices achieved falling from 96% in March to 92% in June.

The Treasury has launched a consultation on the annual charge and capital gains tax it plans to levy on properties worth £2 million or more owned within a corporate envelope, in addition to the higher 15% stamp duty charge. There is some evidence that buyers affected by these changes may be adopting a 'wait and see' approach, as transactions for properties worth £2 million and more slowed in June.

Prime country property prices in England and Scotland continued to slip in the second quarter, falling by 1.5% and 0.9% respectively. This takes the annual decline to 4.8% in England, and 4% in Scotland. But there are some 'hotspots' which have bucked the trend, most notably Edinburgh, where prices rose by 0.6% on the quarter amid a sharp rise in transactions.

Rental market

Rents in prime central London remained flat in June, after falling in May. Rents have only risen once in the last nine months, and are now broadly flat year-on-year, after rises of 15.2% in the year to June 2011. The slowdown in rental activity broadly mirrors the increasing weakness of London's financial jobs market, as city workers from the UK and overseas are key tenants for prime London properties. But the top-end properties continue to buck this trend, as they are much less affected by job losses and budget cuts for corporate relocations.

Across the wider UK market, rents rose by 0.4% in May, but the annual pace of growth slowed from 2.4% to 2.3%.

Residential Research

Gráinne Gilmore
Head of UK Residential Research
+44(0)20 7861 5102
grainne.gilmore@knightfrank.com

Press Office

Daisy Ziegler
+44 (0)20 7861 1031
daisy.ziegler@knightfrank.com

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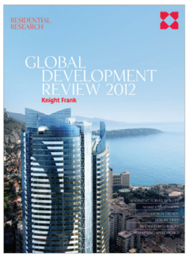

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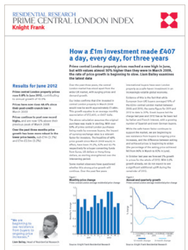

Prime Central London Sales Index June 2012

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