UK RESIDENTIAL MARKET UPDATE

PRICES MOVE ON UP

Average house prices across the UK now exceed 2007 levels, however some indicators suggest that the pace of growth may be set to slow with new mortgage rules adding a dampener. Meanwhile, Mansion Tax is back in the headlines. Gráinne Gilmore examines the latest data from the market.

Key facts July 2014

UK house prices rose by 1% in June, and are now 11.8% higher on an annual basis

Prime central London prices increased by 0.8% last month and are up 8.1% year-on-year

Prime country house prices rose 1.1% in Q2, and are up 5.8% year-on-year

Our House price sentiment index shows easing of expectations for future price growth

GRÁINNE GILMORE
Head of UK Residential Research

"The Bank of England's limits on loans advanced at more than 4.5 times income could serve to take a little of the steam out of London market."

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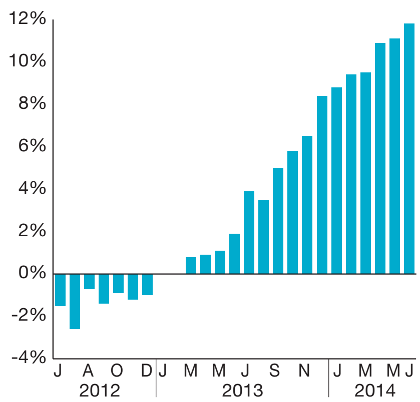
UK housing market and economic overview

The value of an average home has risen by £20,000 or 11.8% over the last year. Data from Nationwide shows that the value of an average property in the UK is now £188,903, above the pre-crisis peak levels seen in 2007.

The speed at which the market has gained momentum is shown in the chart below, but there are still large regional variations in the pace of growth, with London prices up 26% over the year while property in Yorkshire & Humberside has risen in value by 7% over the same period.

Annual change in UK house prices

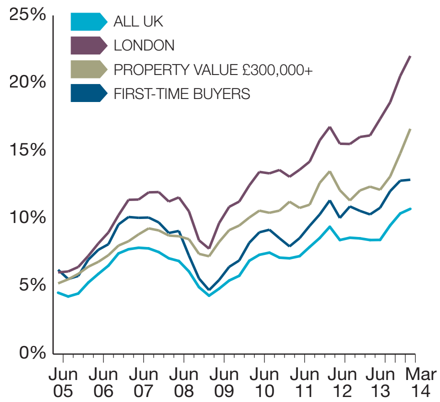


Source: Knight Frank Residential Research / Nationwide

This rapid rise in prices has been identified by Sir John Cunliffe, deputy governor of the Bank of England, as the biggest threat to the UK economy. He said that prices rising faster than earnings led to the risk of rising consumer debt which the bank sees as a threat to stability. His colleagues have been active around mortgage credit in recent weeks, with a much-anticipated announcement by the central bank's Financial Policy Committee that it would step in and apply curbs on new home loans.

From October, lenders will have to limit the number of loans they advance where the value of the mortgage exceeds 4.5 times a borrower's annual income. Lenders will have to ensure than 85% of their loans are under this 4.5 limit. It added that lenders should apply stress testing to ensure that borrowers can still afford their monthly mortgage repayments if interest rates climbed by three percentage points.

New mortgages advanced at more than 4.5 times borrowers' income

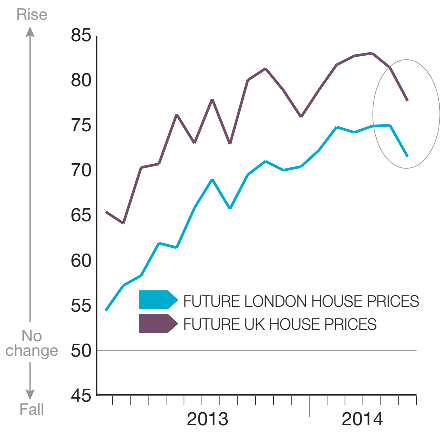


Source: Knight Frank Residential Research / Bank of England

The impact of the changes may be limited on a national level, coming shortly after the new MMR mortgage rules which had already tightened up the application process. In addition, many mortgage lenders already carry out "stress tests" to check that new borrowers can still make repayments. However, the limiting of loans advanced at 4.5 times income could have an effect on the London market, which as the chart above shows, has seen a sharp rise in the number of loans advanced at this level.

It is interesting to note that there are signs that house price expectations are easing, which may come as a positive signal for policymakers. The latest Knight Frank/Markit House Price Sentiment Index, showed that the measure of the price growth anticipated by households across the UK fell by the biggest margin since 2011 in June this year. Londoners' expectations for growth moderated for the second month in a row.

Will prices rise over next 12 months?
House Price Sentiment Index, June 2014



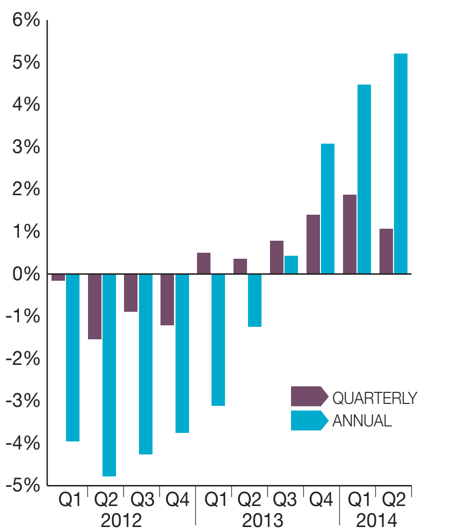
Source: Knight Frank / Markit Economics
NB: A score of 50 equates to no change, above or below representing growth or decline respectively

There is increasing expectation that interest rates will start to rise before the end of the year, and this, coupled with more downbeat economic news from Europe, has helped pushed sterling to near six-year highs against a basket of currencies. Indeed, the UK's economic growth is looking fairly solid on the global stage – the size of the UK economy will overtake that of France before 2020, becoming the second largest economy in the EU, according to a report by PWC.

Prime markets

Prime central London house prices rose again in June, by 0.8%, matching the rise seen in each of the previous three months. But this is lagging the growth being seen in the prime outer London market, where values have risen by between 0.9% and 1.1% over the last four months. The annual rate of growth for this area, which spans from Canary Wharf to Wandsworth, has also leapfrogged prime central London, with prices rising by 12.1% over the year. This underlines the "ripple effect" from the prime central London market. This ripple is also evident in the prime country house market where prices are up 5.2% on the year, the highest level of annual growth in nearly four years.

Prime country houses: price movements
(Q1 2012 - Q2 2014)

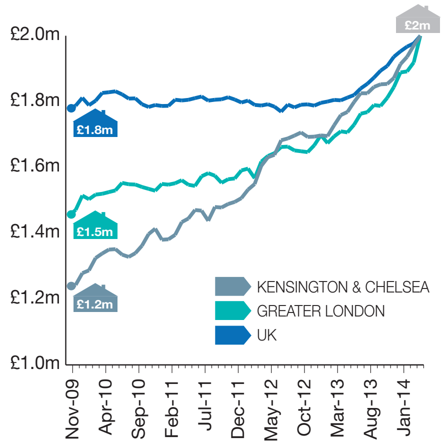


Source: Knight Frank Residential Research

The strongest price growth has been seen in areas with good transport links to the Capital. Prime home prices in Scotland have risen by 2.8% on the year, while values in Edinburgh are up 5.7% over the same period.

New comments from the Labour Party over their plans for a "mansion tax" should they get into power has raised the issue of property taxes once more. In a new report, Liam Bailey, Knight Frank's global head of residential research, has examined how the number of "mansions" has doubled since the idea for such a tax was mooted in 2009, highlighting how the net for this type of levy can widen over time.

What were properties worth £2m today worth in November 2009?



Source: Knight Frank, Land Registry, Nationwide

Rental market

Average rents rose by 1.1% across the UK in May, while prime central London rents climbed by 0.9% in June, the largest increase since the monthly series began in 2011. This took the annual decline to just 0.4%. The number of people applying for prime London rental property jumped in June, in contrast to the sales market, where applicant volumes have softened.

RESIDENTIAL RESEARCH

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