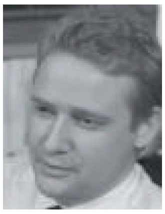
RESIDENTIAL RESEARCH

RESIDENTIAL MARKET UPDATE.

Knight Frank

MARCH 2011

SPRING MARKET OUTLOOK.



"There are so many competing issues for the Chancellor to consider in this month's budget, that there is a real question over the level of attention George Osborne will be able to pay to the housing market. At a time when inflation seems likely to force higher interest rates, and with ongoing scarcity in mortgage funding, this could be a missed opportunity for the sector."

Liam Bailey, Head of Residential Research, Knight Frank

"The economic context of the housing market continues to present difficulties. Net household incomes are under pressure from low earnings growth, tax rises and rising inflation."

Housing market

Ongoing weakness in the UK housing market has contributed to house prices falling by 0.1% on an annual basis, in the year to the end of February.

While not yet representing significant price falls, this reversal of market performance from a year ago, when prices were rising by 9.2%, points to underlying weaknesses in the housing market.

The biggest issue by far is the ongoing lack of liquidity in the mortgage market.

As we reported last month, mortgage approvals for house purchases had been rising steadily from their low point of 27,000 in November 2008 to hit 59,000 in November 2009. Since then mortgage lending has actually fallen backwards, with just 28,500 approved in January this year - a 29% drop from the previous month and the lowest number of approvals recorded since early 2009.

The revival of the UK Residential Mortgage-Backed Securities (RMBS) and covered bonds market, which has been slowly gathering steam since the beginning of 2011, is a positive step for the mortgage industry.

A revival in this sector, which once provided a substantial proportion of the UK's mortgage funds, could lead to the expansion of the market and the relaxing of some of the current rules limiting access to prospective borrowers.

A functioning RMBS market would be unlikely to herald a rapid expansion in new lending - banks will look to pay down government debt under the Special Liquidity Scheme first - but it will be a key part of the market's recovery.

The economic context of the housing market continues to present difficulties. Net household incomes are under pressure from low earnings growth, tax rises and rising inflation.

The UK's economic position itself is experiencing real strains, with GDP figures struggling to confirm meaningful and robust growth.

The potential for rising inflation to translate into higher interest rates is an additional concern. Higher mortgage costs would hamper the sales market, but would also cause problems for existing owners, many of whom have been benefiting from very low variable rate mortgages.

Market activity

The market has suffered from low stock volumes for almost two years, although this measure is improving. While stocks are still down 18% compared to March 2009, they are now 20% higher compared to last March.

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"The most important factor driving price growth in central London has been the growing demand from international buyers."

The volume of buyers in the market peaked last summer and has since declined. Headline volumes of new buyers in the last month were almost 15% lower than a year ago.

Sales volumes are lower over the same time frame, with a decline of 10% year-on-year in terms of the number of properties exchanging contracts. This can be partially explained by the terrible viewing conditions offered by the snow in November and December. It is therefore not surprising that the volume of properties going under-offer in February rose year-on-year by over 30%.

The lettings market has performed better, at least for landlords, with stock volumes continuing to be squeezed, down 20% year-on-year over the last month. Applicant volumes fell back slightly, but only by 5% over the same period, meaning that the supply and demand balance has shifted even further in favour of landlords. Despite stock shortages the volume of tenancies agreed rose 10% in the year to February.

Prime market pricing

Prices slipped in prime central London during the summer and autumn last year, which fitted the wider narrative of a softening UK economy and a weaker national housing market. Since then prices have resumed their recovery, and in the four months to the end of February they rose by 4%. The reasons for this growth, and the divergence of this market from national trends, can be partially ascribed to low stock volumes, and a desire from buyers over recent months to buy and fix their borrowing costs at very low rates.

However, the most important factor driving price growth has been growing demand for London property from international buyers. Over the last 12 months the proportion of £2m+ sales to non-UK buyers hit 52%. The figure was 64% for properties prices above £5m.

Central London residential rents rose 2.2% in the final quarter of 2010.This rise means that rents rose by 16% over 2010 as a whole and by 19% since their low point reached in mid-2009 when the market was suffering from significant over supply.

Rents are now 5% below their peak in March 2008 before the impact of the credit crunch was fully reflected in the market.

The prime country house market remained remarkably strong in the final quarter of 2010. Given the economic uncertainty and government cost-cutting, some were predicting that prices would start to fall significantly. In fact, average values across England dropped by only 0.4% in Q4 and rose by 3.3% during the year.

There were regional variations, however. The market in the north of England saw a 4% decrease in values during the year, while the Home Counties recorded the strongest growth, of 5%.

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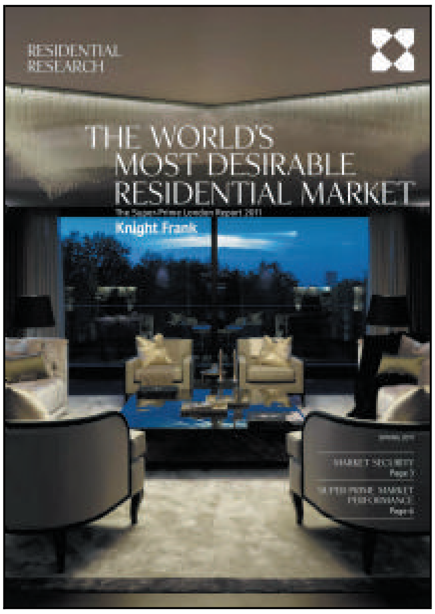

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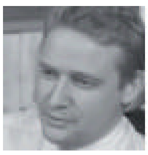

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