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RESIDENTIAL MARKET UPDATE

Knight Frank

Record-breaking London

Prime central London prices hit a new record high in October but average house prices across the UK show little growth as the economic turmoil deepens.

Key figures

UK house prices rose by 1.2% in October, but were down 0.3% on the quarter and 1.8% on the year

Prime central London prices rose by 0.7% in October. Prices are now up 12.5% higher year on year, and are 38.5% higher than March 2009

Prime country house prices fell by 1.2% in the third quarter

Eurozone turmoil deepens, prompting a rise in Libor rates, on which some mortgage rates are based

Expectations for average house price growth over the next year turned negative in October, according to the Knight Frank/Markit House Price Sentiment Index

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UK housing market and economic overview

House prices across the UK rose by an average of 1.2% in October, bouncing back after revised figures showed a 0.3% decline in September. But in contrast to this volatile monthly measure of house price movements, the smoother quarterly data showed that prices were down 0.3% in the three months to October, the first fall on this measure since June.

This downward trend in prices was also reflected in the Knight Frank/Markit House Price Sentiment Index which is a lead indicator of house price movements. The index showed that sentiment among homeowners and renters about the value of their property fell sharply in October, to the lowest level since May, signalling that average prices across most of the UK are likely to slip further in the coming months.

Knight Frank forecasts that the downward trend in mainstream UK prices will continue next year as a 'perfect storm' of economic turmoil in the UK and Eurozone, public sector job cuts, higher inflation and muted earnings growth hits the market. We expect that prices across the UK will drop by 5%.

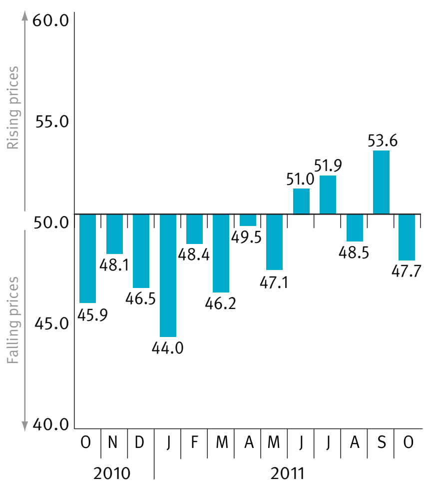
The ramifications of the economic gloom have been obvious in recent weeks with several leading economists and business bodies downgrading their forecasts for GDP growth in the UK this year and next. The CBI now says that UK GDP will rise by just 1.2% in 2012, down from its previous forecast of 2.2% growth. Some economists have suggested that the UK may slide back into recession before the end of this year.

In addition, the Markit/CIPS measure of activity at services firms, which is seen as a bellwether for the economic health of the country, showed that the pace of growth fell by more than expected in October, further exacerbating fears over an economic slowdown.

If the current troubles in the Eurozone continue, it will have a further negative impact on the UK economy – the Euro area is the UK's biggest trading partner.

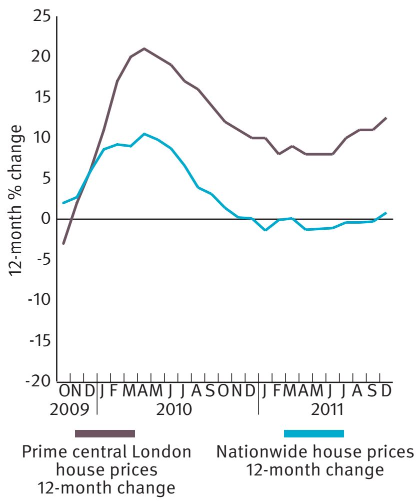
A bright spot for homeowners amidst the economic gloom is that interest rates are likely to remain pegged at the current

Figure 1
Future House Price Sentiment Index (HPSI)



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

Figure 2
12-month price change
London versus Nationwide average residential price change



Source: Knight Frank Residential Research

> "WHILE AVERAGE PRICES REMAIN MUTED, THERE WERE SIGNS OF LIFE IN THE MARKET AS ACTIVITY PICKED UP IN OCTOBER."

historically low level of 0.5% for a sustained period, benefitting those on variable rate mortgage deals who are enjoying low monthly repayments.

But there are some worries that mortgage rates may be pushed up anyway as a result of the Eurozone crisis – making it more expensive for those hoping to buy or re-mortgage. The Libor rate, the rate at which banks lend to each other and which helps determine mortgage pricing, has been rising in recent weeks. It has now hit 1%, up from 0.85% in August.

Housing market activity

While average prices remain muted, there were signs of life in the market as activity picked up in October. Data from RICS shows that new buyer enquiries and new instructions both rose during the month. The measure of newly agreed sales also rose to the highest level since April 2010, while the number of sales completed hit the highest number since April this year.

Rental market

Average rents across the UK rose again in October, but the market in the prime central area market slowed slightly, as anticipated. Rents grew by 0.57% growth in the three months to October, down from 0.93% in the three months to September. On a monthly basis, rents fell by 0.1% as the number of new tenants looking for prime rental properties in central London dipped by a larger than usual 21%. This is a reversal of the trend which has seen demand growth rapidly outpace supply growth in recent months. But despite this, average rents are still near record highs and above the levels seen when the prime London rental market last peaked in 2008.

Prime market performance

The financial and economic difficulties in the Eurozone and the wider global economy may be weighing on the mainstream market, but it has pushed more buyers to the 'safe haven' of prime London property.

Prime central London prices continued the very strong performance seen over the last few years, climbing by a further 0.7% in October to reach a new record high. Prices are now up 12.5% year on year, and have risen by more than 38% since the post-credit-crunch low in March 2009. We forecast that this growth will continue next year, albeit at a more modest pace, with a further 5% rise in prices during 2012.

Prime country prices remain broadly stable, but are down 1.7% year on year in the third quarter as there is limited evidence of any 'ripple-out' effect from the uplift in London prices.

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