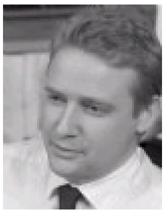
RESIDENTIAL MARKET UPDATE

Knight Frank

OCTOBER 2010
RESIDENTIAL MARKET DIFFICULTIES CONTINUE



"The summer months offer little perspective on the health of the residential market due to the low level of activity typical of the holiday season. It is only after September that we receive an indication as to where the market is heading for the rest of the year and, based on last month's performance, the UK market looks set to weaken further."

Liam Bailey, head of residential research, Knight Frank

"Our sales offices report a slightly different picture to the mainstream UK market, as we are exposed to the higher price brackets. Notwithstanding this, a similar, albeit less negative, tone can be discerned even in the prime markets."

Market Conditions

Whether we look at lenders' pricing data from Halifax or Nationwide, the industry survey from the RICS or mortgage market evidence, a clear narrative is emerging: the UK residential market is weakening. Asking and achieved prices are down, new buyer volumes are in retreat and sales volumes are declining.

September's record price fall - as reported by the Halifax Index, with average prices down 3.6% in a single month - appeared to confirm the increasingly despondent mood being felt across the market.

Our sales offices report a slightly different picture to the mainstream UK market, as we are exposed to the higher price brackets. Notwithstanding this, a similar, albeit less negative, tone can be discerned even in the prime markets.

Our experience confirms that available stock volumes have risen steadily throughout 2010, and now sit at their highest level since December 2008. While the volume of exchanges fell dramatically in September - down 20% on August, and down 22% on last September - the volume of properties under offer rose 27% between August and September, and were only down marginally (by 6%) compared to last September.

The ratio of our sales against available stock hit a high of 16% in March, meaning that we only had 6.25 months' worth of stock on our books at the time. The ratio dipped to 8% in August and recovered slightly to 10% in September (implying 10 months' worth of stock).

Our offices have taken a degree of good cheer from the fact that viewing volumes surged as usual in September, up 48% compared to August. They were also 3% higher than last September. While new applicant volumes rose 21% month-on-month in September, they unfortunately fell back by 11% year-on-year.

The average achieved sale price hit a low of 84% of the average asking price in January 2009, but recovered sharply to hit 98% in July this year. The measure then slipped slightly to 95% in September.

Pricing performance in the prime markets has mirrored the wider UK market. Although prices in central London increased by 14% in the year to the end of September, they fell by a total of 1% across July, August and September. In the UK prices have increased by 3% over the past year, significantly lower than the 10% annual growth recorded in April. More recently UK prices have fallen in two of the last three months.

In summary the UK market, including London and other prime marketplaces, is weaker than it was a few months ago. This weakness is perhaps not yet as severe as many, including ourselves, had expected. But the general tenor across all sectors is that conditions are more difficult, OCTOBER 2010

RESIDENTIAL MARKET UPDATE

"Vendors are beginning to compete more seriously for attention from a more reticent and smaller pool of buyers."

and vendors are beginning to compete more seriously for attention from a more reticent and smaller pool of buyers.

How to explain the market reversal?

Looking back at this year's housing market data, the inflection point appears to have occurred during the second quarter, around April and May. On balance, economic conditions have probably improved in the months since the beginning of the housing market weakness, albeit very slowly and with noticeable reversals in some measures.

A feel-bad factor among consumers can be partially explained by the fact that real disposable incomes (adjusted for inflation) fell by 1.6% in the second quarter - the third quarterly fall. Consumers are increasingly having to access their savings in order to fund living costs.

Unfortunately, there doesn't appear to be any reason to expect this situation to change in the short-term. Wages and salaries rose by 0.3% in the second quarter, which was equivalent to a decline in real terms of 0.8% when inflation is taken into consideration.

Turning to the mortgage market, the headline figures make for gloomy reading. The Bank of England confirmed that mortgage approval levels fell for the fourth month in August. Transaction volumes, as recorded by HM Revenue & Customs, are up by 45% from their late-2008 low, but are now 21% below December 2009 levels.

As well as there being a lack of appetite for credit (as confirmed by the third quarter's Credit Conditions Survey from the Bank of England), the availability of credit for secured lending has only improved very slightly. The financial system in the UK is adjusting to the need to move away from government support very slowly. In turn, the flow of credit to the wider economy, as banks' balance sheets improve, will be a very slow process.

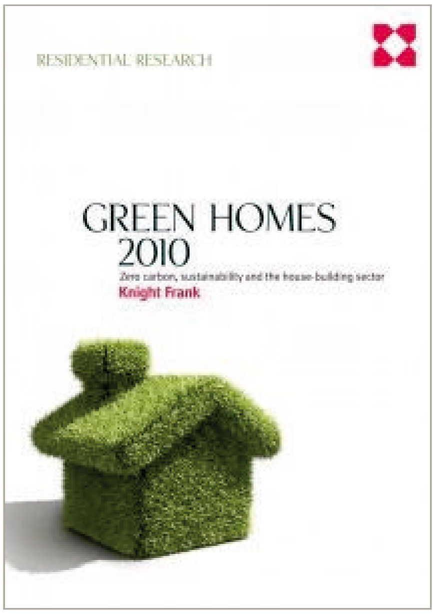
Further short and longer-term pressures will come to bear on the mortgage market. In the short-term, a number of lenders need to prepare to repay the government loans they received during the most difficult stages of the credit crunch in 2008. In the longer-term, the FSA's proposals around mortgage market regulation suggest that an increasing number of borrowers will find access to mortgage finance harder to obtain.

Taking into consideration the increasingly negative consumer sentiment, together with the more testing conditions in the mortgage market, our view remains that price falls will continue through the remainder of 2010 and into 2011. The determining factor as regards the scale of these price falls will be the ability of the Bank of England to keep interest rates as low as possible for as long as possible.

OCTOBER 2010
RESIDENTIAL MARKET UPDATE

Recent market-leading research publications

View our Global Property Wealth Survey 2010 PDF here



View our Green Homes Report 2010 PDF here

View our Market Insight PDFs here

› Contacts

Liam Bailey
Head of residential research
T +44 (0)20 7861 5133
M +44 (0)7919 303148

Andrew Shirley
Head of rural property research
T +44 (0)20 7861 5040
M +44 (0)7500 816217

James Kennard
Research consultancy
T +44 (0)20 7861 5134
M +44 (0)7500 065142

Knight Frank

Knight Frank Residential Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Knight Frank research reports are also available at KnightFrank.co.uk