RESIDENTIAL MARKET UPDATE.

Knight Frank

AUGUST 2011
PRIME LONDON BUCKS ECONOMIC GLOOM.

"Economic uncertainty is dampening activity in the mainstream UK housing market although there is a silver lining for mortgage borrowers who are enjoying low interest rates. But the demand for prime London properties continues unabated, pushing prices up to a new record high."

Gráinne Gilmore, Head of UK Residential Research, Knight Frank

"Yet there is a silver lining to this economic gloom for UK borrowers and would-be buyers, as it compounds the chances that interest rates are set to stay pegged at a record low of 0.5% for months to come."

UK housing market and economic overview

Mainstream house prices remained broadly stable in July while prices in prime London hit a new record high. This is a further reminder of the stark contrast between the housing market in London and the rest of the UK.

While UK mainstream house prices edged up by 0.2% during July, average prices are now 0.4% lower than in July last year. The annual rate of decline represents an improvement on the 1.1% fall seen in June. But the quarterly house price data, which is less volatile than the monthly figures, showed that the pace of growth eased from 0.4% to 0.3% last month.

A slight rise in mortgage lending, reported by The Council of Mortgage Lenders (CML), indicated that some buyers are finding it easier to access finance, but confidence-sapping economic data was also released at the end of last month, signalling that the economy is struggling to make a convincing recovery from the recession.

The data showed that GDP grew by just 0.2% in the second quarter, although the Office for National Statistics (ONS), which compiles the figures, said that several one-off factors such as the hot weather in April and the Royal Wedding had dampened growth. It estimated that without these factors. GDP growth could have been as high as 0.7%.

Hopes that growth might pick up in the third quarter were also raised as separate figures showed that activity in the dominant services sector, which includes businesses ranging from accountants to hotels and makes up more than three quarters of the country's economic output, rose at the fastest pace in four months in July.

But the economy needs to stage a rebound to meet the government's growth forecasts. Sluggish economic growth not only has an impact on consumer confidence, but will also affect the government's efforts to cut the country's deficit. The International Monetary Fund warned earlier this week that there was a risk that the government's fiscal plan would fail to balance the country's budget.

In addition, the global picture is downbeat. The US came to a last-minute agreement about its debt ceiling, but it is likely to face more questions over its finances. The eurozone crisis continues, as fears escalate about Spain and Italy where sovereign bond yields have soared to record highs.

Yet there is a silver lining to this economic gloom for UK borrowers and would-be buyers, as it compounds the chances that interest rates are set to stay pegged at a record low of 0.5% for months to come.

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Borrowers on their lenders' standard variable rate are enjoying very low monthly repayments, and in some cases are taking the opportunity to overpay – thereby making a sizeable dent in the capital they owe. Mortgage rates for new buyers have also dropped to record lows, especially for fixed-rate deals, although the effect is muted by lenders demanding high deposits, pricing out all but the most cash-rich buyers.

Gross mortgage lending climbed by 16% in June compared to July, according to the latest data from the CML. However this was still 3% lower than lending in June last year.

We forecast that prices in the mainstream UK market will fall by 6% this year, but will bounce back by 6% next year. But if interest rates remain pegged at 0.5% for the rest of the year, this year's decline may be more modest as prices are supported by low mortgage rates. In turn, the rise next year could be more muted if interest rates start to climb in 2012.

Housing market activity

Economic uncertainty is weighing on transaction levels across the UK. Buyer enquiries and vendor instructions remained broadly flat in June, according to the latest RICS survey. But the difference between London and the rest of the UK was again highlighted as the price index, which was -22 for the whole of the UK, signalling that prices fell between April and June, had a reading of 27 in the capital, indicating that prices rose.

Agents expect that transaction levels will pick up over the next three months, although they are more downbeat about the outlook for prices in the mainstream market, with the majority forecasting further price falls.

Demand for rental property is continuing to rise however, boosted by the lack of mortgage funding which is driving potential buyers into the rental sector.

In the prime London market, rental demand has also been driven up by overseas tenants and activity has been strong as families try to organise a new property in time for the start of the new school year in September.

Prime rents climbed by 0.3% in July, taking the increase in the three months to July to 1%. Rents are now 1% higher than their previous peak in March 2008 and have risen by more than 17% over the last 12 months.

Prime market performance

Prime London property prices rose by 0.7% in July, taking the annual increase to 9.6%. Prices are now 35% higher than the post-credit-crunch trough in March 2009.

In contrast to the mainstream market, sales activity in the prime central London market has been strong in recent months, with a rise in new instructions and a subsequent rise in transactions.

But supply is still not meeting the pent-up demand in the market. Buyer demand for prime properties in the capital looks set to continue, signalling a further rise in prices throughout the rest of the year, albeit at a more modest pace. We forecast that prices will rise by 9% this year and 6% next year.

Prime country house prices have remained broadly flat so far this year, falling by 0.7% in the three months to June after a 0.5% rise in the first three months of the year. Prices are around 1.6% lower than in June last year, but they are 6.4% higher than the post-credit-crunch dip in mid-2009. The strongest market is the £1m - £3m sector in south-east and south-west England, which has seen price growth of 10% since mid-2009. We forecast 2% growth in prices for properties more than £5m this year, while prices for houses valued at between £1m and £5m are expected to remain flat.

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