RESIDENTIAL MARKET UPDATE

Knight Frank

"Fuzzy guidance" as market moves up a gear

The Bank of England has moved to reassure markets that interest rates will remain low for some time yet, as activity in the housing market steps up. In prime central London property prices continue to rise, and rents climb for the first time in nearly two years. Gráinne Gilmore examines the latest trends.

Key facts February 2014

UK house prices rose by 0.7% in January, and are up by 8.8% on an annual basis

Average prices in prime central London rose by 0.4% in January, taking the annual increase to 7.8%

Prime central London rents climbed by 0.2% in January, the first rise for nearly two years

Residential development land prices increased by 7.1% in 2013 in England & Wales

English and Scottish farmland prices rose by 11% in 2013

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UK housing market and economic overview

Average UK house prices continued on their upward trajectory in January, climbing by 0.7% to take the annual increase to 8.8%, according to data from Nationwide. However the pace of growth is highly regionalised, with slower price growth outside the South East and London. There is firm evidence that activity in the housing market has also picked up substantially over the last year.

Data from HMRC showed that there were 1.07 million transactions last year, the first time the number of transactions in the market has exceeded 1 million since 2008. As the chart below shows, there were more than 100,000 transactions in November and again in December, the first time this has happened since January 2008. Mortgage approvals data suggests that this rate of activity will continue. New figures from e surv suggest there were 65,142 approvals for house purchases alone last month, some 24% higher than the level in December 2013 and 75% higher than in January last year. Activity levels have been boosted by increased confidence in the economy, as well as the Government's pledge to aid home buyers and home movers through its Help to Buy programme. The market is also being underpinned by low interest rates.

Interest rates were top of the agenda at the Bank of England this week however, as central bankers revealed their latest thinking on the economy in the quarterly Inflation Report. The verdict on the economy is positive – the central bank revised up its forecast for economic growth this year to 3.4%, from a previous forecast of 2.9%. This would mark the highest growth in annual GDP since before the financial crisis.

The dramatic improvement in the economy has also led to a recovery in the jobs market – and as a result, unemployment has fallen

GRÁINNE GILMORE
Head of UK Residential Research

"Mortgage borrowers must now consider preparing for the fact that, barring any economic shocks, interest rates will start to rise at some point next year."

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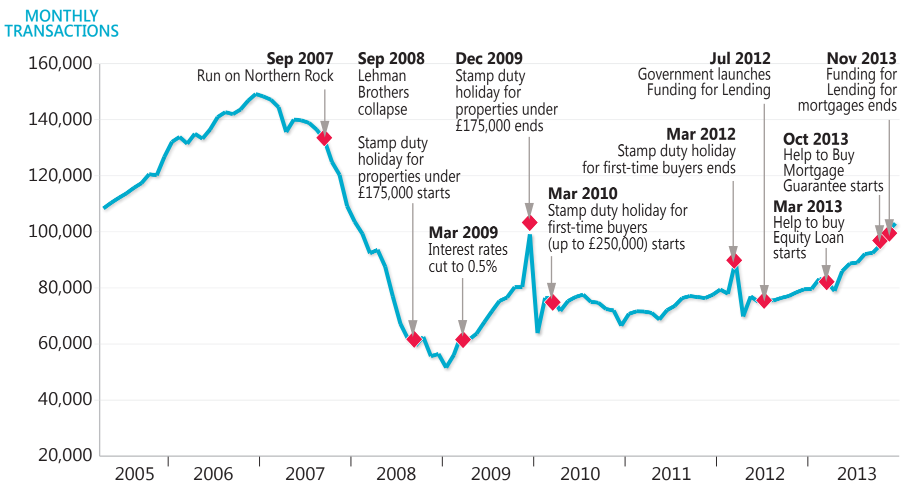
FIGURE 1
Housing market activity is picking up
Residential transactions per month



Source: Knight Frank Residential Research/HMRC much faster than the Bank expected. This meant that Mark Carney, the Bank Governor, had to row back slightly from the "forward guidance" he gave on interest rates last year. At that time he said that the bank base rate would not rise above 0.5% until the unemployment rate fell to 7%, something which was broadly expected in 2015/2016. Since then the unemployment rate has tumbled to 7.1%. So this week, Mr Carney moved to assure the markets that despite this, interest rates would still not move in the near future – leading some to dub his comments "fuzzy guidance". We expect rates to remain pegged at 0.5% this year, but mortgage borrowers must now consider preparing for the fact that, barring any economic shocks, interest rates will start to rise at some point next year.

Prime market performance

Prices in the prime London market continued to climb in January, rising by 0.4% during the month. This took the annual rise to 7.8%, according to Knight Frank's prime central London index. Although this index stretches back to 1976, last month marked the tenth year that Knight Frank has been producing monthly data on the Prime Central London market. Over that ten year period, the value of prime property in central London has climbed by 135%, outpacing growth in the FTSE 100, but keeping pace with the increase in value of a case of Chateau Margaux 2000 or a classic Porshe. There is more detail in the PCL index anniversary edition.

Prime country house prices rose by 1.4% in the final quarter of 2013, taking the annual increase to 3.1%, while prime prices in Scotland climbed by 1.6% last year.

Rental market

Average rents fell by 1% between November and December in the UK, resulting in an annual increase of just 1.5% in 2013. While average UK rents dipped at the end of last year, prime central London rents rose in January. The increase was a modest 0.2%, but still marked the first upward move in rents in this market since April 2012. The move can be attributed to a return in confidence in the city jobs market, and the indicators are that there will be further increases in rents this year as economic growth in the capital continues to gain momentum. In contrast, prime rents in the Home Counties are still on a downward trajectory, declining 3.6% last year. Yet activity levels in the market remain robust, with a marked pick-up in corporate relocations.

A snapshot of the state of the wider private rented sector in the UK, including the increased interest from institutional investors, can be found in our latest report: A Rental Revolution.

Land markets

The most recent residential development land index shows that land prices rose by 7.1% across England and Wales last year, climbing by 2.7% in the last three months of the year alone. In prime central London, residential development prices rose by 14.4% in 2013. Agricultural land values continued to climb last year, rising by 11% in both England and Scotland. Scottish agricultural land prices have increased by 220% over the last ten years, outpacing the 210% rise in agricultural land values in England over the same period, as well as outpacing the 212% increase in the price of gold – seen by many as the ultimate safe-haven investment.

> *"The dramatic improvement in the economy has also led to a recovery in the jobs market – and as a result, unemployment has fallen much faster than the Bank expected."*

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