June 2013

RESIDENTIAL RESEARCH

RESIDENTIAL MARKET UPDATE

A changing market

Some key dynamics within the housing market have changed over the last six months. Gráinne Gilmore examines the trends, and outlines Knight Frank's new price forecasts for 2013.

Key facts

UK house prices rose by 0.4% in May, and are up 1.1% year-on-year

Prime central London prices rose by 0.3% in May, taking the annual rate of growth to 7.2%

Prime central London rents were unchanged in May, and annual decline eased from 3.2% to 2.9%

Knight Frank revises forecasts for UK property price growth in 2013

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"We have revised our forecasts for mainstream prices this year to show a 3% increase, just outpacing inflation."

Gráinne Gilmore, Head of UK Residential Research

UK housing market and economic overview

This month marked the end of an era as Sir Mervyn King, Governor of the Bank of England, chaired his last monthly rate-setting meeting. Sir Mervyn, who will hand over the governorship of the Bank to Mark Carney on July 1st, has presided over 194 Monetary Policy Committee (MPC) meetings since 1997. Over the same period, average UK house prices have risen by 184%.

Despite the long-term growth in house prices, market conditions have been strained since the financial crisis amid credit constraints and wobbly buyer confidence. The MPC's rapid moves to drop the interest rate to a record low of 0.5% in early 2009 (figure 1) – a rate we still have today – has helped put a 'floor' under house prices in the UK, as have several policy interventions, such as the multi-billion Funding for Lending scheme designed to boost bank lending to homebuyers and home movers.

At the other end of the funding pipeline, FirstBuy and NewBuy were designed to help homeowners who had modest deposits to climb onto the property ladder by offering government guarantees. The NewBuy scheme has had relatively modest take-up in its first year, but it has been useful as a pre-cursor to the Government's 'big gun' policy to push activity levels higher: Help to Buy.

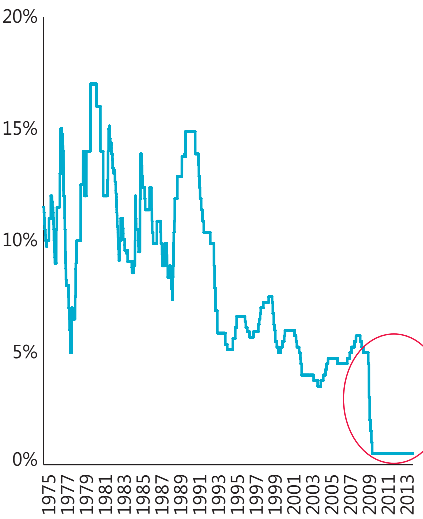
The Help to Buy scheme comes in two parts. The equity loan, under which the Government effectively offers a 20% interest-free loan to cash-strapped buyers for five years, was launched at the start of April. It is designed to help 74,000 extra people to buy a new-build property over the next three years – funded from a central pot of £3.5 billion. Our recent Housebuilding Report, showed that it had boosted expectations for development activity, and certainly developers recently reported that the scheme has got off to a flying start, with around 4,000 reservations in the first two months.

It is notable that the upper threshold for house purchases under the scheme is £600,000 – meaning that it will be available to buyers in most parts of the country including London, not just those areas

Figure 1

Bank of England base rate

1975-2013

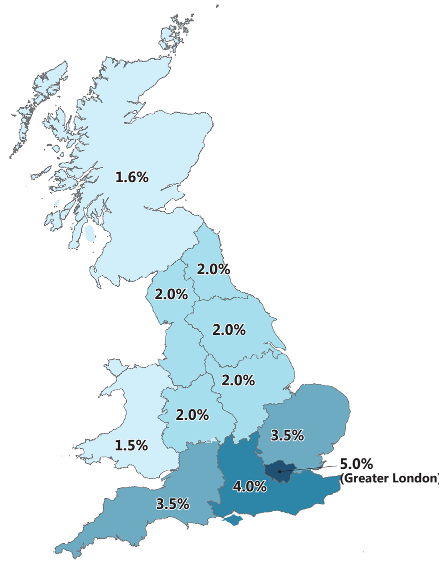


Source: Bank of England

Figure 2

Regional house price forecasts

Annual price growth forecast for 2013



Source: Knight Frank Residential Research

"PRICES IN PRIME CENTRAL LONDON ROSE AGAIN IN MAY, BY 0.3%, TAKING THE ANNUAL INCREASE TO 7.2%."

where prices tend to be in or around the national average.

The second part of Help to Buy, the mortgage guarantee, is a much bigger £12 billion plan to help buyers by guaranteeing part of the mortgage for new-build and older homes. The scheme, which will last for three years, will not launch until January next year and as yet there is little or no detail on how it will work.

Despite the lack of detail, the scheme has had an immediate impact on the market. Our monitor of housing market sentiment, produced in conjunction with Markit Economics, jumped significantly in the weeks after the scheme was announced in the March budget and has remained at new, higher, levels ever since, suggesting increased confidence that property prices are set to rise.

Alongside this increased buyer confidence there is evidence that Funding for Lending is putting further downward pressure on mortgage rates, with some historically low fixed-rate deals now available from high street lenders. The expectation that Mark Carney, the incoming Bank of England governor, will give a 'guarantee' that the base rate will stay at its record-low rate for a further set period of time could help pull down mortgage rates even more, and give buyers some short-term certainty over their finances.

The dynamics of the market have certainly changed since March, and as such we have **revised our forecasts** for mainstream UK house prices this year, as shown in figure 2. We see prices rising by 3% this year, just slightly above inflation. We will revisit our longer-term forecasts for mainstream pricing once further details emerge on the Help to Buy mortgage guarantee during the summer. On a longer-term basis, we believe that a further adjustment in mainstream house prices is needed; we see this happening through modest price rises for an extended period, leading to minimal real overall price growth and gradually bringing prices back into line with the longer-term average house price to earnings ratios.

Our prime central London forecasts remain unchanged, with cumulative 10.2% growth forecast between now and the end of 2015.

Prime market and rental market

Prices in prime central London rose again in May, taking the annual increase to 7.2%. Although the headline figure shows a rise in prices, values in some areas experienced modest price falls, an indication that buyers are becoming ever more price sensitive.

Prices of prime country homes rose in the first quarter of 2013 for the first time since the beginning of 2011, but prices are still down 3.2% year-on-year. Prime Scottish property has fallen in value by 2.5% over the last 12 months.

Prime central London rents were unchanged in May, but are down by 2.7% year-on-year. We forecast that prime London rents will rise by 1% this year, before posting stronger growth from 2014 onwards.

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UK Housing Market Forecast

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