RESIDENTIAL RESEARCH

RESIDENTIAL MARKET UPDATE

Knight Frank

The great divide

Average house prices across the UK remained broadly unchanged in September, in contrast to prime central London where prices continued to rise.

Key figures

UK house prices rose 0.1% in September, but are down 0.3% year-on-year

Prime central London prices continue to climb, rising 0.6% in September and 11.4% since September last year to hit a new record high

Prime country house prices slipped in Q3, falling by 1.2% between July and September, contributing to an annual decline of 1.7%

Economic gloom deepens as ONS confirms economy is stagnating, prompting the Bank of England to re-start quantitative easing this month

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UK housing market and economic overview

The price of an average home in the UK edged up by 0.1%, or £350, last month to £166,256, according to Nationwide. This is 0.3% lower than in September last year, but more than 12% higher than when the market troughed in early 2009.

The newly launched Knight Frank/Markit House Price Sentiment Index (HPSI), a leading indicator of house price movements, signalled that house prices across the UK would continue to slip downwards in the months to come. The index for future house prices highlighted the regional split across the UK, with households in the South East and London expecting price rises over the next 12 months. Households in the Midlands and North West expect prices to keep falling.

The broad stability in the market over the last year has been underpinned by a shortage in the supply of new homes, and this trend is expected to continue for the rest of this year. But the darkening economic outlook, especially in the eurozone, is weighing on buyer sentiment. The recent run of party conferences has also underlined the problems facing the UK economy, which could further impact confidence in the market.

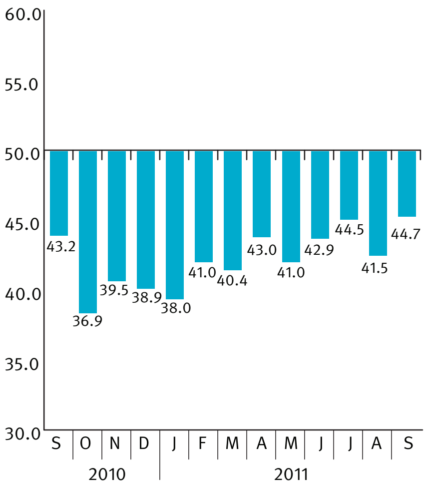
Adding to the economic gloom was a recent large-scale revision of GDP data by the Office for National Statistics (ONS) which showed that the economy had really failed to kick into recovery mode and had been broadly stagnating for the last nine months. It also showed that the recession was sharper and deeper than had previously been estimated, punching a bigger hole in economic output.

However there was also some positive news this month, with a rise in the closely watched PMI indicator of activity in the services sector, which accounts for about three quarters of economic output, signalling that economic activity may have picked up towards the end of the third quarter.

But this was not enough to stay the hand of the Bank of England's Monetary Policy Committee (MPC) which voted to inject more

Figure 1

House Price Sentiment Index (HPSI)



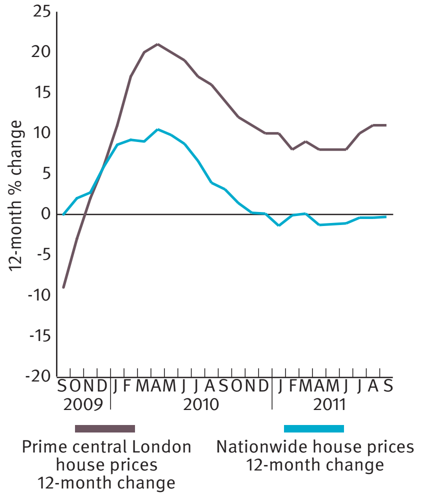
Source: Knight Frank/Markit

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

"ALTHOUGH DEMAND ALSO CONTINUES TO RISE, IT WAS OUTSTRIPPED BY THE RISE IN SUPPLY IN SEPTEMBER."

money directly into the economy in a bid to aid growth. The MPC received permission from the Treasury to buy up another £75 billion in government bonds, to take the total amount pumped into the economy in this way to £275 billion.

Under the scheme, the Bank creates electronic money, the modern version of printing money, and uses it to buy gilts from financial institutions. The theory is that the banks and other institutions will use the money they receive from the sale to invest in corporate debt and shares, easing the credit constraints in the market.

Housing market activity

The market remained sluggish across England and Wales in August, partly due to the summer slowdown, but also because of the economic uncertainty and the lack of mortgage finance, according to agents surveyed by the Royal Institution of Chartered Surveyors (RICS).

Constrained mortgage availability is hitting all borrowers, especially first-time buyers who are trying to climb onto the property ladder. Buyer demand fell in August, while supply remained unchanged.

Rental market

Rents across the UK continued to rise in the three months to July, according to the latest data from RICS, as demand continued to outstrip supply. But the pace of growth slowed slightly from the previous three-month period.

Prime London rents also continued to climb in September, rising by nearly 1% in the third quarter, marking the ninth consecutive quarterly increase. Rents are now 27% higher than the market trough in early 2009 and are 2% higher than the previous record high hit in March 2008.

But the growth in rents is likely to moderate in the coming months as supply of properties to rent begins to rise, in part due to the number of new-build completions in central London. Although demand also continues to rise, it was outstripped by the rise in supply in September.

Prime market performance

Prime country house prices slipped by 1.2% between July and September, contributing to an annual 1.7% decline. While the country market usually benefits from an uplift in London prices, there has been little evidence of this during the current cycle. While prices of prime property in the South East have risen by 0.4% in the last year, prices have struggled to rise in other areas beyond the M25.

Within central London the picture is much brighter. Prime central London property prices have risen by 11.4% over the last year, gaining an average of £1,117 every day over the past 12 months. Prices are now 5% higher than the previous market peak in 2008. There is a possibility of strong double-digit growth in prime central London this year, and we forecast another uplift next year.

Residential Research

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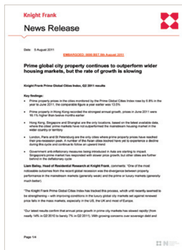

Prime Global Cities Index August 2011

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