UK RESIDENTIAL MARKET UPDATE

RATE RISE ON ICE?

UK deflation returned in September and wage growth eased, leading some to speculate that the first rise in the base rate in more than six years may not happen before the summer of next year. Meanwhile price growth eased across the board as the rate of policy change in the housebuilding sector speeded up.

Key facts October 2015

Average UK house prices rose by 0.5% in September, taking annual growth to 3.8%

Prime central London values fell by 0.1% in September. Annual growth is at 1.3%

Prime Country house prices rose by 0.7% in Q3, and are up 2.7% on the year

Average values for prime Scottish homes fell by 0.7% in Q3, taking annual growth to 0.6%

GRÁINNE GILMORE
Head of UK Residential Research

"On a regional bases the annual average change in house prices ranges from 10.6% in London to -1.3% in Scotland."

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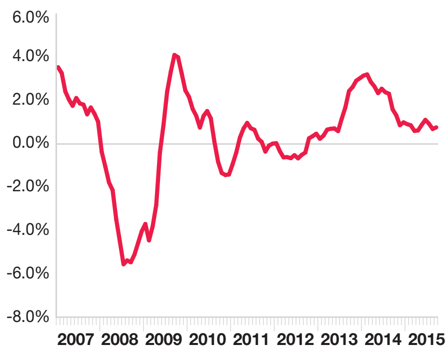
Housing market and economic overview

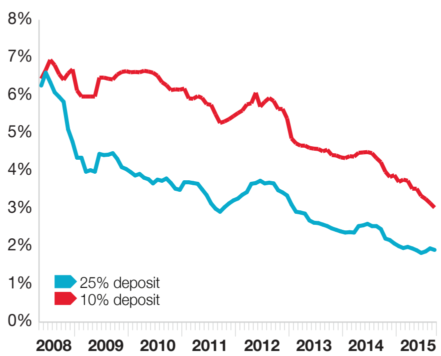
UK quarterly house price growth
Quarter-on-quarter change



Source: Knight Frank / Nationwide

The pace of average price growth across the UK is easing on an annual and a quarterly basis. However, market dynamics differ across the country. Even on a regional basis, price change in the 12 months to the end of September ranges from 10.6% in London to -1.3% in Scotland.

Falling mortgage rates
Average mortgage rates for 2-year fixed-rate deals

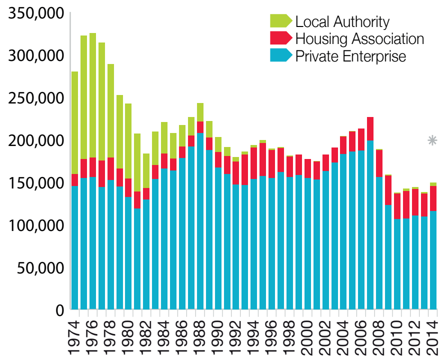


Source: Knight Frank / Macrobond

Ultra-low mortgage rates for those who have access to equity or a sizeable deposit, and who can navigate the tougher application criteria under the new mortgage rules, are helping underpin the market.

Although the expectation is that interest rates will rise before June next year, the Bank of England was thrown a curveball this week as the country dipped back into deflation. The negative inflation reading means that the cost of goods and services is falling year on year, and leaves the Bank further from its sole target – hitting 2% inflation in the medium term. Despite strong employment figures, wage growth also eased, meaning that the Bank of England may hold off for longer on raising rates, good news for homeowners with variable rate mortgages.

Housing completions in the UK



Source: Knight Frank Research
*Minimum housing requirement

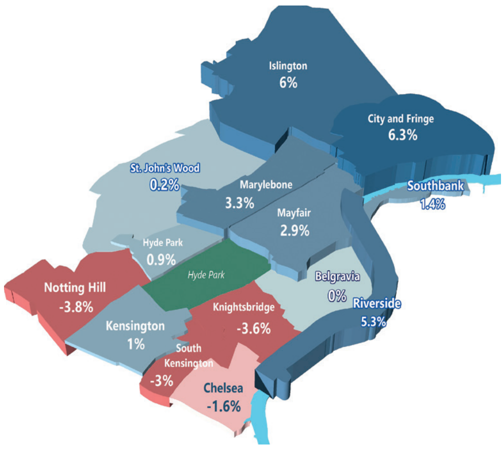
The undersupply of housing is also a key factor in the current market. It is estimated that around 200,000 to 250,000 homes a year need to be built in the UK. As shown in the chart above, total delivery is some way below these targets.

In order to try and address the shortfall, the Government this week unveiled its Housing Bill, designed to try and boost the supply of housing. Key among the changes is the introduction of "Starter Homes" – homes will be sold at 80% of market value (and will remain priced at this level for five years) and will be available to first-time buyers aged under 40. The Prime Minister has pledged that 200,000 such homes will be built by 2020, an ambitious target. Details of how this type of housing will dovetail with the current affordable housing requirements are yet to be released, but are expected in the coming months. This comes just months after the Government announced cuts to social rents, creating more uncertainty in the affordable housing market. So while there is a fast-paced policy environment, the current lack of detail is creating a sense of limbo in some corners of the development market at present.

Housing is also taking centre stage in the London Mayoral election, with Sadiq Khan, the Labour candidate for Mayor, pledging to turn the contest into a referendum on housing in the Capital.

Prime markets

Price growth in prime central London by area in the year to October 2015

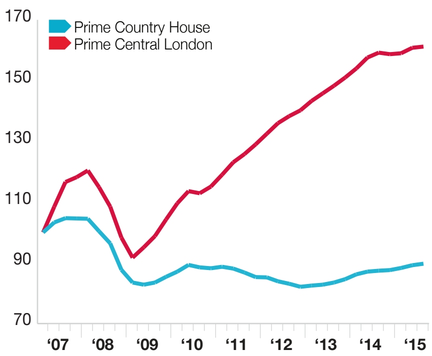


Source: Knight Frank Research

Price growth in prime central London continued to slow in September, with increased stamp duty charges for transactions worth more than £1.1 million weighing on values. Activity picked up after the summer, although this was not uniform across all areas, and it is yet unclear if demand will keep up with an increase in supply. Knight Frank has adjusted its forecasts for the prime central London market for 2016 from 4.5% growth to 2%.

Prime London v Prime Country price differential

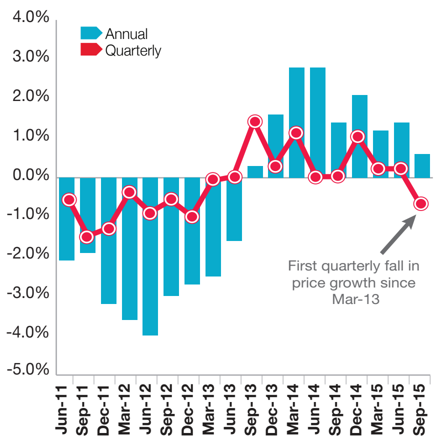
Nominal price change since Q1 2007
(100 = Q1 2007)



Source: Knight Frank Research

The average values of prime country property across England and Wales has been edging up for 11 consecutive quarters now, although the pace of growth is still modest, with annual growth at 2.7%. Higher stamp duty charges have affected activity, but there is also increasing evidence of buyers from London taking advantage of the relative price differential for homes within and outside the capital, especially in key commuter towns.

Prime Scotland: annual and quarterly price growth



Source: Knight Frank Research

Prime Scottish prices are moving in a different direction than those in England and Wales due to the alternative tax treatment of properties in Scotland. Prices fell by 0.7% in Q3, the first decline in two years. Yet despite the slip in prices, activity levels rose in the third quarter, according to Knight Frank data.

Rental market

Average rents across Great Britain rose by 2.5% in the year to June, according to the latest data from the Office for National Statistics. Rents in London grew by 3.6% on average over the same time period. Knight Frank's own data shows that rents in prime central London eased to 2.4% annual growth in September, down from a high of 4.2% annual growth in May.

This easing in rents reflects the effect that global economic jitters have had on corporate demand for rental property in which to house executives. However demand remains strong among young professionals and at the top end of the market as more people choose to rent while they consider the higher stamp duty charges for home purchases.

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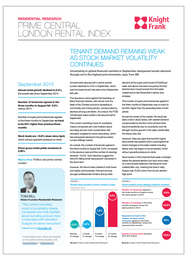
The Wealth Report 2015



PCL Rental Index - Sep 2015

Prime Country House Index - Q3 2015

Prime Central London Sales Index - Sep 2015

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