# UK Property in 2011

## "Flat at Best or a Year of Falling Home Prices?"

UK Property Prices have been surprisingly resilient following the devastating banking crisis of Autumn 2007. Few at the time would have dared predict that the Bank of England would cut the base lending rate to a 300-year record low. This bold move has served to support house prices by keeping mortgage payments low and limiting the number of distressed sales. Without this low interest rate policy house prices would have fallen much further and faster than they did in 2008.

UK home prices found their feet again in 2009 and 2010 and stabilised in nominal terms. However, when corrected for the effect of monetary inflation prices have continued to fall albeit more slowly. One should also note that the national average figures hide marked differences between the English regions, Wales, Scotland and Northern Ireland. Some regions such as London and the South East experienced strong price recoveries whilst others continued to slide. The outlook for residential property prices in 2011 will also be subject to considerable region variation.

**Which Factors Are Pushing House Prices Down?**

- The mortgage and remortgage market remains in turmoil. In particular proposed mortgage regulation could make it even more difficult to get mortgages. Moreover, banks may be very reluctant to advance mortgage funding when they need to pay back their huge government bailout loans (via the Special Liquidity Scheme).
- Falling buyer demand.
- Distressed sales are becoming more prevalent particularly at the higher end of the market.
- The financial squeeze and lack of consumer confidence dissuade potential buyers from large financial commitments. In particular, the prospect of spending cuts in 2011 is raising fears over a prolonged economic slump. Many jobs cuts are planned in the public sector with knock-on effects.
- As prices drop the equity accrued against a mortgage debt drops and it is harder to remortgage.
- Some new build property on the market and has yet to become fully occupied.
- First time buyers have lost confidence and have lower savings for a sizeable deposit.
- The housing market is being viewed as increasingly risky.

**Factors Supporting House Prices**

- Record low interest rates are likely to persist for foreseeable future. In some instances they have reduced mortgage payments, but most importantly they have served to reduce the number of distressed sales entering the market.
- House prices defied expectations in 2009 and early 2010, suggesting the UK still has an underlying belief in home ownership.
- The rental sector shows renewed vigour.
- The likelihood of rising inflation due to further stimulus measures (Quantitative Easing) will encourage capital flight to hard assets such as property.
- Any extension to bank bailouts will ease mortgage supply

## The Rental Sector

Property investors will also be aware that the various UK property sectors present different opportunities. Increasing demand in the rental sector is strengthening investment by private landlords. Owing to the difficulties faced by the first-time buyer in obtaining mortgage credit, the buy-to-let market has replaced, at least in part, this vital role in the residential property market. Having been the heaviest falling sector in 2008, flats (and smaller properties that are more easily let to tenants) have found increasing price stability in 2010 and this trend is likely to continue in 2011.

## Demographic trends

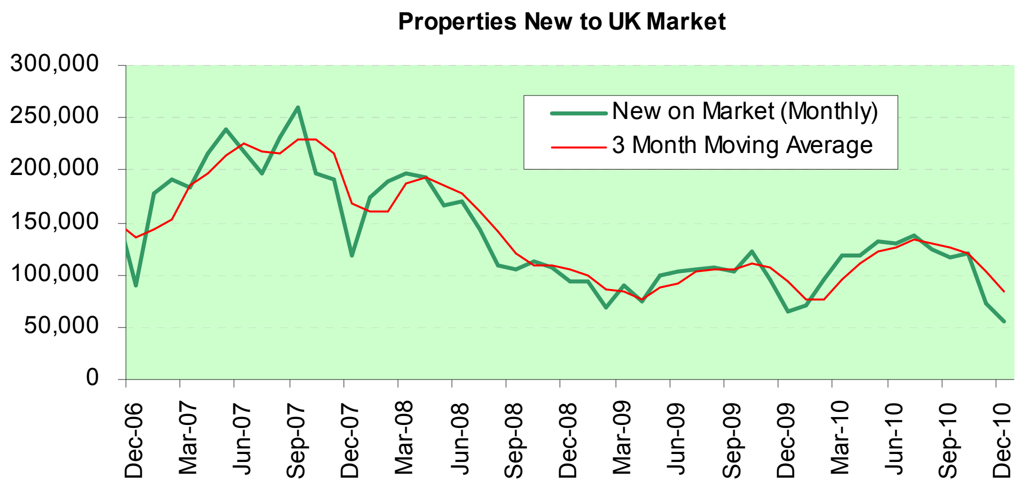
Baby boomers and the 'inheritance generation' are starting to liquidate assets as parents downsize, pass away, move to sheltered accommodation or look to boost pension income. However, much capital will be reinvested in property as this has proved, to many, to be a good long-term investment. Cash or near all-cash purchases can drive a hard bargain in the current UK housing market

## Government Cuts

Austerity measures being the talk of Westminster are clearly undermining owner-occupier confidence in the residential sales sector. Job security will be a worry for many workers in Government agencies in 2011 and this will likely effect a downward price trend for medium- to high-priced properties. Sliding prices for premium property will be most keenly felt in the Northern regions, Scotland and Wales.

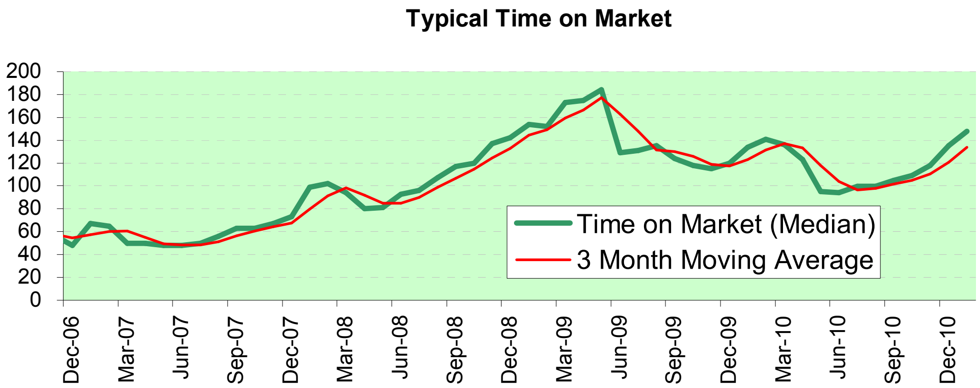
## Supply and Demand

The supply dynamics of the UK property market following the credit crisis in 2007 served to support prices. The number of properties new to the market each month fell until the spring of 2009, by which time prices began to stabilise. Renewed confidence in the market spurred a rising trend in property supply culminating in the recent peak in August 2010. It is worthwhile noting that this peak represents only 50% of the volume of properties being placed on the market during the record months in 2007. Hence, on a nominal level, property supply remains comparatively low but these trends must be judged relative to demand.



A key indicator of property demand is Time on Market. The chart below shows the typical (median) time on market since December 2006 for properties for sale.

The typical marketing time for UK property soared post-crisis to reach a maximum of 184 days in May 2009 as buyer demand diminished. Marketing time reduced considerably following this peak to a low of 94 days in June 2010: still twice the time on market for unsold property in June 2007. Since then the median Time on Market for property for sale has been rising, as buyer demand wanes and portends falling prices in 2011.




The single most important driver for housing is the availability of mortgage credit. The considerable uncertainty surrounding the supply of mortgage funding in 2011 casts a black cloud over the future horizon for residential property. Mortgage approvals are currently very weak and many commentators suggest volume will fall further as banks and building societies become increasingly risk-averse towards the housing sector.

**Conclusion**
UK Home Prices will slide downwards in 2011, despite heightened activity in the buy-to-let sector. How far and for how long they fall depends almost entirely on the availability of mortgage funding. Should it contract significantly we could witness a price drop of 10% or more in 2011.

**Opinion**
UK House Prices need to be much lower, relative to earnings, to improve the competitiveness of the UK economy. A drop in home prices would be good for the UK economy and the health of the UK housing market in the medium term despite the short-term pain for lenders and mortgagees.