

A Bilfinger Real Estate
company



Research report

UK housing market outlook

Q3 2014





House prices

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Six months ago, concerns focused on whether the housing market was overheating. Nationwide report that average prices increased by 10.5% for the UK in Q3 2014, following an 11.5% increase in Q2, the first time the UK average has increased by double digits for two consecutive quarters for a decade (see Figure 1). All regions recorded growth with the strongest being London at 21%, taking the average house price in the capital to £401,000, almost £100,000 higher than the price in Q3 2007.

This resurgence in growth has also filtered out to the markets surrounding London, including the South West, East of England and East Midlands, helping to bring the UK average price to 2.5% above the previous highs recorded in Q3 2007 and increasing the north/south divide within the market (Figure 2). Several regions are still more than 5% below peak, while prices in Northern Ireland are still almost half the 2007 level.

Despite this, there are signs that the prime market in the capital is cooling, as exemplified by London leader Foxtons suffering a 4% drop in trading year on year during the period for July to September. Quarter on quarter growth for London as a whole was 0.2% according to the Nationwide, versus 1.2% for the UK. While some of this slowdown is due to a fall in new enquiries and the seasonal summer lull, the growing speculation of a possible Mansion Tax from 2015 will have created some additional concerns.

So how do current house prices fare in comparison to the previous boom and the longer term trend? The long term trend for UK house price growth in real terms (1973 onwards) is 2.6% pa. As of Q3 2014, UK house prices remain 5.4% below the trend rate, compared to 36.7% over at the height of the market in Q3 2007 (Figure 3).

This suggests that claims of a price bubble earlier in the year were unfounded, at a national level at least. For London, real house prices are 10.1% over following a brief below trend correction. This current position however remains noticeably lower than the period from 2000–2008, which peaked at 30.9% above trend in Q3 2007.

With the economic backdrop for the UK looking positive despite concerns of further recession in the Eurozone, latest estimates for Q3 2014 show the economy to be 3.4% above the pre-recession peak. So what is causing sentiment to harden within the housing market? The uncertainty over interest rates, in particular when and how fast will the rises be, is one consideration.

Another possibility is that buyers are being put off by higher prices and deferring new purchases. This is reflected in the fact that the RICS has recorded new buyer enquiries falling from a net balance of higher than 60% in late 2013 to around -10 in September, with the largest regional decline in London, where enquiries have fallen for five consecutive months.

Figure 1: Annual house price growth

Source: Nationwide

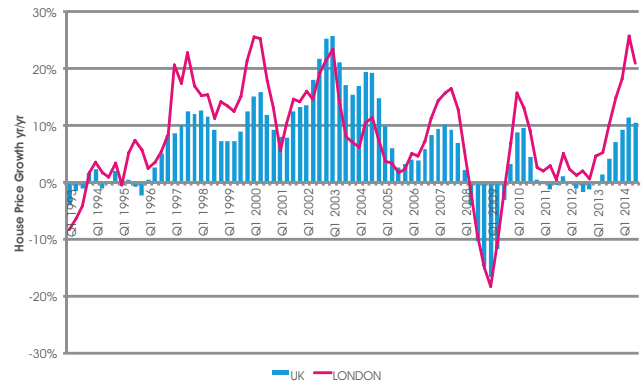


Figure 2: Current average house price compared to peak

Source: Nationwide

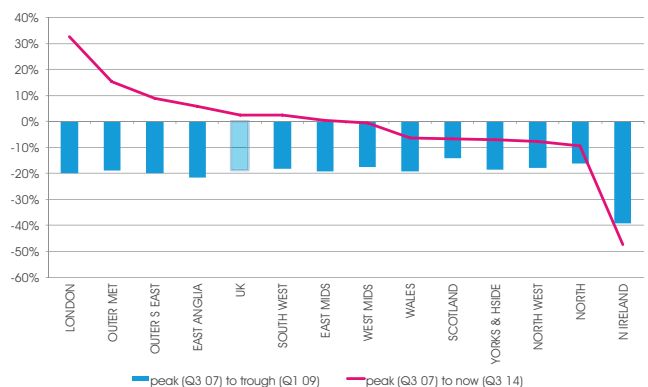
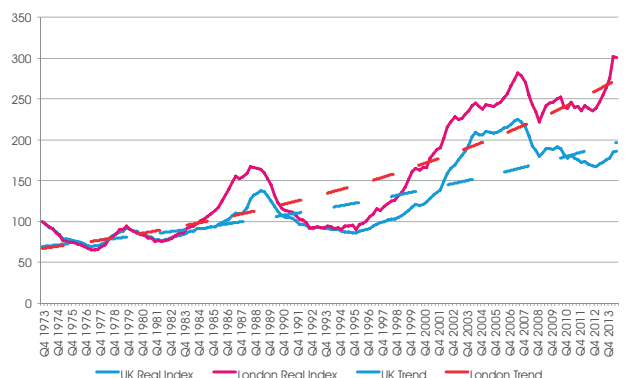


Figure 3: Long term UK house price growth (real)

Source: Nationwide, GVA



Demand trends

Figure 4: UK transactions (seasonally adjusted)

Source: HMRC

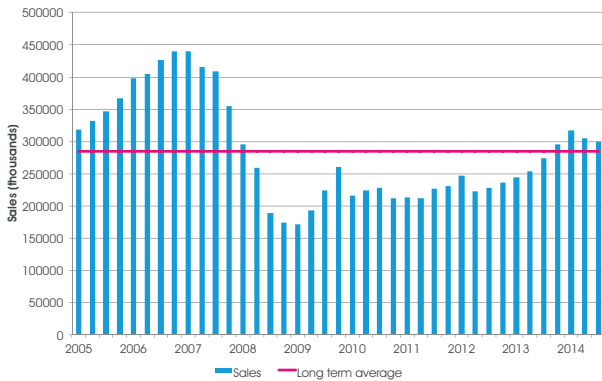


Figure 5: Interest rate forecasts

Source: Experian

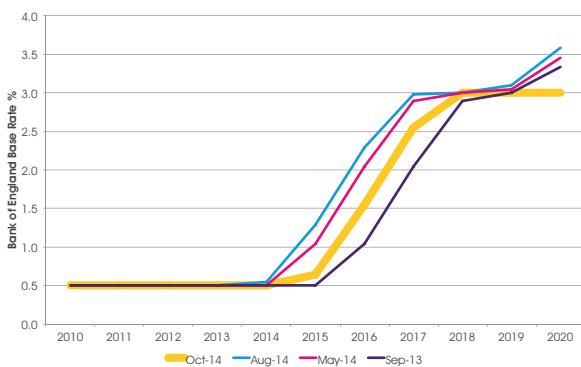
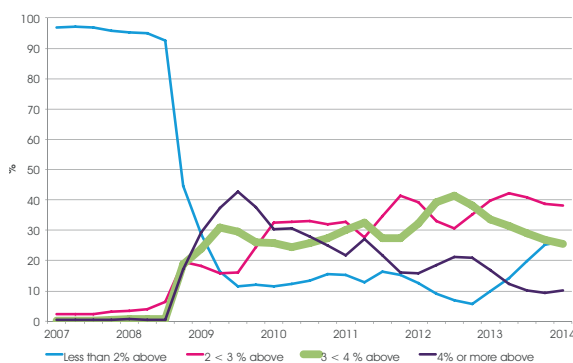


Figure 6: Percentage of new mortgage approvals above base rate

Source: Bank of England



The fall in new enquiries and easing house price growth is also reflected by a slowdown in the number of transactions. Since 2005, the average number of sales per quarter has been almost 285,000, peaking at 439,000 in Q1 2007 (Figure 4). The latest seasonally adjusted figures for Q3 2014 show approximately 300,130 sales. Although this represents an increase of 10% year on year, this figure is down from the 30% annual increase recorded in Q1 2014.

On a quarterly basis, sales in Q3 are 2% lower, following on from a 4% fall in the previous quarter. The number of UK transactions is now just marginally above the long term average, having stood at 11.2% above in the first three months of the year. In Q1 2007 when the market was at its busiest, sales were 54.7% above the long term average.

The number of quarterly mortgage approvals for house purchase in Q2 2014 was 192,410. This is the lowest quarterly number since June 2013 and represents a 9.7% fall on a quarterly basis and the largest since March 2010. Although this is a 12% increase from the same period last year and more than double the 90,870 approvals in Q4 2008 when the financial crisis was at its worst, mortgage approvals are still 23.1% below the long term average (1997-2014) of 250,223 and 43% below the 337,657 approved in Q2 2007.

Over recent months, there has been increased speculation about the future outlook for interest rates and when, not if, they would increase due largely to the strong economic growth figures. In September 2013, Experian forecast the Bank of England base rate to be 0.5% at the end of 2015, rising to 1.0% for 2016 and 2.0% for 2017 (Figure 5).

The forecast for August this year showed a rate of 1.3% by the end of next year, before rising to 2.3% then 3.0% in 2016 and 2017 respectively. The latest forecast for October has since softened its stance somewhat about the pace and timing of any increases due to concerns over the global economy, in particular the Eurozone, and falling inflation, with CPI for September at 1.2%, down from August's 1.5%, well below the Bank's target of 2.0%.

Despite uncertainty over the pace of any increase, the view that a rate rise may be unavoidable over the course of 2015 has strengthened in recent months. The minutes of the Bank's Monetary Policy Committee (MPC) shows support for rates to rise from at least two of the nine members since August, with policymaker Ian McCafferty saying that a rise was vital now to ensure "it more likely that the increase required over coming years to deliver our inflation target can be kept gradual and limited", warning that any spare capacity in the economy will soon be used up.

Consequently, this has led to concerns about how well positioned households are to deal with increased borrowing costs and the implications that this may have on the housing market. It appears however that a large proportion of households have taken steps to protect themselves against any future rise in the base rate. Latest figures from the Bank of England's mortgage lenders and administrators report show that fixed mortgages now account for 81.95% of all advances in Q2 2014, an increase of 9% from the same period last year and up by 120% on Q1 2010.

Further protection to households is also evident by the fact that two in three of all new mortgages are less than 3% above the base rate, compared to just 37% as recently as Q3 2012. A sign of increased confidence amongst lenders is that the share of mortgages less than 2% above the base rate has quadrupled since the end of 2012 to 26.3% as of Q1 2014 (Figure 6).

Supply trends

The widening gap between household growth and completions remains one of the biggest inflationary pressures on the market. Indeed, solving the housing supply shortage could well be one of the main issues of the 2015 general election, as exemplified by the recent Labour-backed Lyons Review.

The latest data show that in Q2 2014 there were 30,680 completions in England, a 7% increase year on year but still some way below the 49,050 completions recorded in Q4 2007.

Yet in one aspect there appears to be some gathering momentum. The number of starts for constructing private dwellings has been steadily increasing since the low point of Q4 2008 when starts in England fell to 16,420, compared to 40,260 for the same period a year earlier. The latest figures for Q2 2014 show over 37,700 starts, the highest quarterly figure for over six years and just 2% below the long term average since 1978 (Figure 7).

When examined at a national level within the UK, it becomes clear that much of this recovery in terms of starts is being driven by the strong house price growth recorded in London and the South East highlighted earlier in the report. Housing starts in Wales remain subdued in relation to the historic average of the last 35 years, with current figures down by 37% (Figure 8).

In Scotland, the situation is even worse, with the latest data almost 40% below the long term average and 64% lower than the level seen in Q1 2007. The recent changes to stamp duty post referendum could act as a further drag in the coming months for developers away from the more affordable end of the market.

With the projected increase in households in England to 2033 set to be in the region of 232,000 per annum, supply constraints will continue to add significant inflationary pressure on the housing market unless there is some structural reform. One possible solution is for the private rented sector to have an increased role in providing intermediate housing.

Since 2002, the number of private rented dwellings in the UK has increased from 9.9% of stock to 18% in 2012, and now matches the size of social sector (16.8%), as highlighted by Figure 9. Over the past 30 years, there has been a 120% increase in private rented households, compared to a 28% fall in social rented.

Based on these current trends, a recent report by the Intermediary Mortgage Lenders Association (IMLA) suggests that by 2032, one in three households in the UK could be private rented. The concept of build-to-let and large scale institutional investment in housing is still in its infancy but is an obvious solution towards meeting some of the challenges the housing market currently faces.

Figure 7: Permanent dwelling starts (England)

Source: CLG

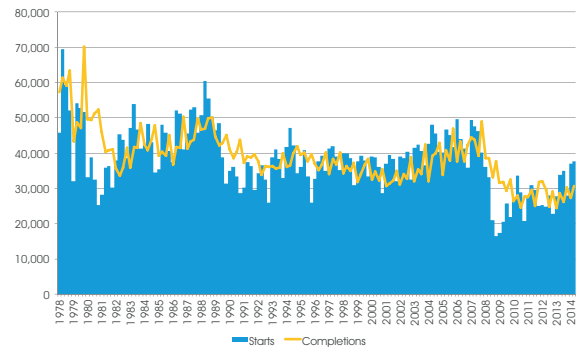


Figure 8: Housing starts by country

Source: CLG

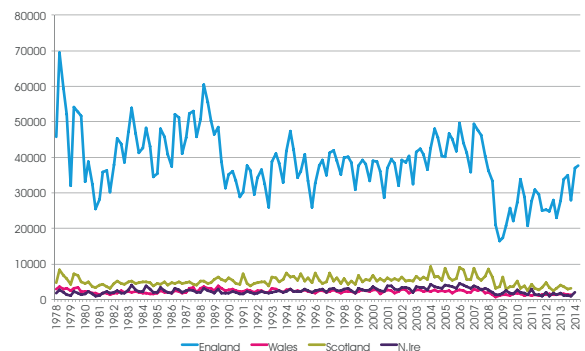
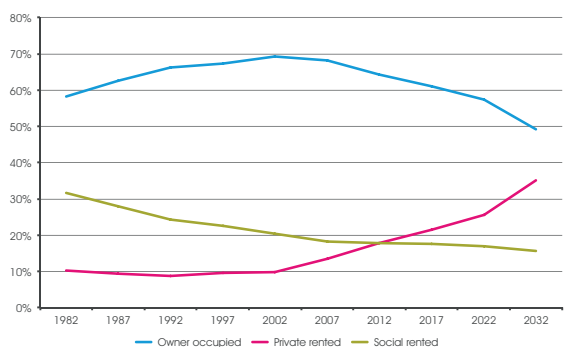


Figure 9: Changing tenure levels for UK

Source: CLG, IMLA



Outlook

Economic growth remains strong and above trend, unemployment is falling and employment is rising. However, wage growth remains muted, constraining consumer expenditure growth, and the Eurozone, our main trading partner risks entering another recession.

We therefore expect economic growth to slow towards trend in 2015, and inflationary pressure to remain subdued. As a result the first rise in the base rate may be delayed until the second half of 2015.

There are already signs of a cooling in housing market activity, and when interest rates do inevitably rise, this may slow the market further. However, it must be remembered that any increase in interest rates will be gradual and many households have anticipated any increase and taken the precautionary measures of switching to fixed mortgages.

The latest consensus forecasts compiled by the Treasury reflect this, suggesting average UK house price growth of around 9% for 2014 as a whole, falling to a more sustainable 5% in 2015 (although Experian are a little more upbeat than the Treasury consensus view at 7%).

The number of housing transactions is now a little above the long-term average, although still well below the levels reached during 2005-07. Yet the imbalance between house building and household growth will continue to grow, maintaining upward pressure on prices in the long term.

Table 1: House price forecasts for 2014-2015

Source: Experian, HM Treasury

	2014	2015
Experian (October 2014)	8.4%	7.0%
Consensus – Mean	9.2%	5.2%
Consensus – Lowest	4.7%	-0.9%
Consensus – Highest	14.6%	17.1%





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