

UK Housing Market Update

A State of Cautious Optimism

May 2011



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Introduction

The UK housing market was a tale of two halves in 2010. Early growth, continuing from 2009, gave way post-election to a period of uncertainty and stagnation through the middle of the year. This was largely the result of the mortgage market, which has constrained new buying opportunities for all but the most credit worthy buyers. In addition, Central Government stated clear intentions to tackle the deficit at a time when the economic recovery remained far from assured.

Now well into 2011 a sustained market recovery continues to prove elusive. This is due to the combined impacts of public sector cuts beginning to gain traction, stubbornly high rates of inflation and broader uncertainty about the economic health of many of our trading partners. Despite early optimism at the start of the year that UK plc had 'turned the corner'; it would appear that the bend will take rather longer to traverse.

Domestic fiscal and economic concerns have been compounded by larger macroeconomic shocks, including the European Union debt crisis, potentially overheating Asian economies (notably China). More recently the destabilising political climate in North Africa and the Middle East has helped to push oil prices to uncomfortably high levels, further straining precious household finances.

Our house price forecasts for 2011 reflected the anticipated erosion in buyer sentiment, particularly in regions of the UK unable to benefit from the



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strength of the London economy. Changes to demand are important, as the supply of properties for sale and therefore transaction levels remain well below long-run averages. As a result a small shift in buyer sentiment will have a stronger than normal impact on average prices in the housing market.

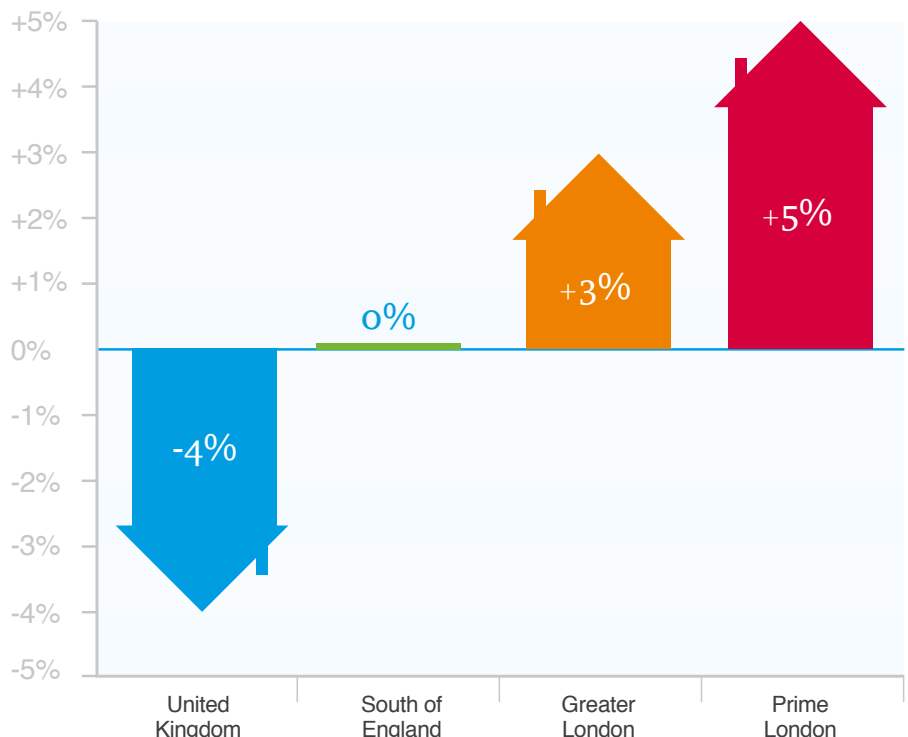
Recent figures seem to suggest that the supply of properties in London has begun to improve. This is in line with the stronger market backdrop for the Capital. However, the malaise in mortgage lending and economic recovery continues to plague residential markets outside of the London commuter-belt. This dichotomy is manifesting itself in a yawning North/South divide in house price movements; our national price forecasts still appear to be the central scenario, but balanced by a more pessimistic picture for the North and more optimistic expectations for London and the South of England. ■

Economic Context

The Comprehensive Spending Review in October provided households with greater certainty about the personal impact of austerity measures. The CSR was followed shortly by positive Q3 GDP growth of 0.8 percent (the second successive quarter that this figure was well above analyst forecasts). Other positive indicators included Standard & Poor's reaffirmed top rating for UK debt and impressive growth in the FTSE All-Share Index. Although still tentative, these indicators provided some sense that the nascent economic recovery appeared to be resilient, despite continued problems in the United States and the Eurozone.

Unfortunately the New Year has not brought with it the positive shift in buyer sentiment that might have been hoped for. Much weaker than expected Q4 2010 performance (of -0.5 percent) was blamed largely on the particularly wintery December weather conditions, ▶

2011 House Price Growth Rate (%)



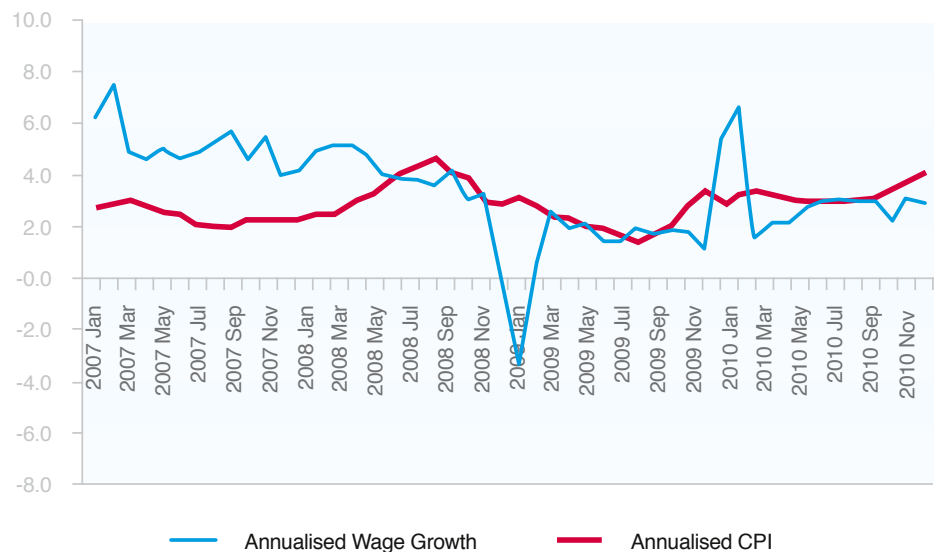
Source: Hamptons International



but in reality has cast a shadow over the more optimistic visions for UK plc in 2011.

The VAT rise from 17.5 percent up to 20 percent was just one factor that has negatively impacted household balance sheets. Alongside this, commodity prices have been pushed up including oil, meaning that there has been a very noticeable price inflation reminder to drivers filling up at petrol pumps. For households, these factors are not being met by significant improvements in wages. Real wage growth (ie. wage growth minus inflation) continues to disappoint and as the austerity cuts begin to bite there is likely to be only limited upward pressure on take home pay. ■

Annualised Wage vs CPI Growth, Monthly



Source: Office of National Statistics

Housing Market Factors

One of the most important themes for the housing market in 2011 has been the widening divergence of house price performance along geographical lines. Our house price predictions for this year reflect the distinct differences we expect for the economic recovery in the North compared with the South of the country. However, even these predictions, which we first began to highlight in August last year have not reflected the degree to which the UK can now be split as a two speed housing market.

Regions	Peak	Trough
London	Jan'08	May'09
South East	Jan'08	Mar'09
Rest of UK	Oct'07	Mar'09

Source: Land Registry, Hamptons International Research

As can be seen in the map and graph of Land Registry house prices, areas that do not benefit from London's economic strength have experienced weaker house price performance over the past two years. As expected, Government austerity measures have been harder on northern cities with a greater dependence on public sector employment. A number of studies have highlighted the extent to which places such as Liverpool, Sunderland and Newcastle are reliant on public sector employment. Job cuts are having a very real negative impact across these local economies and subsequently on demand for new house purchases. Unlike much of the South of England, these locations do not suffer from a chronic shortage of housing stock and in some cases are actually faced with a 'managed decline' of obsolete properties.

At the other end of the scale, prime London is likely to see continued price growth, based on improving financial and business services prospects in the City. This included significant bonus payouts again this year, despite the efforts

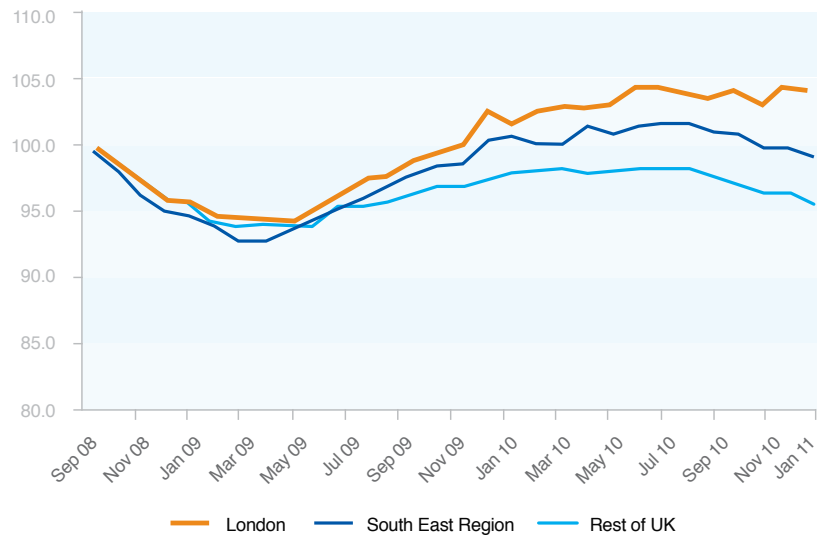
of Government to prevent these payments while the rest of the country is forced to deal with real belt-tightening measures. In addition, ongoing exchange rate weakness for the pound sterling has supported international demand, which made up seven in ten buyers of Hamptons International prime property last year.

Over the rest of 2011 we also expect the gulf between mature homeowners and first-time buyers to widen. Restricted mortgage lending for high loan-to-value purchasers will continue for much of 2011 and this has meant that FTBs will remain limited from access to the first rung of the housing ladder. In contrast, purchasers with at least 25 percent equity are finding quite attractive lending terms at the moment.

There is both a positive and a negative position with respect to mortgage availability. On the upside, the qualifying restrictions for new lending are slowly easing. For example, the proportion of FTBs qualifying for a mortgage with less than 25 percent deposit is now above 50 percent for the first time in two years. ▶



Land Registry House Price Movements by Region



Source: Land Registry, Hamptons International Research

However, as a result of inflationary pressures and the anticipated need for the Monetary Policy Committee to raise the base interest rate, mortgage rates are beginning to tick upwards as well.

Across our market in the South of England, Hamptons International remains optimistic that the economic recovery will support the housing

market. This will provide reassurance to households looking to purchase a new property. Perhaps more importantly, it will diminish some of the perceived risk that mortgage lenders are pricing into new lending. Constricted mortgage lending remains the single most significant factor that is preventing the housing market from returning to a normal level of transactions.

Spurned first-time buyers have remained in private rented properties for longer, placing increased pressure on demand in the lettings market. As a result, rents increased by 15 percent in 2010 according to findaproperty.com. We do not expect this demand to abate significantly in 2011, although improving yields are encouraging investors to increase the supply of rental properties. ■



Indicators to Watch

The strength of global demand for UK exports remains the key to the domestic recovery as consumer spending will be under sustained pressure for most of the year. As a result, the health of the Asian and eurozone economies remains an important consideration, alongside the uneven GDP growth story in the United States.

Domestically, inflation has been stubbornly high, with CPI reaching 4.4 percent in February, but falling back to 4.0 percent in March. The MPC remains resolute that it will continue to fall back sharply by the end of the year. This should help households manage balance sheets, although wage growth is also

expected to remain muted. The GDP growth figure of 0.5 percent for Q1 2011 is encouraging after the weak end of 2010 performance.

The March 23rd Budget offered very little new money to support the housing market, as anticipated. One notable exception was the £250 million FirstBuy programme aimed at helping first-time buyers with up to 80 percent of deposit requirements on new build property purchases. If fully subscribed it will contribute to 10,000 new house sales and between 11,000 and 15,000 jobs in the housebuilding industry. A boost, but hardly the long-term solution for this sector that would need ten times this

volume to meet the current need and normally employs over a million people.

Taken together, we continue to anticipate a flat picture for the volume of house sales in 2011. Prices are likely to follow, with modest improvements or declines being determined by exposure to either expanding private sector employment, largely in the South, or disproportionate public sector job losses. There is significant macroeconomic volatility that could still alter this view, but this central scenario should form the platform for a slow but broad-based improvement for the housing market in 2012. ■

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