MarketView
Recent Residential Market Trends

Q3 2009

OVERVIEW

- There was a continued pick-up in prices this month despite a marginal dip in activity. Seasonally adjusted house prices rose by 0.9% over the month and are at the same level seen a year ago. In contrast mortgage approvals fell by 0.2% in August but remain 63% higher year on year.
- House prices are now likely to end the year slightly higher than at the start of the year.
- This rebound has occurred despite a weak economic backdrop and has surprised many commentators.
- Price rises have been driven by a recent gradual pick-up in house-hunters; the buyer to seller per agent ratio has increased from around 2 at the start of 2009 to near 5 by mid-year.
- In addition, the level of distressed sales has been surprisingly low; just 0.19% of mortgages were repossessed in the first half of this year compared with 0.4% in 1991. This reflects the low interest rate environment and lender forbearance.
- However, even though significant, the pick-up is from an incredibly low base. In reality the housing market remains very weak and fragile. Until economic fundamentals return the market, it will be dictated by local demand and supply conditions and as a result could be volatile.

House Price Trends

Source: Nationwide Building Society

Hot Topics

- "The unexpected pick-up in prices can be partly explained by a lack of distressed sales, which include repossessions, builders off-loading new-build stock and financially constrained households"
- "Repossessions are around two thirds the level at its peak of the last recession; just 0.19% of mortgages were repossessed in the first half of this year compared with 0.4% in 1991"
- "In reality the housing market remains very weak and fragile. Until economic fundamentals return the market will be dictated by local demand and supply conditions and as a result could be volatile"

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PRICES CONTINUE TO REBOUND

According to Nationwide, house prices increased by 0.9% in September. This is the fifth consecutive seasonally adjusted monthly rise; prices are now higher than at the start of the year and at the same level as they were in September 2008.

Underlying market activity has also shown tentative signs of improvement, despite minor falls over the last month. For example, the latest data from the Bank of England shows mortgage approvals fell by 0.2% in August to 52,317. This is a 63% increase since last year when the housing market was well entrenched in a recession. Similarly transactions have slowly edged up this year and, according to the HBF, net reservations on new-build is 28% higher than last year.

This rebound has occurred despite a fragile economic backdrop and has surprised many commentators, us included.

DRIVEN BY A SUPPLY AND DEMAND IMBALANCE

The particularly low level of transactions in the current downturn means the market is especially sensitive to even small changes in demand and supply side factors. In contrast to low and static levels of housing being marketed, there has been a recent gradual pick-up in house-hunters; the buyer to seller per agent ratio has increased from around two at the start of 2009 to near five by mid-year. Despite the constrained conditions and economic backdrop, this imbalance has buoyed prices.

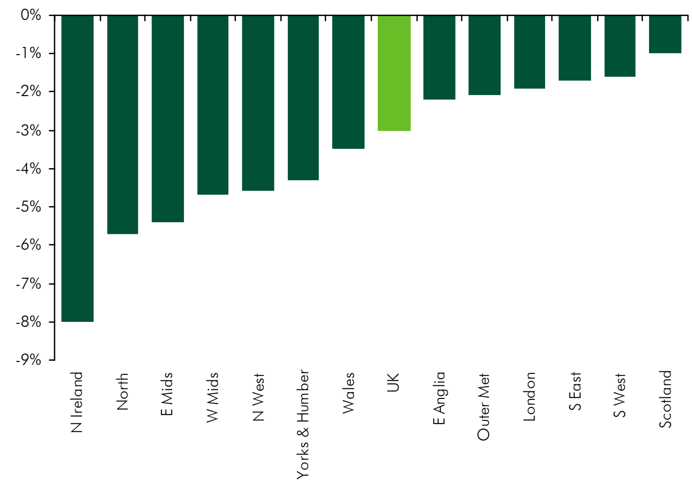
AND REFLECTING A LACK OF DISTRESSED SALES

The unexpected pick-up in prices can be partly explained by a lack of distressed sales, which include repossessions, builders off-loading new-build stock and financially constrained households. Generally during a recession households avoid selling unless it is completely necessary. This means not only is housing market activity subdued, but it is biased towards distressed sales. Often forced sellers will accept well below market value just to off-load stock. Clearly this has a huge influence on the price trajectory and can exacerbate a downward price spiral.

In this latest downturn the level of repossessions and distressed sales is particularly low. Repossessions are around two thirds the level at its peak of the last recession; just 0.19% of mortgages were repossessed in the first half of this year compared with 0.4% in 1991.

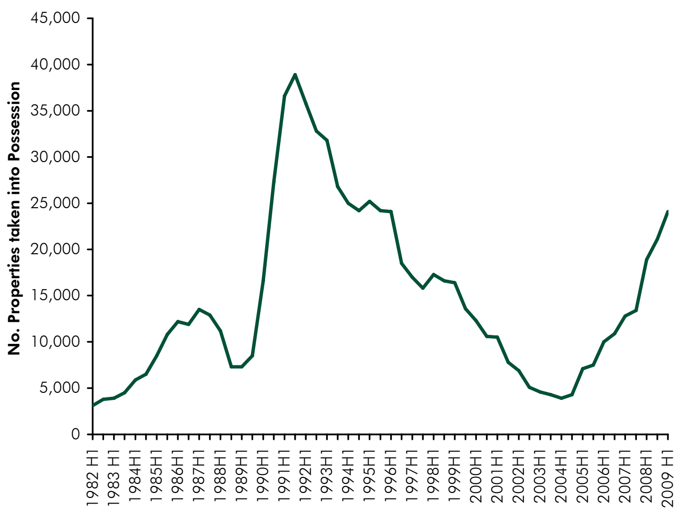
A number of factors are driving this. Firstly, the low interest rate environment means lower monthly mortgage payments for those on tracker and variable mortgages rates, which reduces financial pressure on households. Secondly, although the government initiatives, such as mortgage rescue scheme, have only directly helped a handful of households, it has encouraged dialogue between lenders and borrowers. This, coupled with lender forbearance, has acted to reduce repossessions. Furthermore, home owners are being more creative in finding payment solutions, such as renting out spare rooms or the entire property.

Regional House Prices (Q£ 2009)



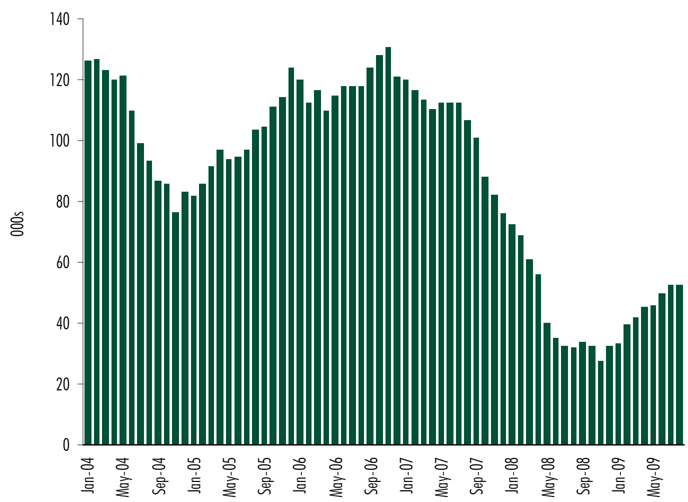
Source: Nationwide Building Society

Repossessions



Source: CML

Mortgage Approvals



Source: Bank of England

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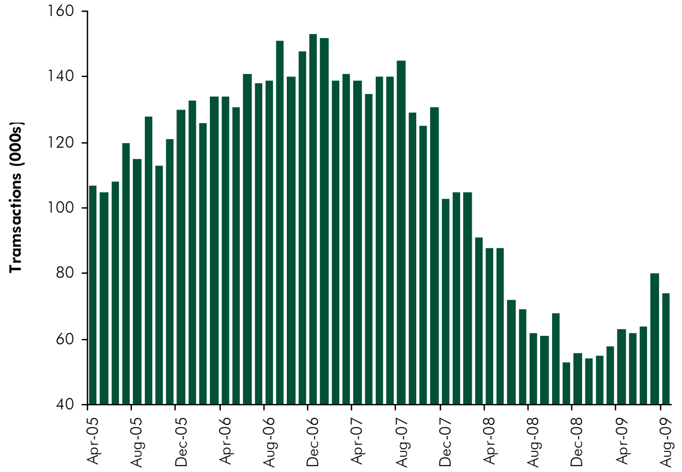
TRANSACTIONS

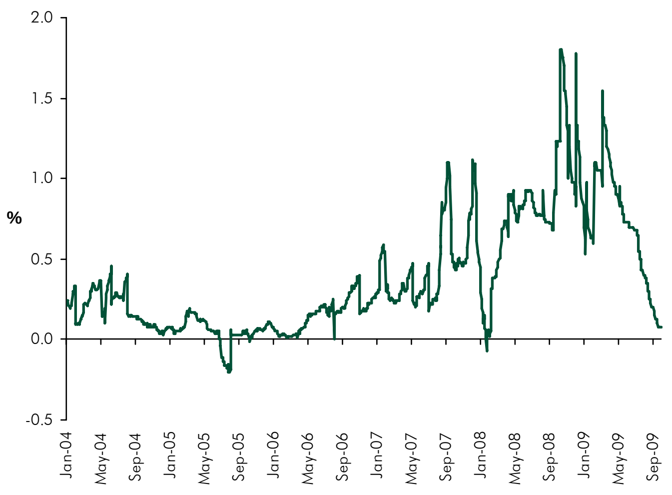


Source: HMRC

Ratio of Buyers to Sellers

Source: NAEA

Difference between the Bank of England Base Rate and LIBOR



Source: Bank of England

This relative lack of forced sales has led to the absence of large scale negative pressure on prices normally associated with such a bleak economic outlook.

NO TIME FOR COMPLACENCY

Many commentators are taking comfort from recent trends suggesting we are on the path to recovery. However, even though significant, the pick-up in activity is from an incredibly low base; approvals remain at historically low levels of around half the long-term average. In addition, the rise in activity doesn't reflect proportionally the increase in house-hunters. This suggests the lack of quality stock, available finance (deposit requirements, etc) and confidence are still putting off some prospective buyers. For example, while the Nationwide's consumer confidence has been increasing steadily since March, the number of those thinking now is a good time to make a major purchase has fallen.

In reality the housing market remains very weak and fragile. Until economic fundamentals return the market will be dictated by local demand and supply conditions and as a result could be volatile.

UNLIKELY TO CONTIUE

In contrast to recent trends, the number of sellers rose in August. This was accompanied by a fall in the number of house-hunters. If as expected, the number of sellers continue to rise throughout the autumn, the supply and demand imbalance will revert in favour of the buyer. This would stem any further significant price rises.

The future trajectory of interest rates will be an important driving factor of the housing market recovery. Since the credit crunch the interbank lending rate has remained stubbornly high, despite cuts in the base rate; this reflects banks unwillingness to lend to each other. As a result mortgage rates have remained relatively high, with interest rate cuts only feeding through to households on tracker and variable rate mortgages. However, gradually over the last couple of months the interbank rate has fallen, thus reducing the differential between LIBOR and base rate. This is starting to feed through to mortgage rates with Halifax, HSBC, Woolwich and Cheltenham and Gloucester all recently announcing cuts in fixed rates.

While this loosening of credit should buoy the housing market in the short-term, we are expecting base rate rises next year. These will undoubtedly be passed on to mortgage holders and will depress market activity.

There are a number of conflicting pressures facing the housing market over the next twelve months. As a result it is hard to predict a smooth recovery. And although we suspect the general trajectory will be upward, there will be a certain degree of volatility with monthly falls in activity and prices as well as rises.

HOUSE PRICE INDICES	M-on-M	Q-on-Q	Y-on-Y	Level
Nationwide (Sep)	0.9%	3.7%	0.0%	£161,816
Halifax (Aug)	0.8%	1.7%	-10.1%	£160,973
Land Registry (Aug)	-0.1%		-9.4%	£155,968
Hometrack (Aug)	0.1%		-6.7%	
CLG (Jul)	1.4%		-8.3%	£196,338
Rightmove (Sep)	0.6%		-1.5%	£223,996

ACTIVITY INDICATORS	M-on-M	Q-on-Q	Y-on-Y	Level
Mortgage Approvals (Aug)	-0.2%		63%	52,300
Gross Mortgage Lending (Aug)	-13%		-37%	12,600
Housing Completions (Q2)		36%	6%	39,800
Housing Starts (Q2)		68%	-9%	30,700

ECONOMIC INDICES	M-on-M	Q-on-Q	Y-on-Y	Rate
GDP (Q2)		-0.6	0.3%	
CPI (Aug)	-0.1		4.1%	
RPI (Aug)	-0.8		3.0%	
Unemployment (May to Jul 09)		0.7%	2.3%	7.9%

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