Residential Property Focus

Housing market recovery
The four stages

Savills
Research

savills.co.uk/research

savills

This publication
This document was published on May 1. It contains a review of all the key housing market indicators and news to the end of March 2009. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document.

Glossary of terms
- **Mainstream** – Mainstream property refers to the bulk of the UK housing market with, for example, price movements monitored by reference to national and regional average values.
- **Prime** – The prime market consists of the most desirable and aspirational property by reference to location, standards of accommodation, aesthetics and value. Typically it comprises properties in the top five per cent of the market by house price.
- **Patient equity** – non-income generating long-term investment

The most commonly used abbreviations are:
- Q408 – refers to the last quarter of 2008
- Q109 – refers to the first quarter of 2009
- H109 – refers to the first half of 2009
- PCL – prime central London
- Peak – refers to the first half of 2007

Welcome

Housing begins to look good value

With the worst of the falls now over, the UK residential market is offering recovery potential as well as the prospect of long-term income, observes **Yolande Barnes**.

Savills Research department is now 20 years old. Searching through our archives, past research publications have provided an interesting perspective on the current downturn. It appears that we have just seen the turn of a 17 or 18 year cycle.

This credit crunch is distinctly different from the housing crisis of the early 1990s in that price falls have been rapid and universal, due to the withdrawal of credit rather than the extreme affordability problems of 1989. Nevertheless, this edition of the Residential Property Focus has distinct resonance with what we said in 1992.

In late 1991, the markets were falling significantly and there was no sign of respite. By spring 1992 though, our tone was less gloomy than it had been the year before but there were still few signs of life in the market. We wrote: "It is unlikely that there will be spectacular growth in [mainstream] house prices in the next two years or so." 17 years on, we are telling a very similar story but with an eye on the situation that might pertain by the end of this year.

At the time of going to press, we were beginning to experience the first signs of change in the UK residential market. Most importantly, the rate of price falls is slowing, especially in prime markets. Quarterly falls in central London, according to our prime market indices, are half the level they were last year and, occasionally this year, building society monthly figures in the mainstream, mortgaged market have been positive.

Over the course of this first quarter of 2009, the previously downbeat mood in the housing market seems to have shifted towards a cautious air of optimism. Our agents report the number of buyer inquiries are significantly up and beginning to translate into transactions. It may be that the very rapid adjustment of house prices has shortened the period of house price falls experienced, compared to the last cycle, suggesting the bottom of the market, certainly in the prime sector, is now in sight.

So we can perhaps now repeat verbatim something that we wrote in December 1992: "It is rather unfashionable at present to be optimistic regarding the future of the housing market but we now believe that conditions are looking more favourable for recovery than at any time since the market turned down." Having said this, we are in no way anticipating a rapid bounce-back in values and this edition of the Residential Property Focus contains revised forecasts pushing out the timing of future house price growth in the face of deepening recession.

Significantly though, we have not changed our projections of the depth of house price falls since our prediction of -25% peak to trough in April last year, and we believe that the residential market has seen the worst of the falls.

The wider impact

The falls already seen mean that housing is now looking like good value, particularly given current interest rates. This has important implications for investors: yields have now moved out to levels that look very attractive against gilts, and the poor performance of equities and other investment sectors makes property look relatively attractive again.

Significantly, our 1992 forecasts were relatively bullish for the prime markets, particularly in London and the South East. These markets showed a pronounced bounce-back in the second half of 1992 and 1993. Once again, we believe that it will be the rarer properties, bought by cash-rich purchasers and overseas investors that will lead the recovery.

Against this backdrop, we have looked in this issue at local and sector 'hotspots'. What do the significant prices falls mean for recovery in both the UK mainstream and prime markets? Who is in a position to take advantage of vastly improved affordability? What factors will drive the regional variations in the recovery process? ■

Yolande Barnes is a Director of Savills residential research. She joined Savills in 1989 to pioneer the, then new, field of residential research. Since 2003, Yolande has also taken on another new research discipline known as Place Making, looking into mixed use and land issues.

Inside this edition

Yolande Barnes
Director
020 7409 8899
ybarnes@savills.com

Long term investment

The future of residential investment

The housing market currently offers opportunities for cash-rich investors but, as **Jacqui Daly** notes, investment models will need to evolve.

This year marks the 20th anniversary of the creation of Savills' residential research department, a milestone reflecting the benefits of a long term investment. One of the biggest changes in the attitude towards home ownership during the past 20 years has been an increasing tendency for residential property to be considered as a wealth generator over the medium to long term, as well as a home.

Indeed, it is the cash rich investor looking to buy back into the market at, or near the bottom of price falls, who will start the process of recovery in this particular housing market cycle.

Our experience shows that for those who are able to invest at this stage, the financial returns are significant. On average the 10 year growth in the value of UK residential property between 1968 and 2008 has been 170%. Put into perspective this means that during the past 50 years prices have grown on average by 2.9% per annum according to Nationwide in real (inflation adjusted) terms each year and by 40% over each decade.

This growth has vastly increased the wealth of those home owners without a mortgage, who now account for 31% of all UK households (compared with 26% in 1989). This means that some 45% of privately owner-occupied stock is held debt-free. The use of equity is now a significant driver in the economics of home ownership.

Benefits of buying

By 2019, our long term forecasts suggest that inflation-adjusted, 10-year house price growth should be in line with the long term 40% inflation-adjusted average, even if nominal growth is less aggressive than it has been historically. This highlights the potential benefits of buying during 2009 for those with the cash to do so.

The flip-side of such long term price growth is that, long before the credit crunch increased deposit requirements, it became increasingly difficult for first-time buyers to accumulate even the more modest deposit necessary to obtain a mortgage. This group's only real alternative has been the private rented sector which has grown significantly, particularly in the last decade. The foundations for this expansion were laid by the Housing Act of 1988 and was triggered by the subsequent provision of 'buy-to-let' finance.

Now the big unanswered question is what, or who, will take the place of the geared, buy-to-let investor, who has been pivotal in providing rented accommodation

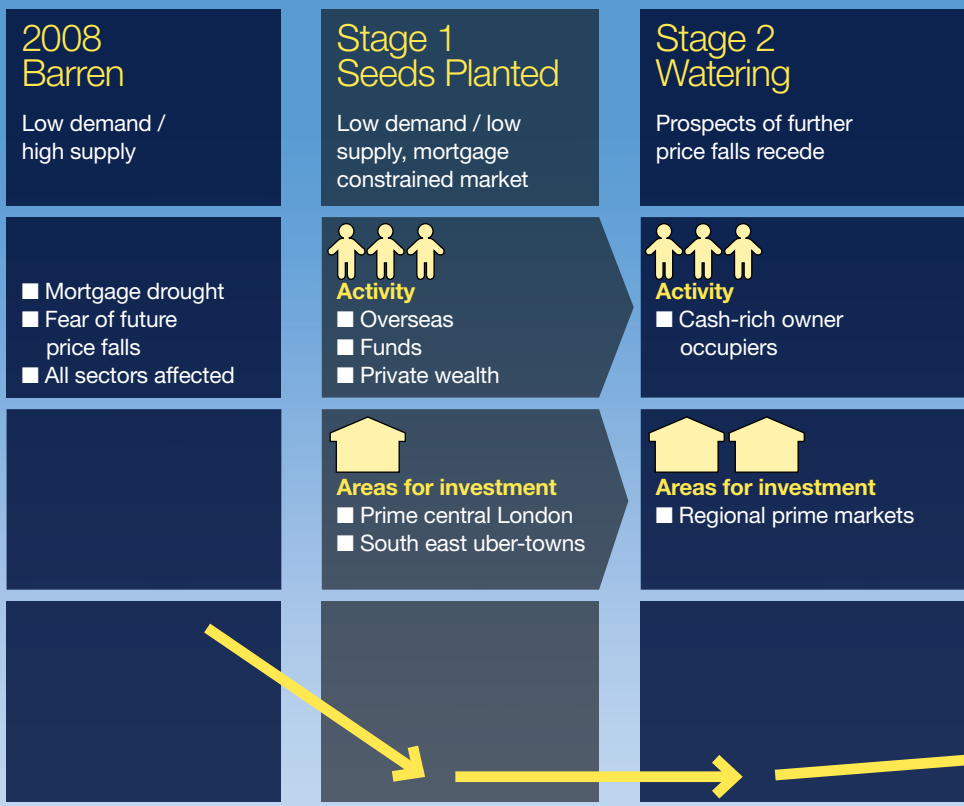
Projected Stages of Recovery

The recovery process as illustrated by the adjoining diagram includes many stages and regional variations. The beginning is characterised by investor activity, firstly in prime central London and some favoured locations beyond the capital.

This is followed by a spread in cash rich homebuyer activity into the regional prime markets.

Stage 3 is perhaps the stage most sensitive to the depth and length of the current recession. It will only commence when credit liquidity eases, banks increase their loan to value ratios and buyers have sufficient confidence over their job security and earnings to consider increasing their mortgage commitments.

The final stage is reached when the most depressed sectors show signs of recovery and first-time buyers and geared buy-to-let investors reappear.



and meeting the needs of tenants. Buy-to-let investors needing any significant mortgage are effectively out of the market as the number of buy-to-let mortgage products has shrunk from just over 3,500 in June to 2007, to under 200 in March 2009.

We believe there will need to be a change in the way homes are owned and financed in order for investors to take advantage of highly competitive returns, such as those that residential property has generated, despite the downturns of the last 20 years. These returns have generally out performed commercial property, equities and gilts whilst proving less volatile than these other asset classes. The difficulty for many investors is that, increasingly, they have been reliant on capital growth, in the face of downward pressure on income yields.

Investment models

In certain situations, most notably in the case of distressed sales, yields have now been restored to sufficiently competitive levels to generate interest from those already comfortable with the residential investment model. Overall, we think that income yields are still insufficient to bring a wider range of investors, particularly institutional ones, to the market, whatever the total return. To find a wider investment model, one which both lenders and borrowers are comfortable with and under which the underlying occupational demand for housing can be met, it will be necessary to further develop products such as shared equity and 'build-to-let'.

It is unlikely to stop there. Recently, equity loan schemes (whereby an occupier is given an interest free loan on part of the purchase price for a fixed period) have been one of the most effective means of bringing potential occupiers and property together when conventional models of raising a deposit have failed.

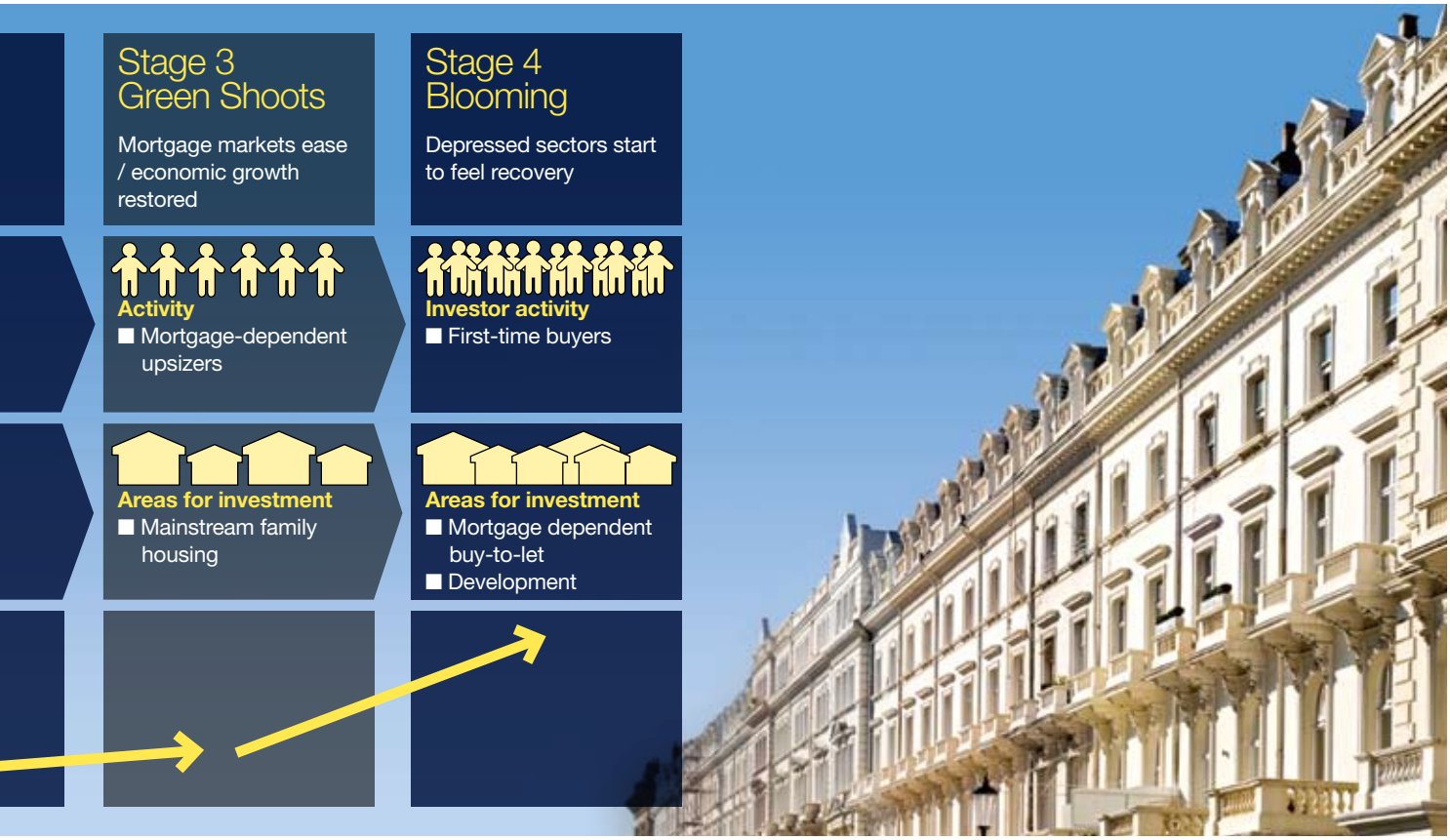
Variations on this model are also emerging, alongside the Government's HomeBuy Direct schemes. We believe that there is huge scope for more investment whereby a third party retains patient equity in property, in a manner that enables them to generate a return from it over the short, medium or long term.

Residential investment is evolving, with new players seeing current market conditions as a cyclical buying opportunity. Some are attracted by income streams from financial products sitting alongside the property. Others are attracted by capital growth prospects, which may include development margins and a long-term regeneration premium.

Residential investment is evolving, with new players seeing the current market as a cyclical buying opportunity.

Residential investment looks set to expand during the next 20 years, but in different ways to the experience of the past two decades. ■

Jacqui Daly is a Director of Savills, and specialises in the residential investment market. Jacqui has 12 years research experience in the residential sector. She has substantial investment experience and has worked with a large variety of clients including investment banks, institutional clients, private investors, and local Government.



The mainstream market

Cautious optimism for the mainstream

While the road to recovery is undoubtedly a long one, growing buyer activity illustrates a significant shift in sentiment, as **Yolande Barnes** investigates.

In marked contrast to 2008, the mainstream residential market is now characterised by growing applicant activity. The Royal Institution of Chartered Surveyors (RICS) has reported an increase in the numbers of people looking to buy in every month since November 2008, which indicates an important turnaround in buyer sentiment.

While those buying or considering re-entry to the market are restricted to cash buyers and the equity rich, their importance in sealing the bottom of the market should not be under-estimated. The resulting transactional activity, combined with a lack of new stock coming to the market, is likely to provide the basis upon which prices will stabilise over the course of the coming months.

The cost of owning is now in line with, or in many cases cheaper than, the cost of renting, even accounting for moderate falls in rental values…

Despite the very low transaction levels reported by RICS in the three months to the end of March (just 9.7 sales per surveyor), sales to stock ratios rose very slightly over this time, as the amount of property on agents' books contracted. Many discretionary sellers have either withdrawn or delayed participation in the market.

Stock levels are likely to be further reduced by the increased levels of sales seen in March, raising the distinct prospect of a shortage of property to buy.

This is not to say that a full recovery is around the corner as there remains significant constraints on demand particularly from the mortgage-dependent buyer. It's more likely that we are in a period where the worst of house price falls are behind us.

Improved affordability

Increased buyer activity has been a function of several factors. First, affordability has vastly improved given both the falls in house prices seen over the past 18 months and prevailing low interest rates. Our favoured measure of purchasing power is surplus household income after the costs of housing finance (expressed as a proportion of other, basic spending). The measure has now been restored to well above the long term average seen in the period of sustained house price growth from 1997 to 2007, meaning households, theoretically at least, have more than sufficient income to afford houses at their current value (see graph 1.1).

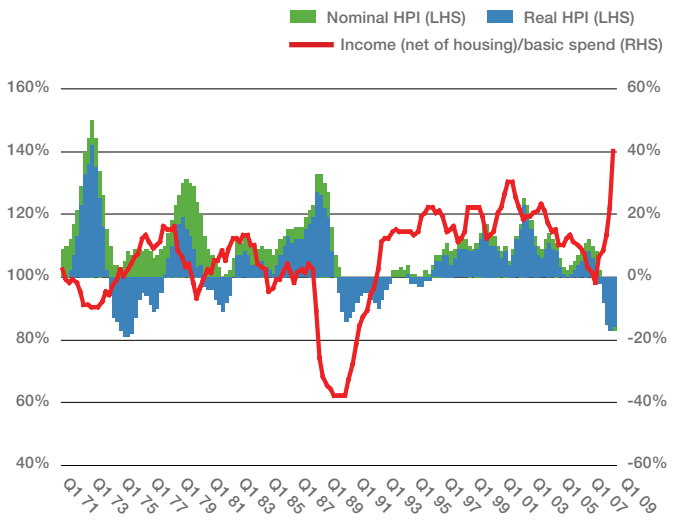
Similarly, the cost of owning is now in line with, or in many cases cheaper than, the cost of renting, even accounting for some moderate falls in rental values. This is a position not seen since 2002.

Second, those potential buyers who are prepared to take a medium term view are sensing that, while values may not have fully reached the bottom, they are sufficiently close to warrant buying. Many deals are now being transacted at -20% to -25% off peak values (less for the best in class properties), suggesting that this level is now low enough to motivate equity-rich buyers to return to the residential property market, particularly given the medium-term prospects for price growth.

Exceptional times

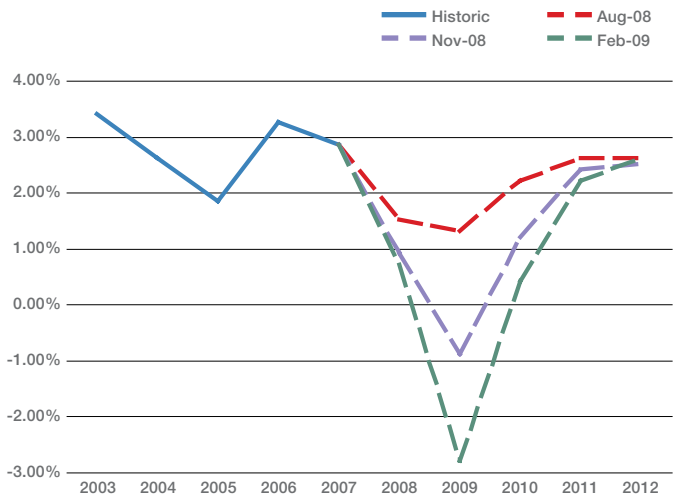
In theory, these combined factors should drive a strong increase in demand among

Graph 1.1
Affordability is restored



Source: Savills

Graph 1.2
Economic outlook (GDP growth forecasts)



Source: HM Treasury

buyers, however, these are exceptional times. Fear of redundancy and credit constraints are still major factors.

Transaction numbers should begin to rise, especially in areas and sectors where prices have been quick to adjust and equity usage is high. The value of gross mortgage home lending rose by 16% in March to £11.5bn (albeit from an extremely low base of £9.9bn in February).

While this can only be good news for the housing market, it has to be remembered that all growth, in values and turnover, is from a relatively low figure in an historical context.

The prevailing economic uncertainty continues to put a brake on the cheaper, mainstream markets. As we go to press, it was announced, not unexpectedly, that unemployment had topped two million with a forecast it could rise to three million by 2010. A significant proportion of potential buyers have concerns over their job security and this is likely to keep them out of the market for some time (see graph 1.2).

Significantly, many would-be buyers continue to be excluded from the mortgage market, not because they cannot afford the mortgage repayments but because they hold insufficient equity to meet lenders' loan to value ratios.

First-time buyers and, to a lesser extent, mortgage-dependent upsizers, will only become active in the market when, and if, equity becomes available to them. Given that many lenders are continuing to apply maximum loan to value ratios of 75% (with more competitive deals available only to those with a 35% deposit), significant numbers of such potential buyers can only watch from the sidelines.

Despite some talk of 'forced lending' (whereby lenders benefiting from of the Government bailouts would be obliged to hand out higher loan to value ratio), there are few signs of this playing out yet.

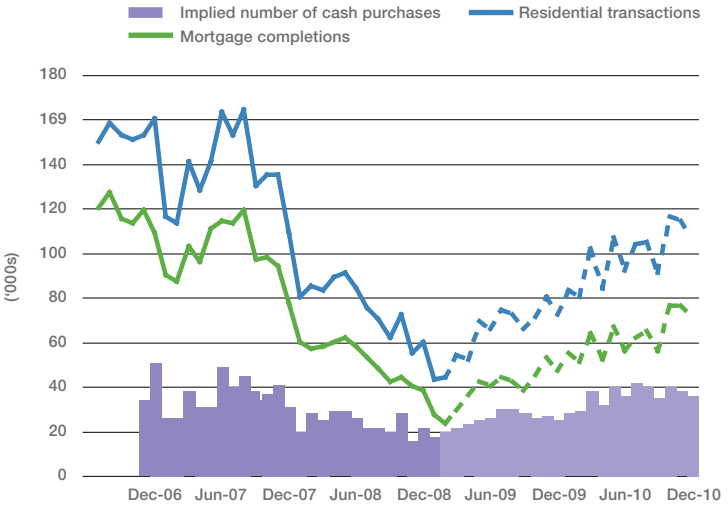
A slow recovery

We do not expect a bounce, but a slow return to more normal trading patterns. This underlies the clear distinction between the market bottoming out imminently, and the restoration of both transaction numbers and sustained house price growth to former levels, which remains some way off.

The success or otherwise of quantitative easing – the latest in a line of drastic financial measures designed to arrest the economic downturn – will be crucial to a recovery in both economic confidence and the availability of credit. Only then are the mortgage-dependent upsizers, who are crucial to restoring high activity, likely to enter the market in significant numbers.

In November, when we last reviewed our forecasts, we stated that growth would not return to the mainstream until early 2011. For the moment, the continued deterioration in the economic outlook and uncertain employment forecasts suggest that this will be delayed until late 2011 or early 2012, irrespective of how soon prices stop falling. ■

Graph 1.3
Transactions and mortgage completions



Source: Inland Revenue, CML, Savills

The future of mortgage regulation…

Restrictions may have a profound impact

The ability of mortgage dependent buyers to rejoin the market will hinge on the outcome of the Financial Services Authority's paper on regulating the mortgage markets, due for publication in September.

The Turner Review, published in March, raised the prospect of restrictive maximum Loan to Value (LTV) or Loan to Income (LTI) caps being imposed on home loans, either or both of which could have a profound impact on the accessibility of home ownership and in turn be fundamental to the recovery in the mainstream market.

A blunt instrument

We believe a LTI cap is a very blunt instrument that would be seriously restricting, particularly for the first time buyer end of the market. The ability to service a mortgage at say three and a half times income is a very different matter for a household on an income of £20,000 than for a household on £100,000.

What matters is the cost of servicing debt. At current rates of interest, a loan at three and a half times income costs just 14% of total household income, while the long-term average in the past has tended to be around 25% of household income.

Measures to ensure a prudent assessment of risk by lenders are clearly needed to avoid a repeat of the lax lending criteria, which have been at the heart of the downturn, but the setting of arbitrary limits on lending are likely to be counterproductive. ■

Market dynamics

What drives local markets?

The housing market's rate of recovery from the current downturn will differ on a regional basis. **Jim Ward** identifies the five key factors.

The so-called 'curse of averages' means that the relative performance of localised residential property markets generally becomes lost among market-wide statements and national statistics.

As the withdrawal of mortgage finance has been the single biggest factor contributing to the current downturn, average prices have fallen significantly across all regions, with job losses in the finance and construction sectors leading to slightly higher price falls, so far, in London and the southern regions.

As the recession spreads to other sectors, the other regions will catch up. This all masks the fact that, at a more local level, individual locations will have fared differently to a much greater degree than the regional and national figures suggest. The nature of the downturn hides the different prospects of recovery of both regional and local markets.

When recovery comes we expect to see a pronounced North/South divide based on a assessment of the mechanics of supply and demand. London and the South East are forecast to show the strongest recovery in the early part of the next growth period. Such regional variations are expected to be fuelled by the following five key drivers.

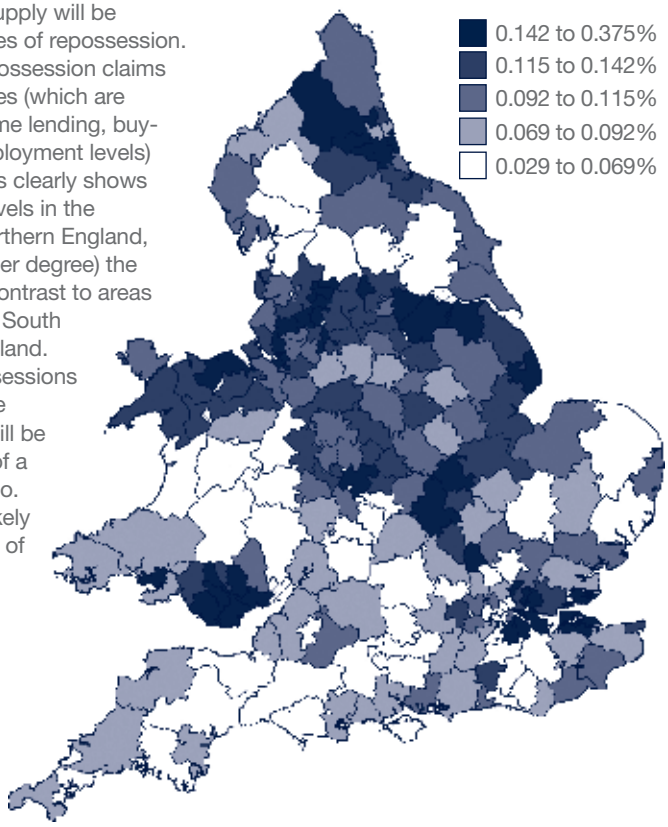
1 Number of repossessions

While less of an influence nationally, through the downturn and early parts of the recovery, localised supply will be heavily influenced by rates of repossession.

The distribution of repossession claims across England and Wales (which are closely linked to sub-prime lending, buy-to-let lending and unemployment levels) is shown in the map. This clearly shows the high repossession levels in the metropolitan areas of northern England, South Wales and (to lesser degree) the Midlands. These are in contrast to areas such as the South West, South East and the East of England.

Not all of these repossessions will find their way into the sales market, as many will be retained or sold as part of a rental investment portfolio. Nevertheless, they are likely to be a drag on the pace of market recovery.

Possessions claims issued as percentage of total dwellings Q408



Regional Forecasts

Table 1: Savills annual forecasts for house price growth

Table 2: Regional price falls from peak to trough including Q109 falls, current total falls from peak and projected falls from peak to trough

* If bought at the end of 2009

Source: Savills

Table 1

Forecasts (as at April 2009)	2008 (Actual)	2009	2010	2011	2012	2013	2014	Total five year growth*
UK	-14.7%	-11.0%	1.0%	1.0%	9.0%	10.0%	8.0%	32%
London	-15.1%	-14.0%	1.0%	3.0%	12.0%	10.0%	9.0%	40%
South East	-15.4%	-10.0%	2.0%	5.0%	14.0%	10.0%	8.0%	45%
South West	-14.9%	-10.0%	2.0%	3.0%	9.0%	10.0%	10.0%	39%
East	-16.6%	-11.0%	1.0%	3.0%	8.0%	12.0%	12.0%	41%
E Midlands	-14.2%	-12.0%	1.0%	1.0%	8.0%	12.0%	12.0%	38%
W Midlands	-14.0%	-12.0%	-1.0%	1.0%	6.0%	10.0%	12.0%	31%
North East	-11.0%	-13.0%	-1.0%	0.0%	1.0%	6.0%	8.0%	14%
North West	-14.4%	-12.0%	-1.0%	0.0%	1.0%	6.0%	8.0%	14%
Yorks & Humber	-13.6%	-12.0%	-1.0%	1.0%	2.0%	6.0%	10.0%	19%
Wales	-12.1%	-16.0%	-1.0%	1.0%	6.0%	6.0%	8.0%	21%
Scotland	-8.1%	-12.0%	1.0%	2.0%	8.0%	12.0%	10.0%	37%
PCL	-18.3%	-14.0%	2.0%	10.0%	16.0%	10.0%	5.0%	50%

2 Economic recovery

The projected pattern of economic recovery is another linked factor. It is expected to start like the mid 1990s, with the more highly skilled workforces who are better placed to adapt to the new economic opportunities that emerge post recession. Accordingly, employment and income growth is expected to return more quickly in southern England. This will stimulate housing demand earlier in the cycle than elsewhere.

3 Committed supply

The nature and level of committed, new supply is key in the short term and will have a noticeable impact on the severity of the downturn at a local level. Over the past 18 months new build housing has been perceived as something of a dirty word, an overly simplistic view based on the issues facing urban high density flat schemes, particularly those in regenerating markets.

Where there are high levels of such development (for example in parts of East London) the impact on values has been significant. Prices have typically fallen by over 35% and sales are often reliant on investor demand which is likely to be pricing off income yields of over 7%. Regional city centres have seen similar price falls but proved more robust recently in terms of rental growth. However, unsold stock remains an issue and continues to hang over some of these markets. Consequently, their recovery is likely to lag behind that of the preferred city suburbs.

Locations with a more diverse and smaller-scale new build stock have proved more robust, especially where more controllable house schemes (rather than flats) are less likely to swamp local markets.

4 Population growth vs future development

The relative imbalance between rates of house building and the growth in household numbers underpins a likely, continued, longer term issue of housing shortage in London and the South East. This is likely to be exacerbated during the recession because of a dramatic downturn in house building, even if rates of household formation and in-migration wanes.

> Deposit affordability is likely to be more important than mortgage affordability in the future

In some sub-markets the supply and demand balance is more exposed to cyclical factors. For example, in the East of England, Cambridge has high underlying scarcity based on a diverse employment base plus demand from students. As such, it is better placed to withstand the downturn and see a relatively swift recovery than, say, Peterborough or Luton, where the supply and demand balance was more marginal even before the downturn. These are markets where investment linked to long term, large-scale regeneration is most likely to be successful, if structured to capture long-term value uplift.

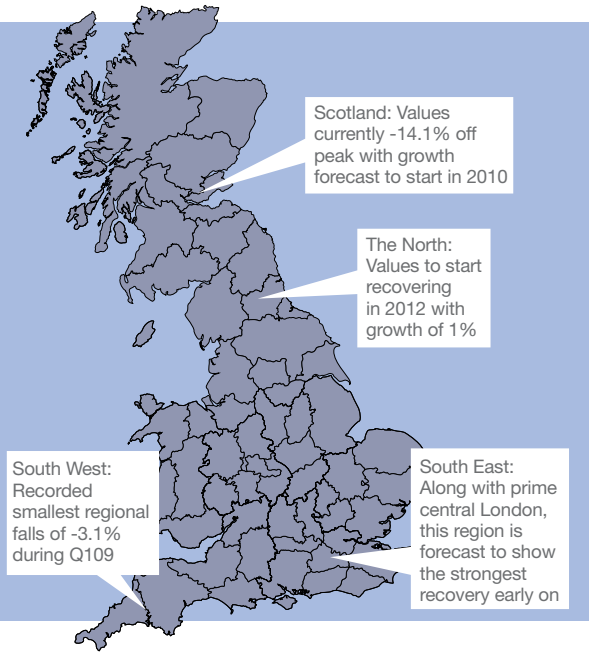
5 Equity

Layered on top of all of the above is the role of equity. This will be crucial given that deposit affordability is likely to be more important than mortgage affordability in the future. High equity is considered an attribute of the markets of southern England but is also a feature of Scotland which has, to date, seen much lower falls in house prices given both a combination of less aggressive medium term house price growth and lower than average levels of mortgage debt. ■

Jim Ward is Director of Savills Residential Research with 19 years experience. Jim specialises in market consultancy projects for developers, investors, lenders and government organisations. These projects tend to focus on market capacity and potential on a local level.

Table 2

New forecasts (as at April 2009)	Q1 2009	Current From Peak	Projected total peak to trough	Projected further falls
UK	-4.5%	-18.7%	-24.2%	-6.8%
London	-5.9%	-20.1%	-27%	-8.6%
South East	-4.5%	-19.5%	-24.2%	-5.2%
South West	-3.1%	-18.1%	-23.9%	-7.1%
East	-5.9%	-21.7%	-24.6%	-5.4%
E Midlands	-4.8%	-19.3%	-25.4%	-7.5%
W Midlands	-4.0%	-17.5%	-25.2%	-9.3%
North East	-4.7%	-16.0%	-24.1%	-9.6%
North West	-4.1%	-17.9%	-25.5%	-9.2%
Yorks & Humber	-4.7%	-18.5%	-25.6%	-8.6%
Wales	-8.9%	-20.0%	-26.9%	-8.7%
Scotland	-5.7%	-14.1%	-20.0%	-6.6%
PCL	-4.2%	-23.3%	-31.1%	-10.2%



Prime markets

Opportunity knocks in prime markets

In the context of the current economic outlook, **Lucian Cook** believes there is value to be found in prime central London property.

The prime markets, particularly those of central London, are often seen as a barometer for the rest of the residential property market. With mortgage-dependent buyers thin on the ground, this is likely to continue to be the case over the coming year. We expect equity-driven markets to be the first to respond to improved market sentiment.

Additionally, prime central London's historic attraction to investors, particularly those from overseas, means that close attention is being paid to the early signs of increased buyer activity. Traditionally, this has been an indication that prices are bottoming out. We do not expect this cycle to prove an exception.

Market regains a pulse

Following the significant price falls in the fourth quarter of 2008, triggered in no small measure by the collapse of Lehman Brothers, applicant activity within the prime markets rose in January and February 2009. This increase in applicant activity both gathered pace and started to translate into increased buying activity in March.

Our prime indices indicate that, at the end of March, prices of prime property in central London, south west London and the regions had fallen by 23.3%, 25.8% and 19.3% respectively since their peak. Such falls appear to have been sufficient to stimulate demand among those taking a medium term view on house prices.

> Prime central London's historic attraction to investors means that close attention is currently being paid to the early signs of increased buyer activity.

Rates of fall in the first quarter of 2009 were half those seen in the closing months of 2008, and buyers seem to be sensing that the market is approaching its floor.

In March, transaction numbers in prime central London had recovered back to the same level as a year earlier. In the country they were only 10% lower.

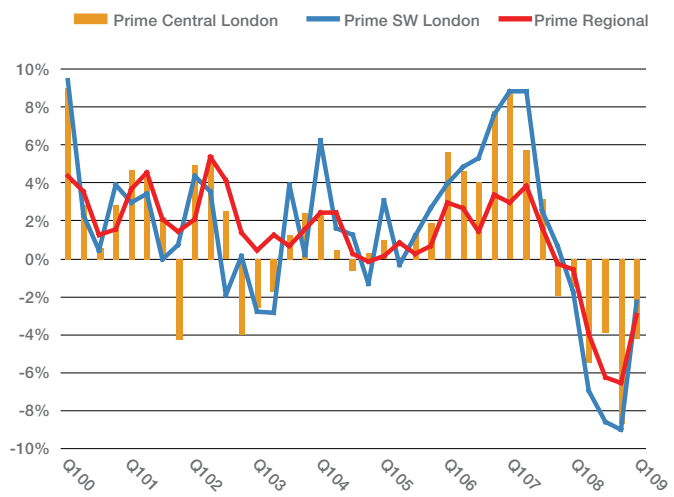
It has not gone unnoticed by investors that, while rental values have fallen in the prime markets (much more so than in the mainstream), the extent of price falls has exceeded rental faults and yields have moved out.

Investment opportunities

History tells us that gross yields in prime central London generally correspond closely with those of gilts. It is therefore important to note that yields on government bonds have fallen. Prime central London residential real estate has generally been seen as a relatively secure bricks and mortar investment, and this increases the relative attractiveness of prime central London property as an investment opportunity.

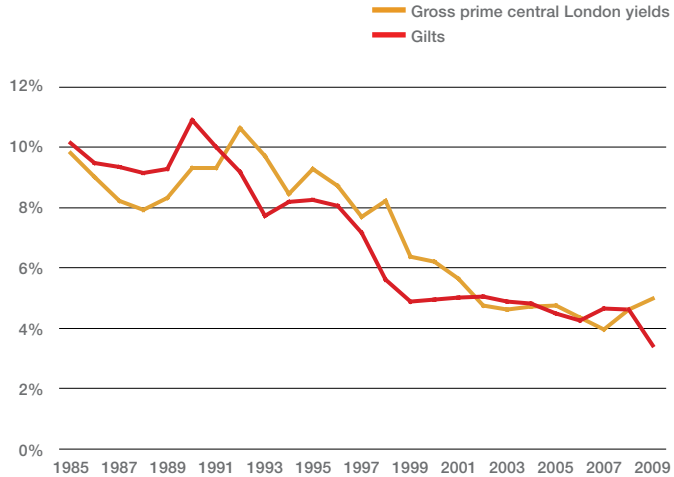
Investment funds are starting to be attracted to this market, recognising the historic medium to long term out-performance of prime central London over other markets and asset classes. Furthermore the fact that exchange rates against the dollar was 12% below the 25-year average at the end of March, has increased the purchasing power of overseas investors and made London residential real estate look like increasingly good value.

Graph 2.1
Prime market movements



Source: Savills

Graph 2.2
Gross yields vs Gilts



Source: Savills

Unless there is a further significant shock to the global financial system, evidence continues to suggest that London will lead the recovery.

Established prime locations

In prime markets such as those in south west London, regional cities and the country, which are more traditionally associated with full time, owner-occupier demand there has also been a noticeable increase in demand and activity.

In particular, those who sold at or near the top of the market and have spent the downturn in rented property, are beginning to attempt re-entry to the market, but are already finding themselves chasing a lack of prime stock. Prime markets have become much more dependent on the need-based sellers.

This is reflected in the fact that while death, debt and divorce sales typically account for 15% of all transactions, this figure has risen to nearer 35% in the last six months. As might be expected, debt-related sales have risen, particularly in the £500,000 to £2million markets where buyers have overstretched themselves in their attempts to work their way up the prime housing ladder. While the number of such sales has doubled, the overall effect is limited given that prior to the economic crisis they only accounted for between 2% and 2.5% of the total market.

Those buyers who have sufficient equity to make the move are looking to get the best value out of that equity, avoiding fringe locations but concentrating their efforts on established prime locations offering more property per pound. As a result, 'good value areas' such as Islington, Wandsworth and Clapham Old Town have seen a noticeable increase in activity.

Outside of London, price falls have been consistent across the country with very small regional variations. Evidence of new buyer registrations and viewings suggests that demand is flowing out of London in a ripple effect, most noticeably in the Home Counties and the South East.

The lack of bonus money has contributed to the fact that the lower tiers of the prime markets have been more active than the upper tiers, re-imposing thresholds in the market. Agents are reporting a ceiling of £1.5-£2million above which buyers are more reluctant to trade.

While indices are yet to show price stability, we believe the increase in activity suggests the prime markets are within 5% and 10% of their bottom. Rates of fall have slowed, and though we expect two or three more quarters of marginal falls we continue to forecast that falls from peak will not exceed -30% in prime central London and -25% in prime regional markets.

Unless there is further significant shock to the global financial system, evidence continues to suggest that prime central London will lead the recovery, returning to modest levels of positive annual growth as early as the end of next year. ■

Lucian Cook is a Director of Savills. He joined the research team at the beginning of 2007. Lucian is a qualified chartered surveyor with over 13 years of professional experience. He has now established himself as a leading commentator on residential property issues in the press.

Prime markets

Spotlight on second homes

Research illustrates price falls in the most desirable second home locations have, for the most part, remained in line with prime residential property.

Although second home ownership levels increased by 2.6% across the country in 2008, the average levels of second home ownership in the top 10 areas fell by just over 6%.

The common perception is that areas such as South Devon, North Cornwall, North Norfolk and the Suffolk Coast where there are high levels of second home ownership, have all been particularly exposed to the current downturn. However, our research findings largely contradict this.

In the 10 local authorities with the highest concentrations of second homes outside of London, second home ownership levels vary between one in 10 and one in 16 dwellings.

Locations within striking distance of London providing weekend, as opposed to holiday, accommodation, have witnessed smaller falls.

In the areas with highest levels of second home ownership, such as Salcombe and East Portlemouth in the South Hams and Padstow, St Meryn and St Minver in North Cornwall, rates often run at 30% to 40%. Second home prices in these areas average 50% to 60% more than the local authority in which they sit.

Our research indicates value falls of prime second homes averaged -18% to the end of March. This figure is in line with the average for prime regional property.

Geographical differences

This statistic hides the significant difference between the least and most affected properties. The most-affected quartile fell by -25.4%, while the least affected quartile saw values fall by just -11.9%. This reflects the difference between properties in prime settings, best suited to second home demand and those in weak markets that have now become reliant on local demand.

There are also geographical differences. In Devon and Cornwall prices have been most affected. Locations within striking distance of London providing weekend, as opposed to holiday, accommodation have witnessed smaller falls.

Given the highly discretionary nature of demand, and the very high premiums paid for some second homes, the extent of price falls in this market may have been expected to be higher.

However, part of this is reflected by the fact that debt-related sales of second homes have been rare, so transactions have been the main casualty.

Many of the most prestigious locations are exposed to the potential of forced sales. Some families have relocated to their former second home when facing financial stress. The ability to commute and opportunities for home working have played an important part in this trend. ■

Second Homes Markets

How price falls differ from region to region

Second Homes Market	Regional movement since peak
Devon	-14.7%
Cornwall	-15.1%
Sandbanks / Canford Cliffs	-15.4%
Cotswolds	-14.9%
Dorset	-16.6%
Scotland*	-14.2%
Norfolk	-14.0%
Suffolk	-11.0%

* East Lothian and Fife eg. St Andrews, Level, Gullane

Source: Savills

Leasehold property

Time to act on enfranchisement?

The time could be right to consider lease extension for owners of long leasehold interests, according to **Lucian Cook**.

One of the overlooked casualties of the housing market downturn has been enfranchisement activity. Owners of long leasehold interests in residential property have been much less inclined to use their statutory rights to extend their lease by 90 years. This is due to several reasons.

The first, and most potent reason, is that the most usual trigger point for enfranchisement, namely the sale/purchase of leasehold property, has been reduced as turnover levels across the residential property market have plummeted.

Secondly, many owners of leasehold interests will have delayed the decision to extend their lease since the cost of doing so is intrinsically linked to the underlying freehold value of the property. This makes it cheaper to enfranchise tomorrow rather than today in a period of falling prices.

Finally, in 2005, legal precedent provided a prescriptive formula for the calculation of the costs of enfranchisement. This precedent means it has become increasingly difficult to justify the costs of enfranchisement by reference to the increase in the value of a leaseholders interest in their property. In a rising market leaseholders are prepared to trade off the lack of immediate profit against the prospect of future price growth. In a falling or static market, however, this becomes increasingly difficult.

For many the inclination will be to 'do nothing'. However, because of the wasting nature of the leasehold interest, the costs of enfranchisement will rise on a much steeper curve than house prices when values start rising again. For example, while we forecast that prices in prime central London are due to return to their peak at the end of 2013, we predict that the costs of enfranchisement will return to their 2007 levels some 18 months earlier.

Time to act

For an individual holding a long leasehold interest in a flat with a freehold value of £500,000 and with 40 years of their lease remaining in 2007, the costs of enfranchisement would have been £118,000, a figure which would fall to £89,000 in 2009, but would increase to £144,000 in 2013.

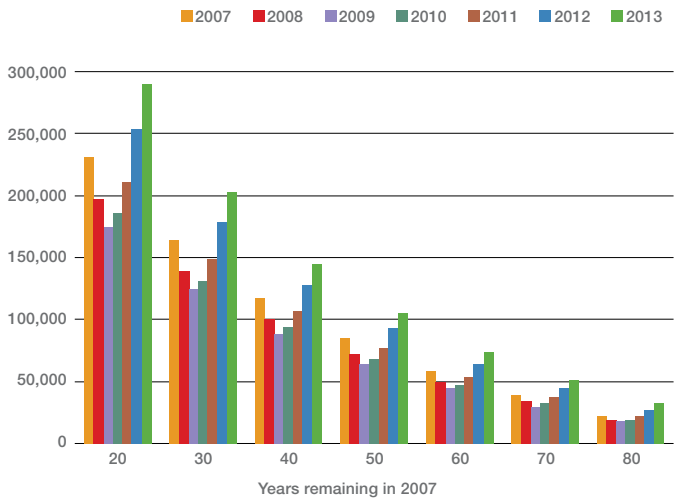
All of which means that 2009 is likely to be the cheapest year in which to enfranchise. This fact should, theoretically, bring a surge in enfranchisement activity, but many will at least want to see house prices bottom out before making a decision to extend their lease by 90 years. Even then, unless there is a shift in the perception of the value of leaseholds, especially those with a short remaining term, the issue of extracting value remains.

Costs of enfranchisement

Our analysis indicates that in order for the leaseholder to cover all costs of enfranchisement and make a notional 10% profit on that cost, the value of an interest with 40 years left to run may need to fall by 5%. This figure increases to 10% in the case of a leasehold with 30 years outstanding.

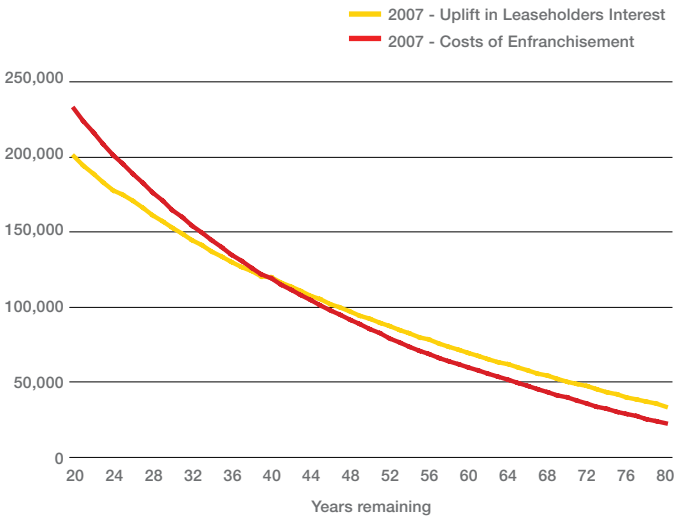
In these circumstances, while there are theoretically very good reasons for a bounce in enfranchisement activity this year, it is likely to be less than logic would dictate, unless the perception of the value of leasehold interests is adjusted. ■

Graph 3.1 Costs of Enfranchisement
£500k central London flat (£100 ground rent)



Source: Savills

Graph 3.2 Cost v Uplift in Value
£500k central London flat (£100 ground rent)



Source: Savills

Summary

Despite signs that the market is close to the bottom, the road to recovery remains a complex one.

■ The very rapid adjustment of house prices has shortened the period of house price falls, compared to the last property cycle, suggesting that the bottom of the market, certainly in the prime sector, is in sight.

■ We have not changed our projections of April 2008 concerning the depth of house price falls of -25% peak to trough, and believe the residential market has the seen the worst of its falls.

■ By 2019, our long term forecasts suggest that inflation-adjusted, 10-year house price growth should be in line with the long term 40% inflation-adjusted average, even if nominal growth is less aggressive than it has been historically.

■ Rates of fall in the prime central London market during the first quarter of 2009 were half those seen in the closing months of 2008.

■ Residential investment looks set to expand during the next 20 years, but there will be a need to further develop products such as shared equity and 'build-to-let', in order to attract lenders and investors, as well as meeting the underlying occupational demand for housing.

■ First-time buyers and, to a lesser extent, mortgage-dependent upsizers, will only become active in the market when, and if, equity becomes available to them. Deposit affordabililty is likely to be more important than mortgage affordability in the future.

■ Some of the most prestigious locations where prices grew dramatically in the boom on the back of city money, remain exposed to the potential of forced sales, although there has been a tendency for families to relocate, making their former second home their main residence.

■ Buyers seem to be sensing that the market is approaching its floor, and we suggest that the prime markets are within 5% and 10% of their bottom.

■ The cost of owning is now in line with, or in many cases cheaper than, the cost of renting, even accounting for moderate falls in rental values.

For further information please contact a member of Savills research team…

Yolande Barnes
Director
020 7409 8899
ybarnes@savills.com

Jacqui Daly
Director
020 7016 3779
jdaly@savills.com

Lucian Cook
Director
020 7016 3837
lcook@savills.com

Jim Ward
Director
020 7409 8841
jward@savills.com

Marcus Dixon
Associate Director
020 7409 5930
mdixon@savills.com

Carrie Scrivener
Associate Director
020 7409 8744
cscrivener@savills.com

Neal Hudson
Associate Director
020 7409 8865
nhudson@savills.com

Faisal Choudhry
Associate
0141 222 5880
fchoudhry@savills.com

Savills Research is a team of property and research professionals dedicated to understanding global real estate markets. Our aim is to use our knowledge to help you to add value to your property interests.

For our latest reports, visit www.savills.com/research

Lansdowne House
57 Berkeley Square
London W1J 6ER
020 7499 8644

savills.co.uk

savills