Residential Property Focus

Housing genetics

The fundamental change in the DNA of the housing market

Savills Research

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This publication
This document was published in August 2011. It contains a review of all the key housing market indicators and news to the end of July 2011. 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.

The most commonly used abbreviations are:
■ H111: refers to the first half of 2011
■ Peak: refers to the first half of 2007
■ PCL: Prime Central London
■ CML: Council for Mortgage Lenders

Foreword

IN SEARCH OF THE MISSING DNA

Forget the old theories. It is the flow of equity that currently drives the housing market and, where it does not reach, there will be little real price growth

Radium, anti matter, and the Higgs Boson particle are not usually items that start an article about the UK housing market but they do illustrate how good physicists are at finding missing elements when their theories show they should exist.

What is true of physicists however is not true of some property economists who seem to be clinging to a few explanatory variables rather than acknowledging that other, previously undiscovered, forces may be at work in the UK housing market.

Predictions of another housing market crash are still being made by some on the basis that the average house prices to average incomes ratio is still high in relation to historic levels.

But it is impossible to explain recent housing market behaviour and price growth since 2009 if all that matters in the housing market is household incomes and mortgage rates.

We have been observing the prime markets for over 30 years and, in so doing, have noticed the very low reliance their behaviour has on mortgage rates, lending policies or the world of debt in general. Rather, it is new wealth, bonuses, savings and investment, domestic and overseas, that drives these markets. In short, equity, not borrowing, is key.

We have long suspected the equity used in prime markets has not just leaked but sometimes cascaded into surrounding markets and down into the mainstream markets. Anecdotal evidence has pointed to such a 'champagne tower effect' but it is difficult to measure and so has been ignored by the macroeconomic scientists – despite being an increasingly obvious component of UK housing market behaviour.

Our Eureka moment has been in measuring, as well as observing, housing equity. First we quantified its existence in the UK housing market as £2.9 trillion of owner occupied stock, then we observed and measured it flowing from overseas into the prime London market at the rate of £3.7 billion in a single year.

In measuring equity, it became apparent there is a divide between those that have it and those who do not. This is a Generational Divide: equity is concentrated among the older age groups; it is a Geographical Divide: equity is concentrated in London and the South; and it is a Tiered Divide: equity is concentrated at the prime end of the market.

With less debt finance available, it is as if the glasses at the edge of the tower have been emptied and are waiting for equity to make up the deficit. The champagne tower of the housing market may be filling at the top and in the centre (London) but it has most definitely not reached the equity-starved edges.

It is this equity movement and its impacts that we have looked at in this publication. The consequences that we have observed have led us to extend our scientific metaphors and declare that "the DNA of the housing market has changed". New theories and methods to measure the mutated creature are now required. Old-School property economists need not apply. ■

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Executive summary

The key findings in this issue

■ The English Housing Survey results show fewer households are currently forming. Those that do are now more likely to move into private rental accommodation than become owner occupiers. For existing households for the first time in at least a decade, there has been a net movement out of owner occupation and into private renting. See pages 4/5

■ This year, housing markets have become increasingly polarised. Prime central London has made all the headlines, leaving prime country houses behind. The prime market in the capital is, seemingly, awash with equity. Price growth has continued through the second quarter of this year, and has shown little sign of being affected by the increase in stamp duty for purchases over £1 million. See pages 6/7

■ This is by no means a one size fits all market. As we have seen in previous cycles, the housing market naturally divides in to market leaders and market laggers. See pages 8/9

■ Research shows the cumulative shortfall in transaction numbers since the beginning of the credit crunch and the end of May 2011 is now more than 2.7 million across the UK. See pages 10/11

■ Headline statistics from the Council of Mortgage Lenders (CML) show that over the past 12 months average interest payments as a percentage of a borrower's income are currently just 10.8%, which is below the 10-year average of 14%. This creation of a mortgage affordability cushion is helping to underpin house prices. See pages 12/13

Contents

Home ownership cycle

A CHANGE TO THE MARKET'S DNA

With the number of new households entering into owner occupation reducing by 55% in the past year, the structure of the housing market is undergoing a fundamental shift

Words by Lucian Cook

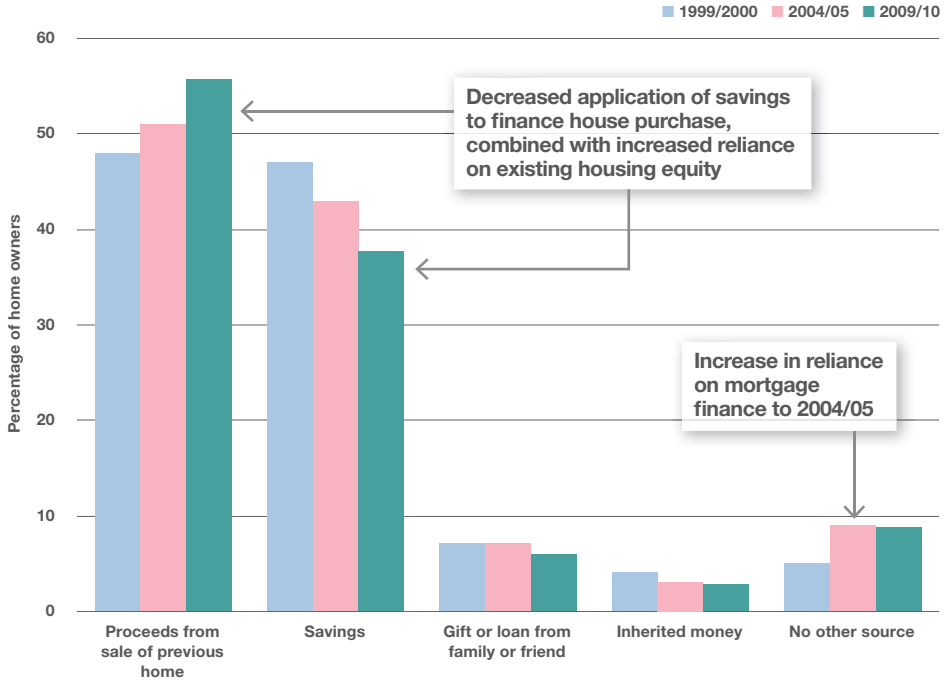
Two recently published housing market surveys highlight the beginning of change in the UK housing market. The affects of tighter mortgage lending criteria and the broader economic situation have filtered through to household behaviour as shown by the English Housing Survey and a report from the National Centre for Social Research (NCSR).

Ultimately, we believe the extent of these changes could be far more influential than the 'right to buy' introduced by Margaret Thatcher in The Housing Act 1980.

The report published by the NCSR concluded that, given the size of the deposit now required to obtain mortgage finance, for 64% of current non-homeowners the prospect of home ownership is unrealistic.

GRAPH 1.1

Source of finance, other than mortgage, for purchase of current property



Graph source: English Housing Survey

Changes to the cycle

Offering plenty of supporting evidence, the English Housing Survey results show fewer households are currently forming. Those that do are now more likely to move into private rental accommodation than become owner occupiers. For existing households for the first time in at least a decade, there has been a net movement out of owner occupation and into private renting.

A reduction in the number of those moving within the owner occupied sector completes the picture. The mechanisms by which equity flows into and through the housing market is now only partially functioning, although this varies by location and sector of the market.

Impact on equity flows

Equity in the housing market comes from two main sources; savings and the sale of a previous property to fund the next one. Currently 38% of homeowners use savings and 55% use sale proceeds to finance their main residence.

Among first time buyers, the ability to raise a deposit through savings is heavily hampered by the current levels of deposit required, the low return on any existing savings and the struggle to save in the prevailing economic environment.

It is no surprise, that for 67% of current non-homeowners raising a deposit, is regarded as a significant barrier to home ownership. Only 14% of these non-homeowners are actively saving towards a deposit.

This is undoubtedly a contributory factor to the formation of 55% fewer new owner occupier households in 2009/10 than seen on average between 1999 and 2008. Conversely, the number of new households entering the private rented sector rose by 21%.

The limited ability to accumulate savings or repay mortgage debt only partly explains the retreat of owner occupiers into the private rented sector though. During 2009/10, those who moved into private rented accommodation in England outnumbered those taking the more

traditional route from private renting into home ownership by 72,000.

This is partly due to rising repossessions as a result of the recession. More fundamentally, they reflect a lack of recent house price growth, which has left some potential 'upsizers' with an insufficient equity cushion to encourage them to make the next move up the housing ladder. Consequently terms such as 'double renting' and 'let to rent' have entered the housing market lexicon.

The future role of equity

The prospect of ongoing mortgage lending constraints raises the question of how equity will flow into, and through, the housing market in the future.

Some sectors of the market are able to function normally. The injection of overseas equity into prime central London, combined with new domestic wealth generation (particularly from the financial and business services sector), is compounding the already high levels of equity circulating in the prime markets.

The capacity for equity to be injected into UK mainstream markets is immediately more limited however. This market depends on owner occupiers repaying mortgage debt or transferring wealth from the older to younger generations. There is some evidence of mortgage debt repayment occurring, though it is likely to be a gradual and drawn out process.

Bridging the equity gap

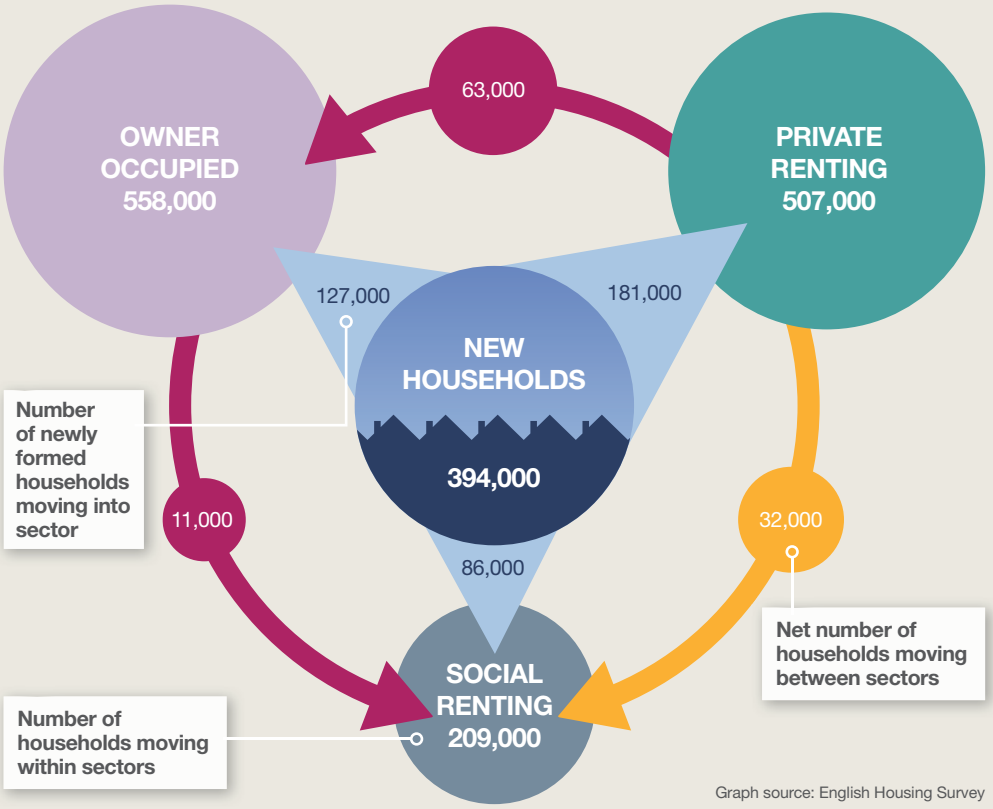
It seems the passing of housing equity down the generations will be critical to the future functioning of the housing markets. Whether this in the form of parents funding their children's housing deposits or supplementing the equity built up by the children of the 1970s.

Across the housing market as a whole, less than 6% of homeowners have used a loan or gift to finance the purchase of their current residence and less than 3% have used inherited money (see Graph 1.1).

Home ownership will come later in life for many future households because of the slow transference of housing equity. All of which means further increases in the private rented sector and a permanent structural change to our housing market. ■

GRAPH 1.2

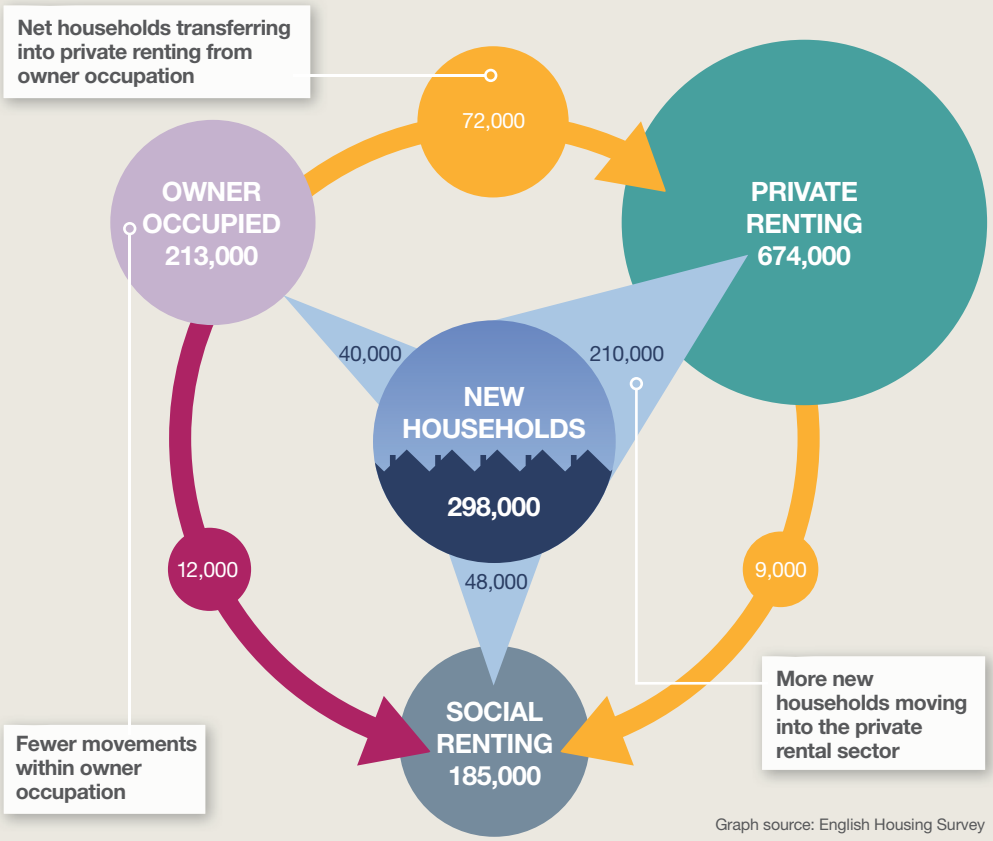
Home Ownership Cycle 1999/2000 to 2007/08



Graph source: English Housing Survey

GRAPH 1.3

Home Ownership Cycle 2009/10



Graph source: English Housing Survey

Prime market

A TALE OF TWO MARKETS

Less equity is flowing out of the capital and into the regions, so the gap in house prices between London and the rest of the UK has widened in the first six months of this year

Words by Yolande Barnes

This year, housing markets have become increasingly polarised. Prime central London has made all the headlines, leaving prime country houses behind. The prime market in the capital is, seemingly, awash with equity. Price growth has continued through the second quarter, and has shown little sign of being affected by the increase in stamp duty for purchases over £1 million.

London rolls on

Overseas equity continues to flow into central London particularly for higher value houses and luxury apartments, where price growth and transactions volumes have been strongest.

Transaction numbers in the over £5 million price bracket were the highest ever recorded in the three months to the end of June.

Normally, the overseas equity injection into prime central London (which we estimate will be in excess of last year's £3.7 billion) spreads down the market and out of London.

This year fewer homeowners in South West and North London are leaving for the country, and taking the London equity with them. They appear reluctant to move into weaker markets during economic uncertainty. So more equity is being recycled within the capital and is helping to drive up prices for family houses.

Regions held back

As less housing equity is being exported from London into the regional markets, values of prime regional property at the end of June were 1.8% below those of 12 months previously.

The number of prime buyers in the prime country commuter zone (defined as an hour's rail journey into London) was down by nearly one-third in the first six months of 2011 compared to 2010. The gap between average prices in prime South West London and prime commuter zone houses has been stretched further than ever before and looks set to widen over the remainder of the year.

Meanwhile, high rates of sale in London are creating an imbalance between high demand and low supply, which is likely to deliver further price growth. This contrasts with a build-up of unsold stock in the rest of the prime UK markets which is likely to be carried over into the autumn.

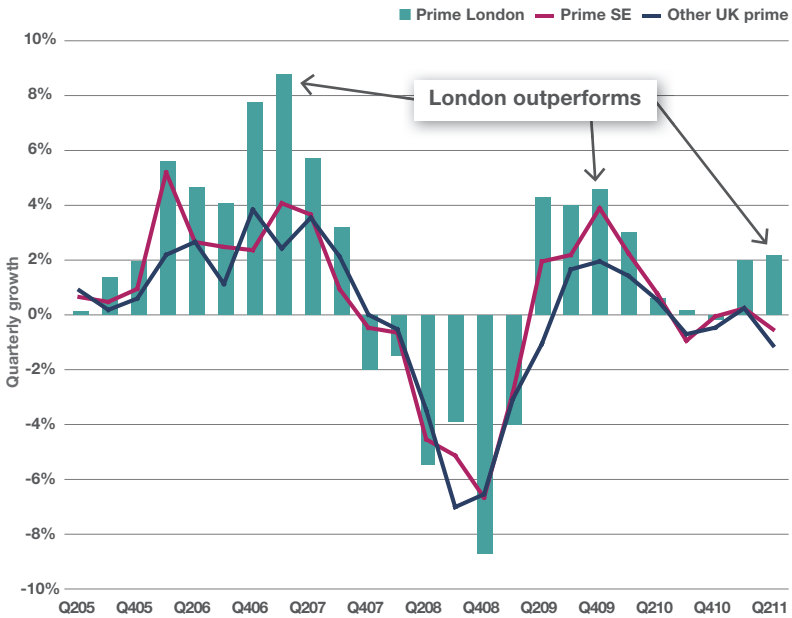
The lull in the market, which we expected in 2011, has been avoided in London but has prevailed in the other prime markets of the UK. We have therefore conducted a mid-year review of our 2011 forecasts for both markets.

The good value effect

We continue to expect all prime markets to outperform their mainstream counterparts over the early

GRAPH 2.1

Quarterly price movements in UK Prime areas



Graph source: Savills Research

£1,300,000
Average price of a 2,000 sq ft, 4 bed house in South West London

£780,000
Average price of a 2,000 sq ft, 4 bed house in inner commuter zone

part of this new housing cycle. Sellers will be forced to price realistically in the prime country markets because stock has increased, but the earlier than anticipated growth in London is making the country seem increasingly good value. This means domestic buyers from London maybe drawn into the country next year after the market has adjusted. ■

PRIME RENTAL OUTLOOK

London values above peak as demand increases

A gap between London and the regions is also evident in the prime rental markets. Prime London rental values have risen by 9.7% in the year to the end of June putting them 3.9% above their 2007 peak.

By contrast in the prime rental markets of South East England rents remain below their peak and annual rental growth stands at 2.1%.

Strong growth is evident in Islington, Hampstead, Canary Wharf and the Docklands. In these cases, double digit growth has been recorded over the past 12 months, fuelling an increase in investor demand within the London sales market.

This ironically has the effect of pulling further stock back out of the rental markets – at least temporarily (Rental stock had risen with the advent of the accidental landlord in the poor sales market of 2008).

Rental stock in the prime rental markets of the South East is not as constrained, as in London and the recent weakness in the sales market has seen the return of the occasional accidental landlord.

Forecast values
PRIME MARKET FORECASTS

The prime markets of London and the South East remain set to lead the recovery in house prices in 2012

PRIME MARKETS: Five-year forecast values

Forecasts	2010	2011	2012	2013	2014	2015	5 years to end 2015
Prime Central London	3.8%	8.0%	6.5%	6.0%	5.0%	5.0%	34.4%
Prime Regional	1.0%	-2.0%	5.0%	5.5%	6.0%	6.0%	22.0%
Prime South East	1.8%	-1.5%	7.5%	7.5%	7.0%	6.0%	29.1%
Prime South West	0.1%	-3.0%	4.5%	6.5%	6.0%	6.0%	21.3%
Prime East	3.4%	-1.0%	5.5%	7.0%	6.5%	6.0%	26.2%
Prime Midlands/ North	-1.2%	-2.5%	2.0%	4.0%	5.0%	5.5%	14.6%
Scotland	0.1%	-3.5%	0.0%	4.5%	5.0%	5.5%	11.7%

Annual house price growth key:
8% and over | 6% to 8% | 4% to 6% | 2% to 4% | 0% to 2% | Below 0%

Key Statistics

+4.3% Annual price growth in prime London

+7.9% Six month price growth for houses (as opposed to flats) in prime Central London

£1.37 billion Amount invested in houses worth over £5 million in London in the second quarter of 2011

-1.8% Annual price movements in the prime regional markets

£520,000 The difference between the average value of a 2,000 sq ft 4 bed house in SW London and the inner commuter zone including Chelmsford, Harpenden, Beaconsfield, Guildford and Sevenoaks

Market snapshot

MAPPING THE GREAT DIVIDE

Key market indicators provide a geographically diverse picture of the current UK housing market. Our forecasts strongly suggest this trend will continue

Overall the prospects for real house price growth over the next five years will be limited by the availability of mortgage finance and by how much the current levels of mortgage affordability are eroded by interest rate rises.

However, this is by no means a one size fits all market. As we have seen in previous cycles, the housing market naturally divides in to market leaders and market laggers.

This geographical pattern illustrated opposite matches the current picture given by price, transaction and repossession levels across the country.

We believe it sets the tone for the next five years. ■

SCOTLAND

Annual Price Movements -3.2%
Prices From Peak -9%
Repossessions Not measured in Scotland
Transactions 55%
Best Performing$ Aberdeenshire
Worst Performing$ Clackmannanshire

NORTH WEST

Annual Price Movements -4.9%
Prices From Peak -17%
Repossessions 0.76
Transactions 45%
Best Performing Chorley 62%
Worst Performing Burnley 28%

WALES

Annual Price Movements -5.6%
Prices From Peak -18%
Repossessions 0.77
Transactions 53%
Best Performing Monmouthshire 65%
Worst Performing Newport 43%

WEST MIDLANDS

Annual Price Movements -3.0%
Prices From Peak -15%
Repossessions 0.65
Transactions 51%
Best Performing Malvern Hills 67%
Worst Performing Stoke-on-Trent 37%

EAST MIDLANDS

Annual Price Movements -1.5%
Prices From Peak -14%
Repossessions 0.69
Transactions 52%
Best Performing Derbyshire Dales 71%
Worst Performing Northampton 43%

SOUTH WEST

Annual Price Movements -2.7%
Prices From Peak -12%
Repossessions 0.43
Transactions 60%
Best Performing North Devon 74%
Worst Performing Swindon 47%

LONDON

Annual Price Movements 2.9%
Prices From Peak -2%
Repossessions 0.53
Transactions 58%
Best Performing Islington 85%
Worst Performing Newham 37%

SOUTH EAST

Annual Price Movements -2.1%
Prices From Peak -9%
Repossessions 0.49
Transactions 59%
Best Performing Waverley 75%
Worst Performing Slough 41%

FIVE-YEAR PRICE GROWTH 2011-2015

NORTH EAST

Annual Price Movements -6.9%

Prices From Peak -21%

Repossessions 0.85

Transactions 51%

Best Performing
Northumberland 52%

Worst Performing
Hartlepool 36%

YORKS & HUMBER

Annual Price Movements -3.1%

Prices From Peak -16%

Repossessions 0.79

Transactions 46%

Best Performing
Ryedale 66%

Worst Performing
Kingston upon Hull 35%

EAST OF ENGLAND

Annual Price Movements -2.5%

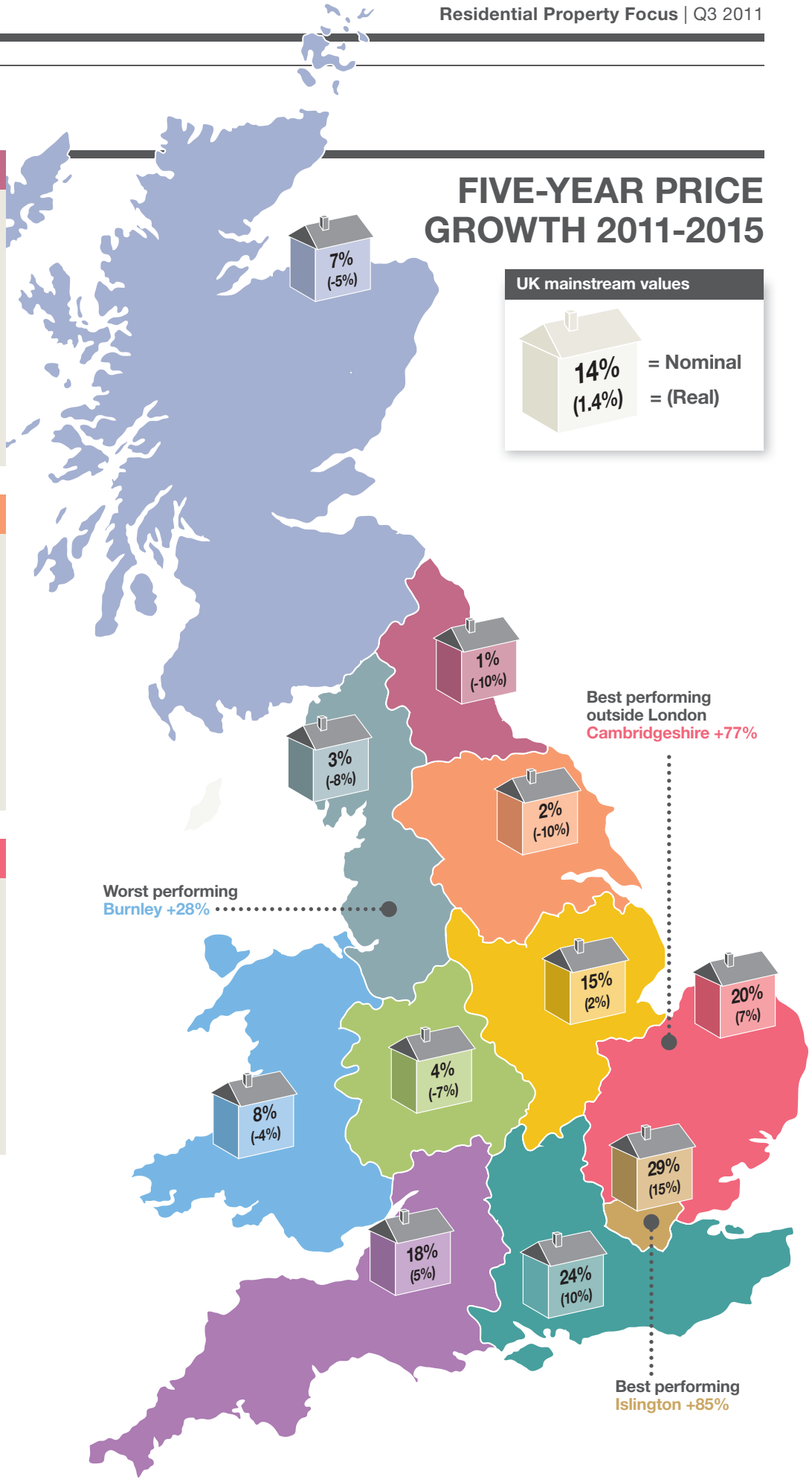
Prices From Peak -11%

Repossessions 0.54

Transactions 58%

Best Performing
Cambridgeshire 77%

Worst Performing
Luton 39%



Notes

Price data taken from Land Register Monthly Index to May (Scotland Nationwide qtly)

Repossessions are orders made per 1,000 household

Transactions are Q2 10 to Q111 vs pre crunch five year average (CLG and Registrars of Scotland)

Best performing and worst performing authorities are based on transaction levels

$Registrars of Scotland

Graph source: Savills Research

Mainstream market

SPRING WITH NO BOUNCE

An unevenly balanced market caused by low interest rates versus constrained access to mortgage finance and weak economic growth led to a lacklustre spring for sales

Words by Katy Warrick

So far this year the mainstream housing market has failed to gain any significant momentum. By the end of May sale volumes were 3% below those for the same period of last year, and less than half of those recorded in 2007.

Research shows the cumulative shortfall in transaction numbers since the beginning of the credit crunch and the end of May 2011 is now more than 2.7 million across the UK.

Abnormal equilibrium

This implies we have an unevenly balanced market, with low interest rates set against severely constrained access to mortgage finance and weak economic growth.

This imbalance has resulted in a lacklustre spring market, almost everywhere except the prime markets of London.

According to the Nationwide, house prices across the country increased by 0.8% during the first six months of 2011, but it would be unrealistic to rule out price falls later this year. The Royal Institution of Chartered Surveyors (RICS) reports an increase in unsold stock since the spring as the ratio between new stock marketed and buyer enquiries weakened.

Regional differences

The map on page 8 ably illustrates that there continue to be big differences in the UK housing market at regional and local levels.

These differences reflect how dependent a market is upon mortgage finance to function. It also reflects the extent of the wider economic pressures on it. The levels of equity held in a particular market, employment levels and household incomes also feed into the diverse geographical picture.

In a regional context London is the most diverse market. Here Land Registry figures suggest that prices in the Royal Borough of Kensington and Chelsea were 4.5% above their peak in the three months to the end of May, while they remained over 15% below their peak in Barking and Dagenham.

Similarly, transaction numbers in Islington in the 12 months to March 2011 were just 12% below their pre-crunch levels while those in the borough of Newham were down by 63%.

Views are split as to which way the scales will tip as the impact of interest rates, mortgage availability and economic recovery changes. Much depends on the extent to which interest rates rise and the capacity of the market to absorb them.

Interest rate rises

There is little prospect of a significant fall in house prices while the desire to protect a fragile economic recovery is pushing back the timings for interest rate rises.

Unfortunately, the certainty of future rate rises is enough to limit the prospects for price growth in the mortgage dependent markets.

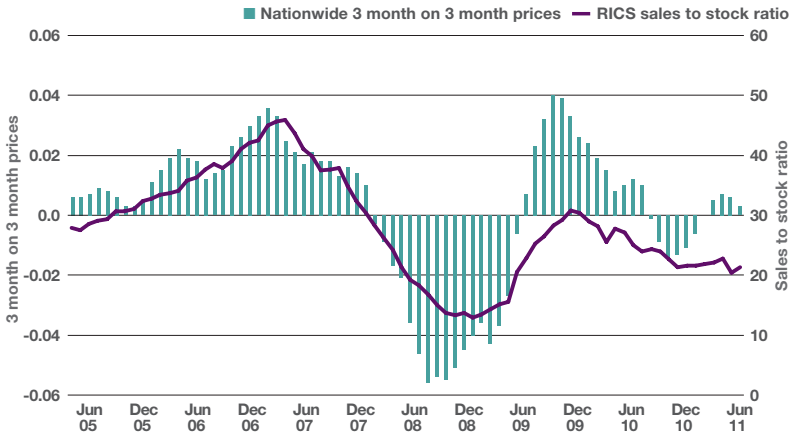
Our UK mainstream house price forecasts for an inflation adjusted price fall over the next five years remains essentially unchanged.

Prices will continue to be affected by the imbalanced market conditions, and the shortfall in the number of housing transactions will carry on rising as more households move into the private rented sector. We believe this will account for one in five UK households by the end of 2016. ■

> "The certainty of future interest rate rises is enough to limit the prospects for price growth in the mortgage dependent markets." Katy Warrick, Savills Research

GRAPH 3.1

Mainstream market housing indicators



Graph source: Nationwide / RICS

RENTAL OUTLOOK

Rental growth continues apace

The substantial shift towards private renting is increasing the importance of rental growth across the housing market. While house prices continue to flat line in the mainstream market, rental growth continues apace.

The LSL Property Services Group reports that in June rental inflation had reached 4.4% across the UK and 6.9% in London.

Increased demands on the private rented sector, from new and existing households, reflect the changing nature of the housing cycle. The big question is who will supply the stock to meet this demand?

Figures from the Council of Mortgage Lenders (CML) show that the increase in the number of buy to let (BTL) mortgages is failing to keep pace with the demand for rented accommodation.

Whereas the Survey of English Housing reports an increase of 286,000 in the number of private rented households between 2008/09 and 2009/10, the CML figures show the number of new mortgages increased by just 71,4000 for the same period.

More recently in the 12 months to March this year 108,000 new BTL mortgages were granted, but taking into account factors including remortgaging this only translated into 75,200 additional mortgages, down from a peak of 190,000 in 2007.

This partly reflects the fact that the BTL buyer now has to work to a maximum 75% Loan to Value mortgage, compared to 85% in 2007. Combined with low house price growth this is restricting the ability to expand a portfolio.

As accidental landlords eventually leave the sector, there is an opportunity for equity rich investors. Whether these are individuals or institutions, rental growth will be critical to delivering the competitive income yields they require.

Forecast values

MAINSTREAM FORECASTS

Wide regional price variations are set to continue, but some regional growth is expected next year

MAINSTREAM MARKETS:
Five-year forecast values

Forecasts	2010	2011	2012	2013	2014	2015	2011–2015 inclusive
UK	0.7%	-1.5%	2.0%	3.0%	5.0%	5.0%	14.1%
London	2.7%	3.0%	6.5%	5.5%	5.5%	6.0%	29.4%
South East	2.5%	0.0%	4.0%	6.0%	6.0%	6.0%	23.9%
South West	2.1%	-1.0%	3.0%	4.0%	5.5%	5.5%	18.0%
East of England	3.8%	-1.0%	3.5%	5.0%	6.0%	5.5%	20.3%
East Midlands	1.8%	-2.5%	2.5%	4.0%	5.5%	5.0%	15.1%
West Midlands	0.7%	-4.5%	-0.5%	1.0%	4.0%	4.5%	4.3%
North East	0.8%	-4.5%	-2.0%	0.0%	3.0%	4.5%	0.7%
North West	-1.3%	-4.0%	-1.0%	0.5%	3.5%	4.5%	3.3%
Yorkshire & Humber	-3.4%	-4.5%	-1.5%	0.0%	3.5%	4.5%	1.7%
Wales	-1.5%	-3.0%	0.0%	2.5%	4.0%	4.5%	8.1%
Scotland	-2.0%	-2.5%	0.0%	1.0%	3.5%	4.5%	6.5%

Annual house price growth key:
8% and over | 6% to 8% | 4% to 6% | 2% to 4% | 0% to 2% | Below 0%

Making the grade The impact of grading on residential values

Deviation from forecast
(end of 2010 – end of 2015)

The new Savills model for evaluating UK residential property anticipates Grade A properties exceeding their local mainstream market 5-year house price growth by 5%, while Grade C properties will underperform by 5%.

Grade A +5%
Grade B 0%
Grade C -5%

Mortgage affordability

DEFLATING THE AFFORDABILITY CUSHION

Low interest rates are currently underpinning house prices, but with an expectation that rates will rise does this accurately reflect affordability in the current mortgage environment?

Words by Jim Ward

One of the key features distinguishing this housing market downturn from that of the early 1990s is the effect of low interest rates.

There is a sense they have softened the blow for much of the mortgaged UK housing market. They certainly have tempered repossession levels and mortgages are currently more affordable for those able to meet the tighter lending criteria.

Headline statistics from the Council of Mortgage Lenders (CML) show that over the past 12 months average interest payments as a percentage of a borrower's income are currently just 10.8%, which is below the 10-year average of 14%. This creation of a mortgage affordability cushion is helping to underpin house prices.

As a measure of mortgage affordability however, this cushion is unlikely to give a meaningful assessment of the future capacity for house price growth. Compared with most of the last decade, we face the prospect of increasing interest rates that could rapidly eat into the cushion, a factor buyers are likely to be mindful of during these uncertain economic times.

Medium term measure

It is arguably more appropriate to look at a medium term measure of affordability, based on five-year fixed interest rates. Substituting these rates for the prevailing abnormally low interest rate would increase the ratio of interest payments to a borrower's income to 14.7%. This is substantially closer to the comparable overall 15.3% 10-year average than headline figures seem to suggest (see Graph 4.1).

For homeowners with a mortgage this means the affordability cushion is actually much smaller, so house price growth prospects for the next five years are much lower than they were in, say, 1995.

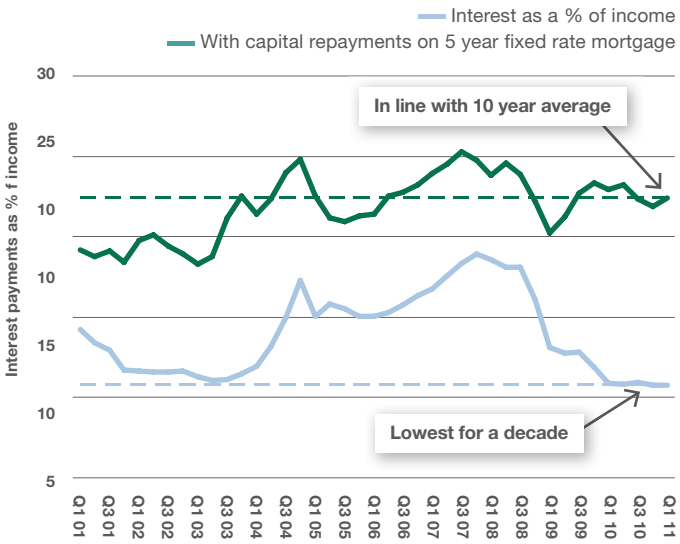
More positively, this factor also suggests for buyers who are able to obtain mortgage finance, current house prices are broadly sustainable even when interest rates rise.

Capital repayments

Another major difference between now and the early 1990s is the substantial change to the mortgage market, a change that looks to be entrenched and has major implications for the way we view affordability.

GRAPH 4.1

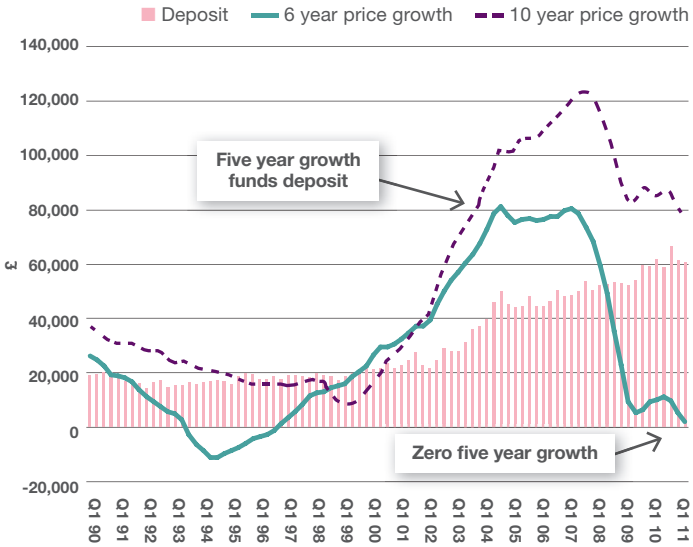
Mortgage payments as % of borrowers income



Graph source: CML / Savills

GRAPH 4.2

Home mover deposit vs 5 year UK house price growth



Graph source: CML / Nationwide

DEPOSIT AFFORDABILITY IN THE LOWER TIERS

A question of inability rather than an unwillingness to buy

For today's first time buyers the primary concern is being able to afford their deposit rather than meeting their mortgage repayments. The explanation is straightforward, the average deposit required by a first time buyer needing a mortgage is £26,500 but their annual income is £32,500, which highlights the extreme difficulty in funding a deposit though savings.

Clearly this will prevent many prospective first time buyers from entering the housing market at all, making mortgage interest affordability calculations academic for many.

For now there seems little evidence of an increase in the availability of higher loan to value mortgage finance other than with punitive lending criteria. Indeed, figures from the Financial Services Authority (FSA) indicate that just over 74% of all mortgages were at loan to value ratios of 75% or below in the first quarter of 2011, the joint highest proportion since the onset of the credit crunch.

Second-steppers

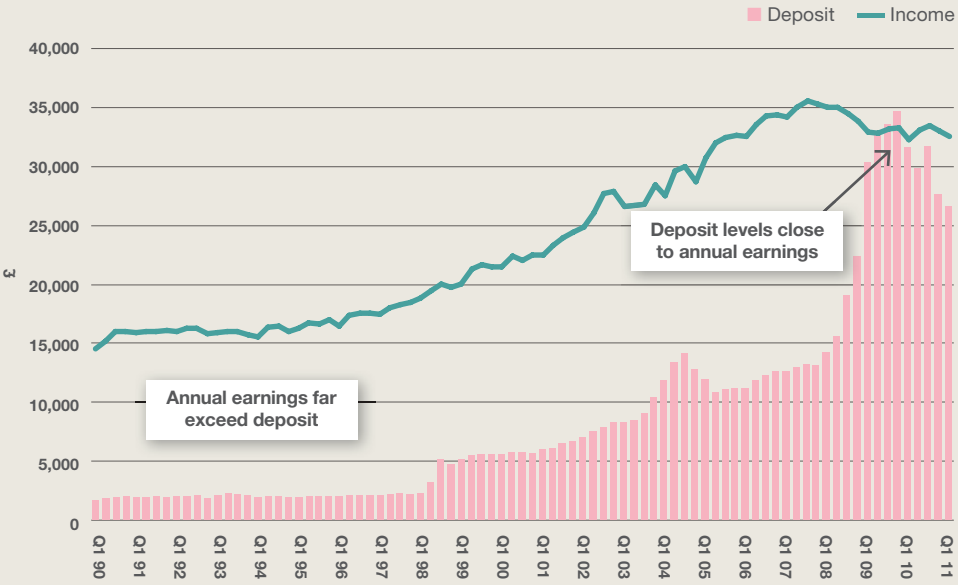
For second-steppers the deposit is an equally concerning issue. Through the bulk of the noughties those looking to move onto the second rung of the housing ladder could have met the cost of their second deposit through the house price growth of the preceding five years. From the beginning of 2000 to the first quarter of 2008, five-year growth for the mean UK house price exceeded the average deposit for a home mover by an average of just under £23,000 (see graph 4.2).

Since then home movers have been unable to fund their next move out of five-year house price growth, effectively excluding a substantial chunk of second-steppers from the housing market. In the first quarter of 2011 the five-year growth in the average UK house price was £2,000; the average deposit for a home mover was £58,000.

Against this context it becomes clear that the 2.7 million cumulative shortfall in transactions since the beginning of the credit crunch is as much a function of an inability to buy in the lower tiers of the market as an unwillingness to do so.

GRAPH 4.3

First time buyers income vs deposit



Graph source: CML

Specifically, with fewer interest only mortgages available the cost of capital repayments becomes increasingly relevant. Add the cost of mortgage capital repayments into the calculation and the five-year cost of all mortgage payments rises to 22.4% of income, slightly higher than the 10-year average of 21.8%.

This has a major bearing on the renting vs buying equation. Though the cost of renting is closely aligned to the cost of buying with an interest only mortgage, when capital repayments are factored in home ownership becomes a more expensive option.

Combined with the other increases in the average cost of living due to persistently high inflation those additional capital repayment costs will act as a disincentive to buy, whatever the longer term financial benefits of home ownership.

This does not preclude a return of house price growth, especially while cash and equity rich buyers are increasingly dictating house price movements.

It does, however, mean that the potential for growth in earnings is now far more critical to price growth in the mortgaged sector than the headline affordability statistics currently suggest. ■

"Compared with most of the last decade, we face the prospect of increasing interest rates that could rapidly eat into the cushion." Jim Ward, Savills Research

Insight

PROPERTY RADAR

A preview of the significant property topics to be covered in the next issue of Residential Property Focus

Mortgage finance

The prospects for the availability of mortgage finance will have an important bearing on transaction levels across the entire UK residential property market, shaping the future pattern and level of house price growth. The speed and by how far the mortgage markets are able to free up will have a major effect on the cost of deposits for prospective homeowners into the market and correspondingly the demand for private rented accommodation.

Inflation, wages and interest rates

Inflation, wage growth and base rates will dictate the potential for price growth in the mainstream markets by how they affect the affordability of mortgage finance. All eyes will be on these three key factors to see the extent to which household finances can support further house price growth and what impact they have on bringing repossessed stock to the market.

The Eurozone debt crisis

The path this takes has big implications for the availability of mortgage finance but could also determine the relative wealth of the overseas buyers who have driven price growth in the prime central London market. To date uncertainty in the Eurozone has driven wealth to London as a safe haven. The success of the most recent bailout will determine whether we see a continued flight to safety or more subdued spending among the super-rich.

Bonuses

There has been little evidence of bonus money in the prime markets of London and the South East so far this year. As an important source of new equity into these housing markets, the spending power it confers will be significant in establishing when it works its way through the established housing market wealth corridors.

Planning and housing policy

With new Government housing policy working its way through the system, there are many unanswered questions over the ability to deliver economically viable planning consents for housing where it is most needed. ■

The next Residential Property Focus will feature our forecasts for the housing market in 2012. If you wish to receive a copy register then please register your interest at savills.co.uk/research.

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"It is impossible to explain recent housing market behaviour and price growth since 2009 if all that matters in the housing market is household incomes and mortgage rates." Yolande Barnes

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"Home ownership will come later in life for many future households which means further increases in the private rented sector and a permanent structural change to our housing market." Lucian Cook

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"Though the cost of renting is closely aligned to the cost of buying with an interest only mortgage, when capital repayments are factored in home ownership becomes a more expensive option." Jim Ward

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