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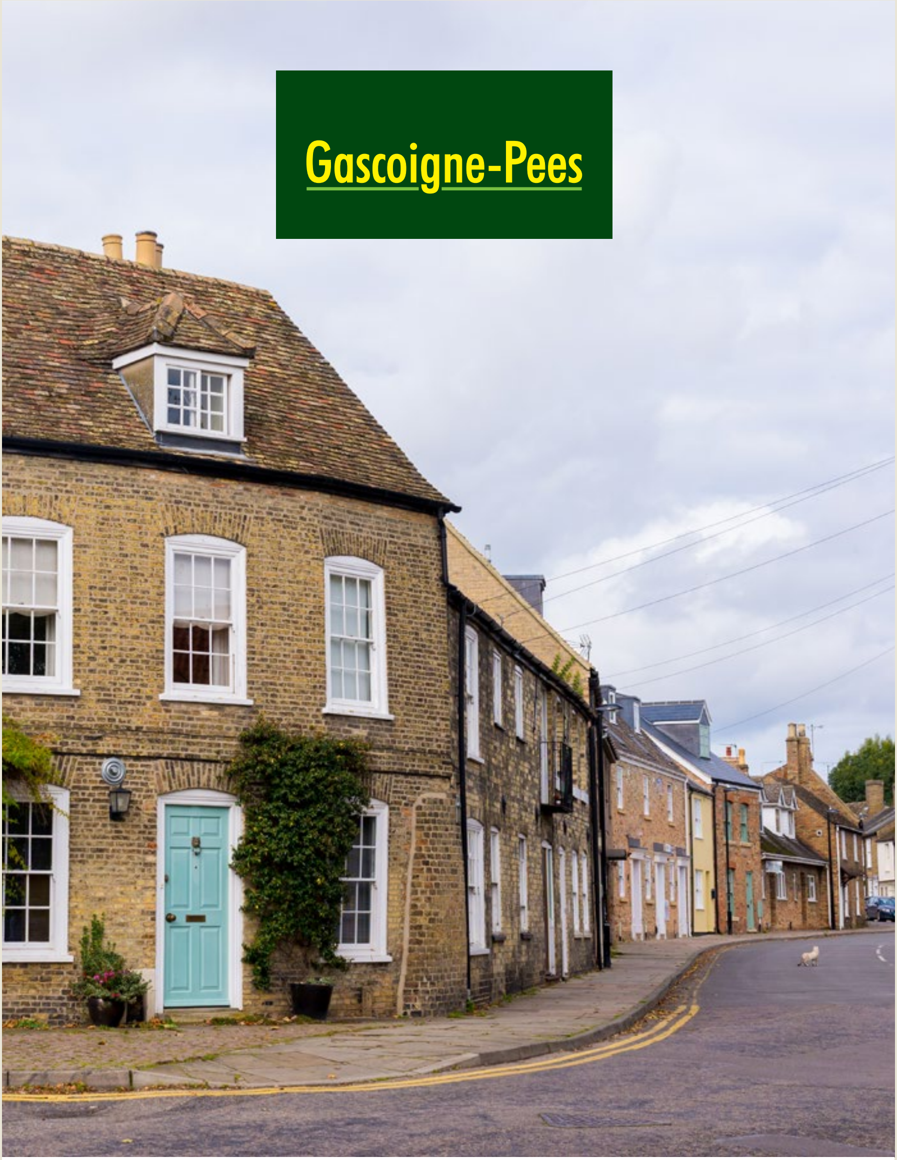


Market Insight

December 2017/January 2018

Rising interest?

Bank of England increases interest rates for the first time in a decade

The Bank of England's Monetary Policy Committee voted to raise interest rates in November for the first time in 10 years. The Bank rate is now 0.5%, back to where it was before the UK voted to leave the EU in the referendum in June 2016.

Having such low interest rates for such a long time is odd for the UK. In the 1980s the average rate was 11.5%, while since 2010 the average has been less than half a percent. Even if such a low rate of interest is strange for the UK in a historic context, this rise is definitely not the start of a consistent and frequent increase in rates to the levels of earlier decades.

The Bank of England has based its latest forecasts on the assumption that there will be only two more 0.25% increases in rates over the next two years. And the financial markets pretty much agree. The markets don't expect rates to get above 1.25% within five years.

The rise in rates will make very little difference to the housing market. Mortgage rates are already historically low and while some of the increase in bank rate may be passed on to new and existing borrowers there are two crucial factors that will limit any negative effect.

The first is that competition for mortgage business is still fierce, which will prevent mortgage rates drifting up sharply. Attractive deals will still be available. Allied to this is the expectation that most mortgage lenders will not pass on the whole increase in their savings rates. That means that the cost of funding will not rise as much, allowing lenders to widen margins, but also giving room to compete.

"The markets don't expect rates to get above 1.25% within five years."

The second is that two thirds of all mortgages are on a fixed rate and will face no change in rates. Even those coming to the end of fixed rate deals will often face lower payments on new deals than they had been paying. That will limit the likelihood of any increase in payment problems or forced sales which could otherwise impact price growth and activity in the market.

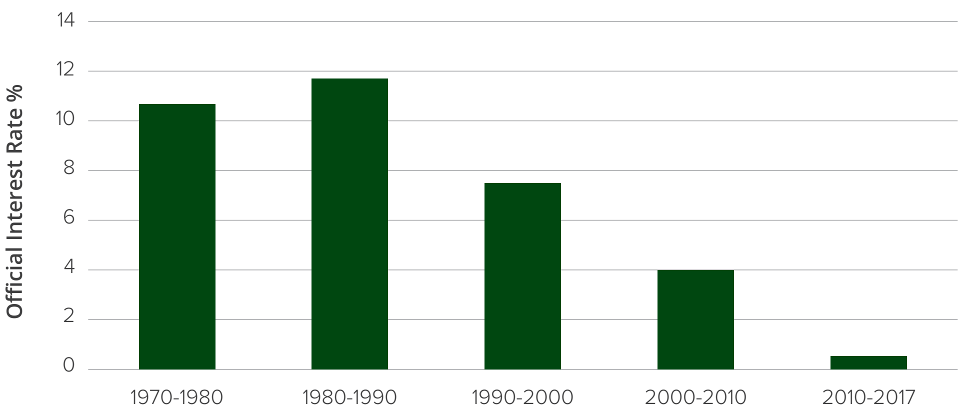
Furthermore, new borrowers already have to satisfy lenders that they can tolerate a rise in mortgage rates to c.7%, significantly beyond the current offered rate even if the whole 0.25% rise is passed on. The overall effect of the rate rise on affordability – of new or existing loans – is therefore minimal.

That is really good news for people wishing to buy property now. Even though the latest generation of first time buyers haven't lived through a period of interest rate rises, buyers are well protected by the affordability tests they had to pass to qualify.

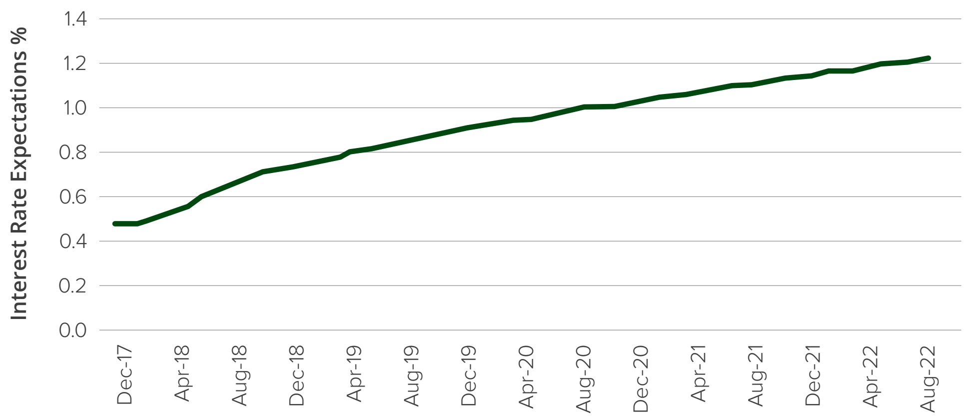
On top of that, they can budget in the knowledge that interest rates will remain low for some time to come, keeping their mortgage payments manageable. And if our forecasts are correct, wages will begin to increase faster than inflation in 2018. That will improve the standard of living of households, in turn helping to boost economic and housing market sentiment.

While this is unlikely to cause the rate of activity to increase sharply, it will help to set the foundations for the market to gradually begin to return to normality.

Interest rates over the decades Source: BoE



Market interest rate expectations Source: BoE



Economy

Don't worry, be happy!

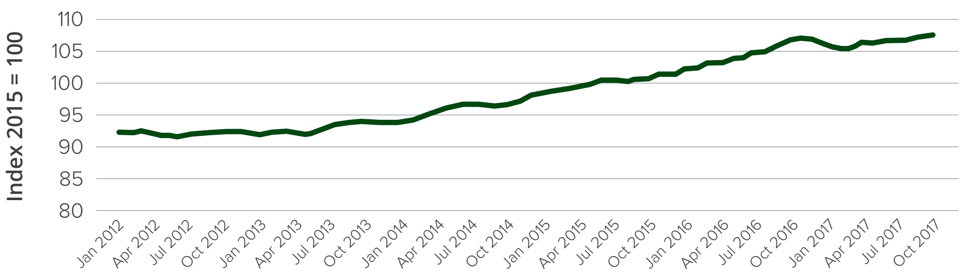
While there's lots of uncertainty about the future of the economy as the Brexit negotiations rumble on, it seems that consumers are looking on the bright side. They are continuing to spend, despite the squeeze on their finances from high inflation.

The latest data show an underlying picture of steady growth in retail sales. In the three months to October, the amount of sales made increased by 0.9% compared with September, while the amount spent increased by 1.5%. The numbers are lower than last year though – by 0.3% and 2.5% respectively – but that's largely due to the milder weather we are having now. No one needs to buy hats, coats and scarves when it's mild.

And there's been other good news this month too. It seems that the UK's productivity is picking up at last. In September, output per hour picked up at its fastest rate since the second quarter of 2011. Productivity is still well below pre-crisis levels, but there is a clear upward trend which will help to increase the growth rate of the whole economy. Good news all round!

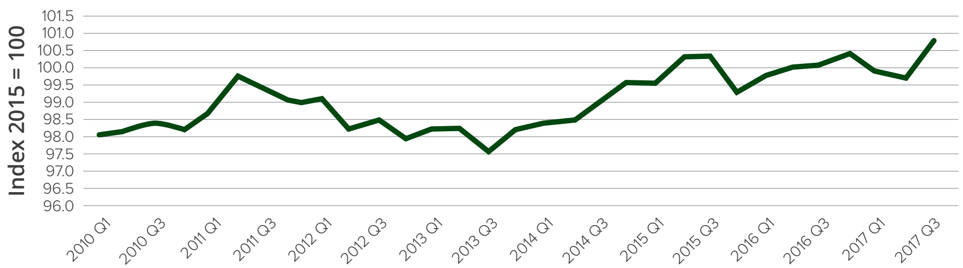
Retail sales

Source: ONS



Productivity

Source: ONS



Sales

A hole in the chain?

First-time buyer! Landlord! Cash buyer! All music to the ears of sellers – especially those in a hurry to move. What they all have in common is the ability to break a chain of sellers waiting for buyers to find buyers to complete their purchases. But rising prices and changes to the taxation of the buy to let market seem to be affecting the numbers of chain free sales.

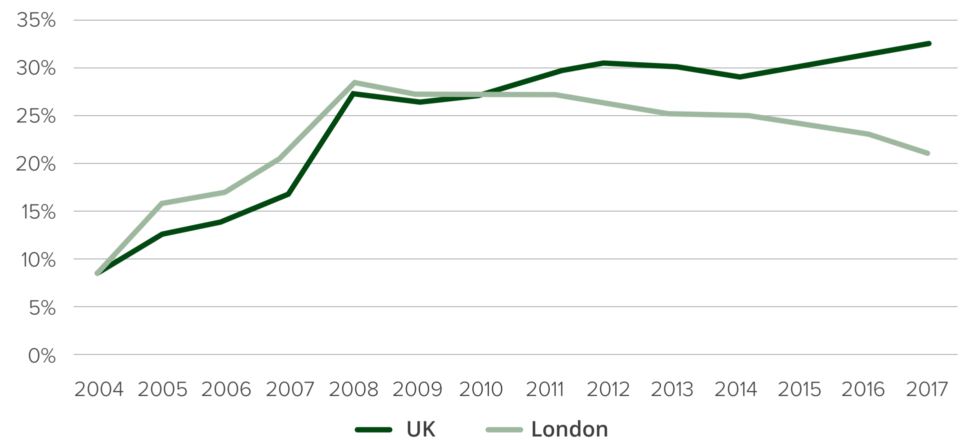
The proportion of chain-free sales in London has been falling for some time and dropped from 28% in 2008 to 21% this year. Rising prices in the capital have a part to play because as house prices rise, more transactions depend on selling an existing property to release the equity. But the trend has accelerated since the introduction of the 3% stamp duty surcharge on second homes and buy to let property.

Buy-to-let landlords have typically been even less reliant on selling a property to complete a purchase, but as prices have risen the extra burden of the surcharge is more difficult to absorb. An extra 3% is a big chunk of money to find on top of basic stamp duty. And on top of that, landlord returns are being hit by the phasing out of tax relief on mortgage interest payments. Buy-to-let investment in London has more than halved since the introduction of the stamp duty surcharge.

But that doesn't mean landlords are abandoning the market. Some of the fall in chain free sales is simply due to a change in where landlords choose to buy. As prices have increased in London, many have chosen to invest in cheaper markets outside, where lower prices mean it is more manageable to buy and absorb the extra surcharge. And that is reflected in the proportion of chain free sales increasing outside of London.

Homes sold with no onward chain

Source: Countrywide Research



Lettings

Cash landlords spend a record £21 billion

Landlords have increased their housing wealth considerably over the last 10 years. This means cash purchases are steadily becoming a bigger part of the market. The rising number of landlords buying in cash means that over the last year they spent more than at any time in the last decade.

Over the last 12 months landlords buying in cash bought £21.0 billion worth of homes which is £0.2 billion more than in 2016 and a 32% increase on 2007 when they spent £15.9 billion. Much of this cash has come from landlords re-mortgaging to take equity out of homes they already own. Rising prices have allowed landlords to take equity out of both their personal or other rental homes to expand their portfolios.

The proportion of landlords buying in cash has steadily increased over the last two years.

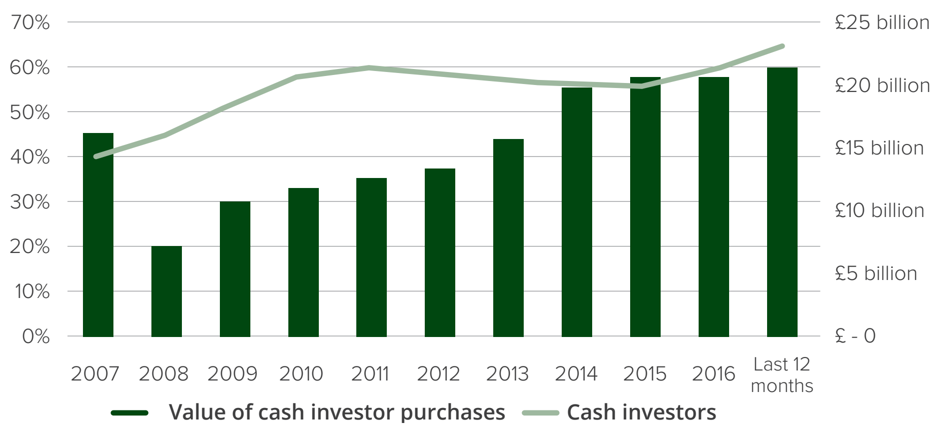
Over the last 12 months 65% of all homes bought by a landlord were paid for in cash, surpassing the previous high of 60% set in 2011. This is the highest figure since Countrywide's records began in 2007, a year when 60% of buy-to-let purchases were paid for with a mortgage.

Landlords buying in Northern England and Scotland are most likely to buy in cash. Seventy-eight per cent of privately rented homes bought in the North East over the last 12 months were paid for in cash, with cash landlords spending £3.17 for every £1 spent by a landlord using a mortgage.

Landlords buying in London are the most likely to use a mortgage. London is the only region where mortgaged landlords outspent their cash backed counterparts – £1 for every 67p.

Number of rented homes and number of landlords in Great Britain

Source: Countrywide Research & DCLG

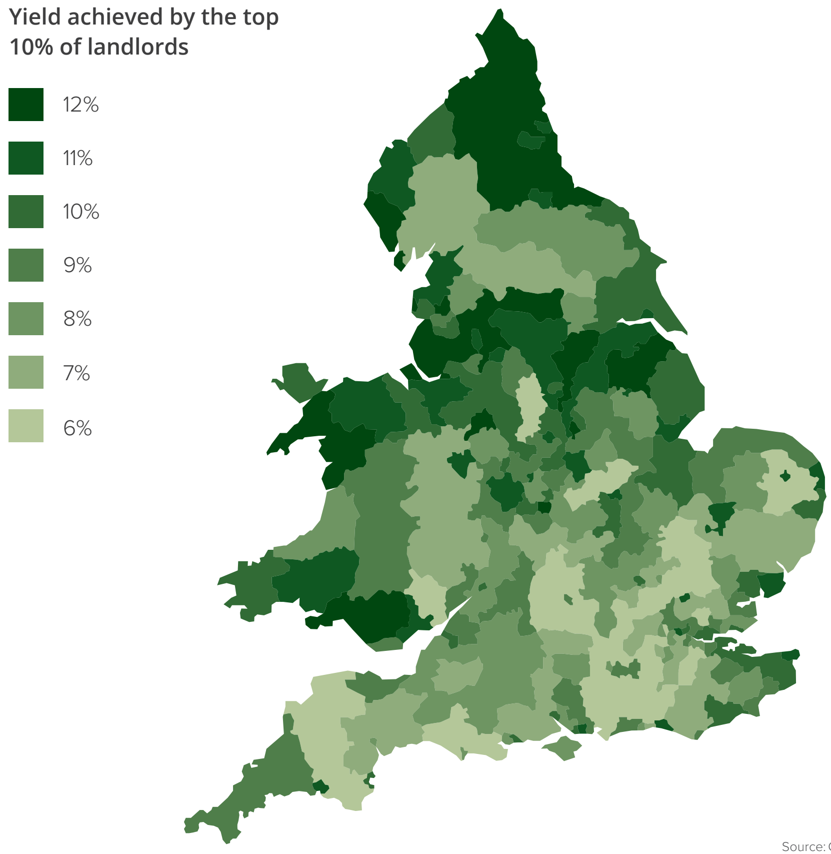


Stat of the Month

Yield achieved by the top 10% of landlords

As house prices have risen faster than rents over the last three years, most landlords have seen their returns squeezed, but many have benefited from capital appreciation. Over the last five years the average landlord saw their yield fall by 0.8% to 5.3%.

But landlords haven't been equally squeezed. The top 10% of landlords who achieve 50% more than the average investor have been hit far less hard. This group of 'super-lords' saw their returns fall by just 0.4% over the same period to a still healthy 7.9%.



Source: Countrywide Research

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