

Where does the UK market go from here?

David Lawrenson looks at the current state of the UK property market and considers what the future has in store.

As everyone is aware, the UK has seen a spectacular growth in property prices. Central London seems to have a boom all of its own, but other regions of the UK have also undergone incredible property price hikes. Northern Ireland, for instance, has watched property prices climb almost 50% over the past year.

But maybe the first warning signs of trouble for investors are now here. Not every region has enjoyed the current boom in Northern Ireland; in fact, a few areas have seen prices drop. Nottingham, in the full year to end September 2006, actually saw prices fall by about 10%.

The first thing to consider is the fact we are now in a period of low historic interest rates. Back in 1997 when I became a very active property investor, mortgage rates were still above 9%. With base rates now at 5.75%, people can afford to borrow at

much higher multiples to their income.

However, while rental incomes have grown, they have done so at a slower rate than house prices, leaving rental yields stretched. Gross yields are about 5.7%.

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Take away running costs and you get NET rental yields of about 4.75%. And with base rates at 5.5% (with the distinct possibility of a further rise), it does not take a genius to see that investors buying

property now are having to hope for good rental growth or for long-term capital growth going forward.

Not only is the growth in house prices uneven geographically, there are also differences in the type of property. Data from the lender Paragon show gross yields on terraced houses are about 6.2%, whilst flats only achieve 5.6%.

Price gains on houses have also been better. The Royal Institution of Chartered Surveyors (RICS) said in a recent report: “Larger and mid-range property types have shown disproportionate price gains compared to under-performing flats, with the largest variation of performance apparent since 2001.” Specifically, it noted that pre-1960 houses with two or three bedrooms were “leading the way with the largest price rises for almost two years”.

Why is this?

Well, past planning policy has created a shortage of family homes in inner cities, whilst the regeneration of some city centre areas has been undermined by the building of too many flats.

In the late 1990s and early 2000s, first-time buyers wanted flats – which was fine – and builders more than met this demand, which was further fuelled by buy-to-let investors, with many buying ‘off-plan’ flats helped out by property companies and syndicates. In quite a few areas, too many ‘identikit – me too’ flats were built, so prices and rents on flats have stayed sluggish, or have even fallen as landlords have had to compete hard for tenants.

At a recent large development I looked at for a client in Manchester, I figured about 50% of the properties were being let out. Unsurprisingly this competition had kept rental growth negative in real terms.

The Government now appears to be shifting emphasis on to councils building enough family homes, but the excess

demand for family homes is so great that I cannot see things changing for many years. In the meantime, it is the price of houses that will continue to rise fastest.

Housebuyers’ behaviour has also changed irreversibly, thanks to changes in the stamp duty land tax bands. Vendors are tending to stay put and choosing to build more onto their existing properties rather than having to face the costs associated

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with moving. The stamp duty leap to 3% at the £250,000 level is particularly painful and is a big factor in the shortage of properties, and hence house price gains.

For example, back in the 1980s people bought a house every 10 years or so. Now the figure is closer to once every 20 years, so it seems that people think that extending a house makes financial sense. A survey by Nationwide found that the average added value achieved by adding on another bedroom has risen from 4% in 2003 to 6% now.

In my view, too many landlords think it’s just young people and couples who rent. Recent research by the Alliance & Leicester found that nearly a quarter of families are now renting or still living with their

parents. For over half of these, this is a lifestyle choice. In other words, they are renting because it suits how they live – not because they cannot afford to buy. Potential first-time buyers, who are on average around 34 years of age, like the flexibility that renting offers them to move to find work or to do further study.

That’s why A&L predicts the trend for family renting will contribute to the private

rented sector growing by 39% by the year 2014. I think it will be even higher than that!

Apart from thinking about houses rather than flats, new investors should look at where the population is growing fastest, or will be expected to grow fastest, and where supply of new housing is limited. In inner London, for example, increases in the population are expected to be as much as 800,000 in the next five years.

Now the doomsayers say we are due a house price crash because the problem of lack of affordability of houses will put an upward limit on house prices. However, right now we are spending about 18% of our incomes on mortgages, which, because of low interest rates, is not significantly

above a long-run average. The Alliance & Leicester has said base rates would need to hit 8.5% before we see the same pain as we did in 1990 when interest rates hit 15% (and we were spending 26.5% of our incomes meeting mortgage payments.) That does not look likely.

Few dare say it, but perhaps the biggest factor driving both rental and capital values is migration. According to recent figures from the Office of National Statistics, the UK population is growing by 500 people every day. The Council of

Mortgage Lenders says that only 20% of people buy a property within five years of entering the UK. Immigrants from the new EU member states are unlikely to qualify for social housing, which means demand from immigrants could see increased demand for an extra 55,000 private rental homes a year.

Of course, what and where you should buy all depends on the local balance of supply and demand, as well as the extent of demand from tenants for different kinds of property. It is still possible to mess it up and buy the wrong kind of property in the wrong area that you will struggle to let out. The trick is to ensure you that research thoroughly and buy the right type of property in the right area.

