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Estate Agents in Prime Central London since 1965

October 2017 Month End Commentary

COMMENTARY:

A rate rise and hawkish language but only just.

Country needs a shock to solve household debt as "it's live now, pay later"

Confidence has extended to housing market but high inflation and lower wage inflation suggest affordability will become an increasing problem with respect to mortgages.

But not for your lender who may have passed on their rate rise, but is still enjoying the SAME level of funding under the BoE's Term Funding Scheme.

Higher costs and MMR mean the house prices levels may not be sustainable and therefore buy in an area with low historic house price volatility.

"We've Never Seen a Rate Rise!" – First Time buyer quoted by the Daily Mail….

Well, At 25 basis points, I think we can argue that you have not really seen one yet, particularly as this was simply a correction to the 2016 rate and we are still in the lowest interest rate environment in history. In any event the language from the MPC was hawkish (just) calling for slow and sustained rises to 1% over the next couple of years. Sterling fell by 1% against the Dollar as investors showed disappointment at the proposed pace given the inflationary pressures in the UK.

However, this headline does suggest a level of shock at a potential monthly increase in mortgage payments – a shock that the country needs in order to reign in household spending and reduce household debt, but a shock which we might not have yet accepted is forthcoming. We are a country who will happily pay £85 a month for a new Iphone when a £20 a month phone will do the same job, as buying on cheap credit is now normal. The Bank will seek to modify this behaviour by finely balancing further rate increases against overtly limiting consumer spending, and not before time: Just before the rate rise, the GFK Consumer Confidence Index rose by 1% and in their release they noted "*It's live now, pay later. This defiant consumer mood seems to the be the new normal. But how long can it last?*"

This confidence has extended into the housing market where we have seen year on year price increases in UK *large towns* of over 4% to May 17 (Hometrak). In the same time Land Registry, recorded an increase over 1% across England & Wales In the year to May 17 and over 28% from May 2012. In their analyses of real earnings, the ONS (18th October 2017) maintain that nominal total pay grew by 2.2% in the year to August 17 vs a 2.7% increase in inflation in the same time. This is a net reduction in spending power of 0.5% which reinforces GFK's concerns. Nevertheless, in the face of less real spending power, mortgage acceptances are still high as home ownership is seen as a right and, currently, affordable.

Affordability has been driven by the Central Bank post the financial crisis, and has little to do with interest rates: The BoE has a number of funding schemes available to Lenders including the Term Funding Scheme (the TFS is operational until February 2018) which will allow them to borrow at 0.25%. When the mortgage market is supported by cheap money from the Central Bank, then we must be concerned with what happens to that market once their intervention comes to an end.

Notwithstanding the rate rise, **The TFS rate remained unchanged post the rate rise (**Lenders have increased their mortgage rates but their cost of funding from the TFS remains unchanged at 0.25%). The 4 year term available to Lenders under the TFS, provides that the mortgage teaser rates do not all come to end at the same time so there will be no short-term cliff-edge where a majority of borrowers go from paying 1.6% to over 4.5%. This staggered conversion to Standard Variable Rate will be very useful for the Government who need 3-4 years where they can focus on Brexit and not have to worry about arrears and possibly defaults in the mortgage market (amazing how that timing worked so well….)

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SALES:

Jamie Hope
Managing Director
0207 581 2216
jamie@maskells.co.uk

Merton Croisdale-Appleby
Development Director
0207 581 2216
merton@maskells.co.uk

LETTINGS:

Peter Hermon-Taylor
Managing Director
0207 581 2216
peter@maskells.co.uk

Arrears & Defaults: Scary words which need context: The UK housing stock has built up considerable equity. Our analysis of the Price increases in the Hometrak Large Town survey to May 2017 and Mortgage Data provided by the FCA suggests that the average LTV in these towns is now just over 42%, A historically very low number. So defaults & arrears are not something which will happen overnight but the housing market has now in earnest become a game of affordability.

So whilst there is little to worry about for the time being, our readers may want to consider what happens over the next 4 years as the mortgages funded under the TFS at 25bps are transferred back to balance sheet where traditional funding will take over (assuming functioning mortgage funding markets are operational) because at this point in 2021-22, we will be facing the full brunt of the economic consequences of Brexit, consequences which will be more severe if UK consumers have to divert funds from day to day spending to make higher monthly mortgage repayments. If a home needs to be sold, however affordability and the MMR (Mortgage Market Review) will almost certainly make it hard for the current pricing to be maintained.

There is no solution to this other than saving and paying off household debt which is unlikely to happen with our low wage inflation. The only thing that current buyers can do is buy property in an area with historically low price volatility – areas where the prices are underpinned by Vendors unwilling to sell at any cost. Given the low sales volumes in Prime Central London, buyers seeking capital protection may be drawn here.

Sales:

The spectre of the budget on the 22nd November has raised the usual false-hopes of a reduction in SDLT: this is slowing the Prime Market Sales in the run up to Budget Day. Unfortunately, it is unlikely that we will see a reduction as 1) The Government needs the money 2) Amending the higher rate means spending political capital that the Government does not have or need to spend - those voters whom this affects will be steadfast in their political views and 3) the additional tax is seen as a dis-incentive to foreign buyers whom voters feel have been pricing them out of property.
We continue to take on properties and sell them although we do wish that there was a bit more depth to this market – and a general lack of applicants does continue to suggest little capital growth in the market in the coming 18-24 months. Forecasts of 20% capital growth over the next 5 years is overly optimistic, in our humble opinion. That said, if your life is in London & the UK and you need a home, waiting will not make things cheaper and with inflation eroding your savings, the wait may make your new home, in real terms, more expensive.

Lettings:

Europeans are continuing to rent rather than buy for the reasons we mentioned in our last review. Our Average rent per calendar month dropped from £8,017 in September to £2,848 in October (£6,700 October 2016). This was interesting as post the high demand in September, the October market tends to be professionals, particularly ones moving from overseas. Whilst the volumes were broadly the same, the type of tenant was not as senior on the corporate ladder accounting for the lower monthly housing budget but also suggesting that the decisions makers were not being relocated to the UK.

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