Factors that affect house prices in uk

If we study the house price chart of UK we would come to know that there had been a rise in prices during the early 00’s. Then a huge decline is seen during 04-05. A small recovery was seen after that but the major downfall in house prices struck in 08.

There were many reasons for the downfall out of which the most important one was the credit crunch. Credit crunch is explained later in the topic.

08-09 brought changes in house prices and it was quiet obvious since the world faced one of the worst slump in the history. Due to this recession almost every sector was affected. Since everything in our society is linked to each other the houses prices were affected too.

Some of the factors have been studied below

The following diagrams may help us to have a fast forward look at what we are going to study below

House prices are affected by a combination of supply and demand factors.

Demand Side Factors:

1. Economic Growth / Real income.

Improved life standards enable people to earn more and spend more. Few years back people use to have a mortgage ratio of 3 times your salary. For example if a person earns £30, 000 the building society would lead £90, 000. Therefore rising incomes enable house prices to rise.

However, the ratio of house prices to income can vary considerably. For example, between 1995 and 2007, the ratio of house prices to incomes have increased significantly.

If the economy goes into a recession and unemployment rises, the demand for buying houses would fall significantly.

2. Consumer confidence

During times of high consumer confidence, people are more willing to take out risky mortgages to be able to buy a house. In the period 2001-07 100% mortgages and interest only mortgages were quite common. In the early 00s, people were optimistic about the housing market and so took out mortgages with a higher debt to income ratio. The economic boom during the early 00s gave the people enough confidence to take loan with even higher interest rates. Since the unemployment was quiet low the consumers had confidence about their earnings. This confidence is clearly reflected in the increase in real estate business during early 00s.

3. Interest rates.

From past few years Interest rate was low. To counter off the inflationary effect bank of England had to increase the interest rates, thus increase the interest rates in the financial markets. The economic recession created a severe credit crunch thus providing the basis for huge crash in real estate markets.

A brief Description of credit crunch is given below.

America is the country which was severely hit by the credit crunch crises. In simple words people were issued loans on the basis of just there pay slips. Though the lands and mortgaged property was taken as security but this was not enough for what future explained. Rise in oil prices proved to be one of the main causes of economic recession ultimately giving rise to unemployment. Thus people went jobless and were unable to pay the mortgage installments. Real estate markets had crashed due to lack in demand and excess supply, since the banks wanted to auction the property for recovery of mortgaged amount.

Interest rates affect the cost of paying for a mortgage. Interest rates are very important as mortgage repayments are usually the biggest part of a homeowner’s monthly spending.

In the UK, the majority of homeowners have a variable mortgage which means increase in interest rate would surely effect the buying’s. The rise in interest rates proved to be significant event in drop in houses demand.

People on fixed rate mortgages will be insulated from fluctuating rates for 2-10 years. Therefore changes in interest rates can have a time lag of upto 18months before there full effect is noted on demand for housing.

It is also important to consider real interest rates (interest rates-inflation)

The Bank of England set base rates and these usually affect all commercial rates. However, sometimes the Bank of England cut interest rates, but, commercial banks don’t pass these cuts onto consumers. In the first half of

2008, the Bank of England cut rates by 0. 5% from 5. 5 to 5. 0%, but the cost of mortgages is still rising.

4. Availability of Mortgage Finance

If we give a glance to the 70s 80s of twentieth century the loan culture was not much common, later by increase in financial institutions & with deregulation of the banking sector increased competition has seen a rise in the number of mortgage products. Products such as interest only, self certification mortgages and mortgages up to 6 times income have enabled people to get more mortgages, thereby increasing demand for housing. However, during the credit crunch of 2008, the number of mortgage products on offer fell due to a shortage of finance in the money markets. This credit crunch has surely proved severe downfall in house prices. Neither people have enough money to buy houses nor are loans available. Loans are provided on higher interest rates.

5. Demographic factors

There have been a rising number of households in the UK. The number of households can rise faster than the population if the average family size decline and there are more single people living alone. If we study UKs population chart the earning ages have declined to 16 or 17 which means more people are earning and getting independent. This independence gives rise to house buyers.

Demand for housing in the UK has been increasing for various reasons such as:

An increase in divorce rates ultimately rising the demands for separate house.

The immigration from east Europe And the eastern countries give rise in the demand of houses in UK

Increase in life expectancy and more old single people

Children leaving home early for earning and a thought of getting independent.

6. Speculation

There are many people in UK who buy houses for the capital gains. The uncertainty in market and rise in unemployment has drawn all eyes away from this business. Increase in interest rates has even attracted the investors to save their money to earn interest.

Not everyone buys a house to live in it. An increasing number of property investors buy houses to try and make both capital gains and income from renting. This buy to let investor is typically more volatile, they will buy when house prices are rising and sell when the market appears to turn. This makes house prices more volatile because speculators will buy in a boom and sell in a bust. The number of buy to let investors in the UK has risen in the past decade.

However, there are quite high fixed costs in selling a house, such as stamp duty and estate agent fees. It is not like dealing in shares where you can easily buy and sell. Many buy to let investors claim they are in for the long term.

The price of rented accommodation

Although UK house prices have increased faster than inflation, renting has also become expensive which is the main substitute to buying a house

7. Inherited wealth.

Increase in life expectancies has decreased the death rates and hence the inherited wealth is distributed lately blocking the amount for a longer time. Division of properties divide the money too. Thus more people get the money to invest.

Low unemployment is often associated with rising demand for houses.

Supply side Factors

In the short run Supply of housing is fixed because it takes time to build houses. Therefore in the short run demand affects prices more than supply

However if the supply of housing is inelastic then an increase in demand will lead to a big increase in price.

The above given factors give us an idea that due to slow pace of house building prices are consistent and do not show any kind of variation. The current situation do not satisfy these conditions because currently inflation has caused the material prices to increase rapidly, rising the house prices.

In the long Run the supply of housing is affected by many factors:

At times investments are blocked in the rural areas due to restriction by government.

Building houses and buildings is a time taking process. Investors hesitate to invest because a huge amount is blocked in construction.

UK has many homes which were built many years ago. Now these houses are being demolished and flats are given priority over the houses giving rise in supply of houses.

An increase in the cost of building new houses will shift supply to the left

In the UK, it is argued there is a significant shortage of housing is this explains why house prices have risen much faster than inflation and earnings. However, in the US, the supply of housing increased in the period upto 2008 and therefore, the excess supply and falling demand led to a big fall in demand. However, it is important to note that house prices can still fall, even if there is a shortage of supply. In 1992, house prices in London fell over 20%, even though we can say supply is inelastic. A shortage of supply just means they will be on average higher. It doesn’t mean they are incapable of falling.

www. Ukhouseprices. co. uk

Conclusion & Forecasting

If we sum up everything we would come to know that the few important factors in the downfall of house prices is

Future Predictions

Let us first analyze what different economist predicts about future of house prices in UK. The data is an extract from the website www. housepricecrash. co. uk.

Savills

Jeremy Helsby

N/A

Jul 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif25%

London

2008-2009

Tick

The chief executive of Savills forecast house prices in London to fall 25 per cent by the end of next year.

GMO

Jeremy Grantham

N/A

Jul 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif50%

UK

Not stated

Tick

Jeremy Grantham of GMO, the $126-bn US investment fund, notes that UK house prices “ could easily decline 50% from the peak, and at that lower level they would still be higher than they were in 1997 as a multiple of income!”

Capital Economics

Roger Bootle

Photo of Roger Bootle

Jun 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif35%

UK

2008-2010

Tick

Revised forecast: House prices may fall up to 35pc over the next three years, Capital Economics has warned, in one of the bleakest forecasts yet for the UK’s property market.

Jones Lang LaSalle

James Thomas

Photo of James Thomas

May 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif1-3 %

UK

2009

Tick

Minor falls predicted for 2009.

Jones Lang LaSalle

James Thomas

Photo of James Thomas

May 2008

http://www. housepricecrash. co. uk/images/arrow-up. gif7-9 %

UK

2010-2013

Tick

Jones Lang LaSalle expect slow growth from 2010-2013.

Morgan Stanley

David Miles

Photo of David Miles

Mar 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif20%

UK

2008-2009

Tick

David Miles, chief UK economist at Morgan Stanley predicts that house prices will fall by up to 20% over the next two years.

Numis Securities

James Hamilton

N/A

Mar 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif30%

UK

Not stated

Tick

James states that “ UK property prices remain 44% over valued we expect them to go to a discount to fair value.” (44% over-valuation would result in a 30. 55% price drop)

Boom Bust

Fred Harrison

Photo of Fred Harrison

Jan 2008

http://www. housepricecrash. co. uk/images/arrow-down. gif30%

UK

2008-2012

Tick

Fred Harrison predicted a drop of 20% in his book Boom Bust (2005) but he now believes the drop will be around 30%.

Almost all the economist has forecasted a further crash in the house prices in UK. Majority speaks about a 30 % decrease which means that the turmoil is going to be worsened with passage of time.

Although the market is said to be in recovery phase, some of the economist still believe that it may be just a mirage. This means that the market seems to recover but in real credit crunch is still not over yet. Un employment is still rising in UK which means that there wont be enough money In people’s pocket to invest in real estate. The economic recession has forced Government of UK to introduce tougher policies for the immigrants. This ultimately has decreased the new immigrants in UK and houses demand is not increasing.

Economist still believes that the market is going to recover by the end of 2010. May be 2010 can bring people out of dilemma of economic cycle.