How far have price falls in London spread into regional housing markets?

June 2019

- House prices in London lead the rest of the market – after high growth between 2010 and 2015, a growing proportion of markets started to register price falls. This peaked in late 2018 when 80% of homes were in markets registering annual price falls. The coverage of price falls has since declined as the 3-year re-pricing process moves into the end phase.
- The same trend is spreading into Southern England. Over a third of homes are currently in markets with annual price falls, concentrated in higher value markets. There are limited signs this trend is reaching the Midlands.
- The coverage of falls may seem high, but the absolute level of price falls is low, akin to the froth coming off the market after a period of high house price growth as markets overshoot on the way up.
- We expect the re-pricing process in regional markets to be more short-lived than in London. Sales volumes have fallen back since 2014 but once values re-align, we expect sales volumes to increase.

London leads the market – up and down

One common adage for the UK housing market is that London leads the way when it comes to house prices and sales volumes. This is as true when the market is on the way up as it is on the way down. We consider the extent to which the recent trends in London have shifted into regional markets and the outlook.

Prices up 70% since 2010 but slowed since 2016

London house prices have increased by 70% between 2010 and 2018, much faster than incomes growth. The rate of growth slowed rapidly after 2016 as stretched income multiples, new mortgage regulations and a slew of tax changes reduced demand.

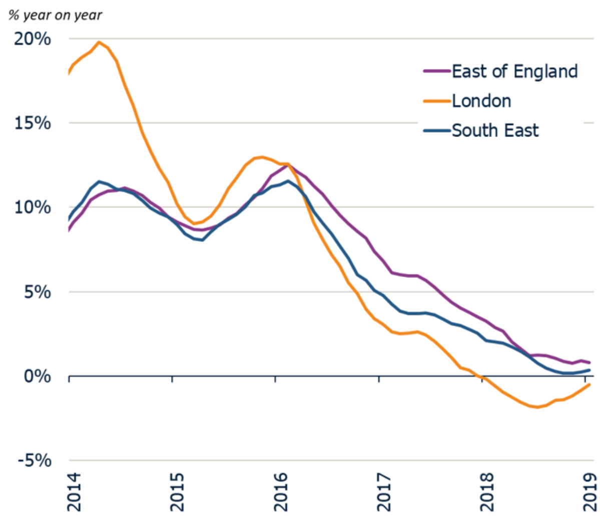
London sales peaked in 2014 and are now25% lower

Housing sales volumes have fallen back much further than prices. Transaction volumes peaked in 2014 at 118,500 and have since declined by 25% to 87,600. Yet the average price of a London property is still 20% higher than in 2014. Residential values peaked in mid-2017 and are currently 2.5% lower at a regional level.

Extent of price falls in London accelerated from 2016

When house price growth is negative at a regional level it means a significant portion of local markets will be experiencing negative growth. This analysis uses Hometrack's granular house price indices to look beyond regional averages to examine how the house price slowdown has unfolded.

Fig. 1 – Regional house price growth (%yoy)

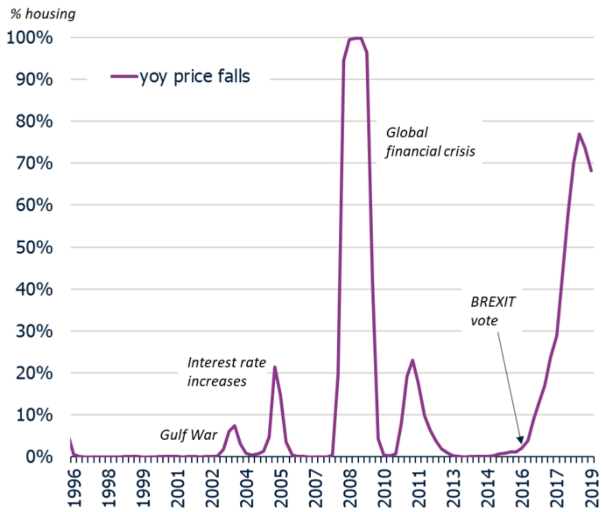


Source: Zoopla Research, Hometrack HPI

Figure 2 shows the proportion of London homes in local markets experiencing annual price falls from 1996. Since 2016, the coverage of housing in markets with price falls expanded rapidly, reaching a peak of almost 80% in October 2018.

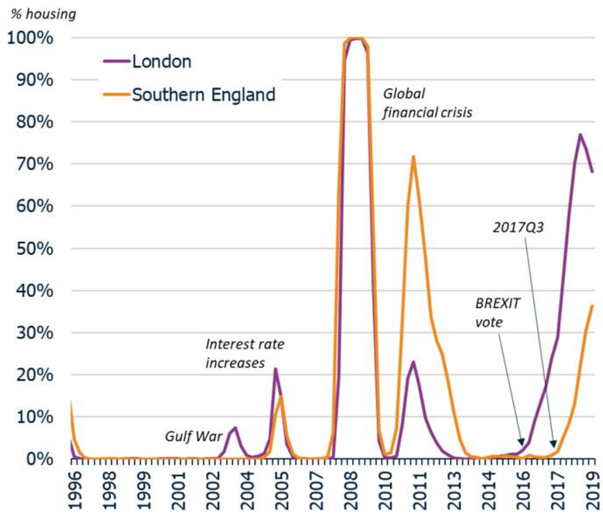
The coverage of price falls has started to decline over the last 6 months after a 3-year re-pricing process. In our view, house prices in London are well on the way to re-aligning to what buyers are prepared to pay, albeit in a market with significant reduced sales volumes which creates scarcity and supports pricing levels.

Fig. 2 – Coverage of annual price falls – London region



Source: Zoopla Research, Hometrack HPI

Fig. 3 – Price falls extending into southern regions



Source: Zoopla Research, Hometrack HPI

Rate of recent price falls is low at <5% yoy

It is important to highlight that today's price declines are small compared to 2009, when there were double digit price falls. The vast majority of markets in London are registering annual price falls of less than 5%.

The reality is that the reductions in residential values over the last 3 years are best described as a modest retrenchment in prices. This is to be expected after a strong growth phase as the market adjusts to weaker demand brought about by stretched affordability levels and a slew of tax changes between 2014 and 2017.

Prices overshoot after a strong growth phase

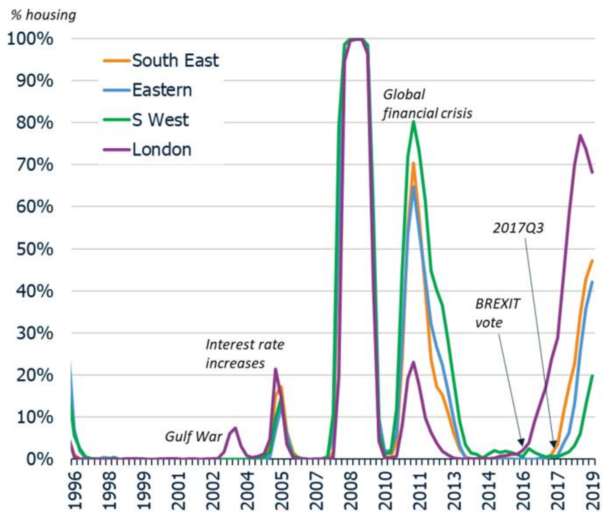
In financial markets prices tend to overshoot on the way up and it is no different for housing. The overshoot tends to be more pronounced in markets where supply is tight and there is a lack of available supply. This is certainly the case in London. This is compounded by the fact that, as a leading global city, demand for housing in London comes from a wide and diverse range of sources than the typical British city.

Southern regions following the London trend

Hometrack's localised house price indices show that housing markets in Southern England are now following the London trend. More than a third (36%) of homes are in markets with annual price declines (Fig 3). We define Southern England as the South East, East of England and the South West regions.

Figure 4 breaks out the constituent regions of Southern England. It shows that the South East and Eastern regions have the larger coverage of housing in markets with annual price falls. With negative growth in less than half of markets it is no surprise that the regional average growth rate, remains marginally positive, as shown in Figure 1.

Fig. 4 – Trends in price falls – southern regions



Source: Zoopla Research, Hometrack HPI

Southern markets weakened from 2017Q3

It took more than a year (5 quarters) for price falls in London to feed into Southern England as prices adjust to weaker demand and lower sales volumes. Annual price falls are low at <2.5% in the majority of cases.

Price falls concentrated in higher value areas

Profiling the areas registering price falls in Southern England reveals a correlation between negative growth over the last 12 months and areas with above average prices and in wealthier socio-demographics.

The lower value, more affordable markets in southern England have the higher average growth rates. House price growth has a clear divide around £325 per sq ft or c.£350,000 for a typical 3-bedroom semi. The higher the average price, the lower the rate of growth.

What next in London and southern England?

We expect both the coverage and level of price reductions in Southern England to remain modest, concentrated in higher value areas adjacent to London or in higher value commuter towns.

We expect price falls to be more short-lived than we have seen in London, most likely extending into early 2020. We are not predicting a subsequent bounce-back in average prices, but we would expect sales volumes, which have fallen by 10% in Southern England since 2015, to plateau and then start to increase over time. Sales volumes are more important to agents and developers than price growth.

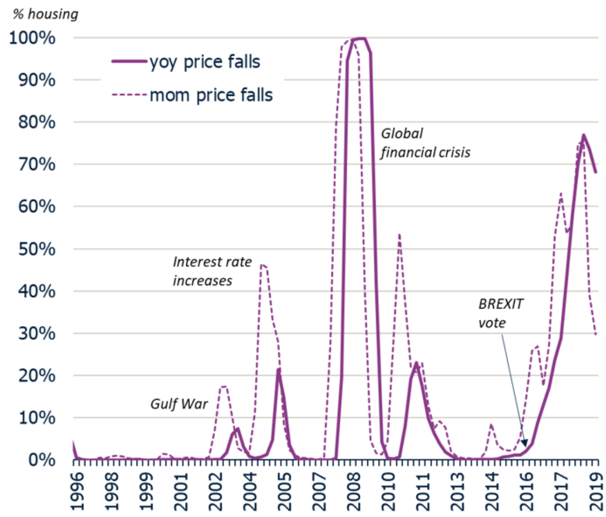
In London, which is further down the road to a pricing realignment between buyers and sellers, we currently expect sales volumes to plateau and slowly start to increase over the latter parts of 2019 and into 2020.

What does the latest price index data tell us?

This view is based on analysis of more recent trends in prices. Figures 5 and 6 compare the trends in the coverage of markets registering annual price falls year on year to those with month on month price falls. Month on month trends lead the annual price changes.

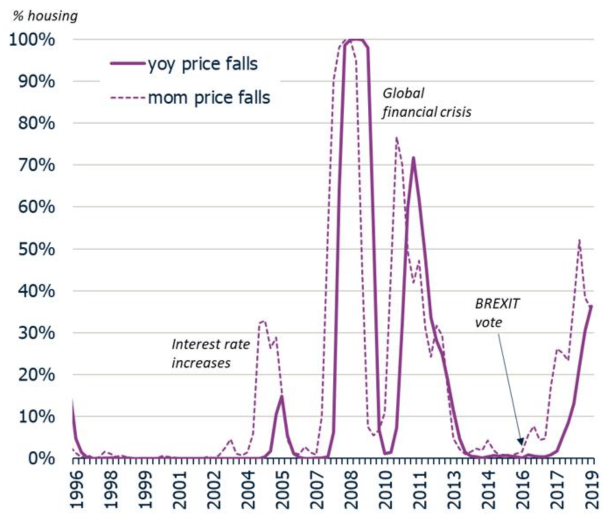
The reduction in the coverage of markets registering month on month price falls in London is marked with just 30% of markets registering monthly price falls. The same is true to a lesser extent in Southern England. This improvement in monthly price changes will in part be down to seasonal factors but we believe it presents a picture that the coverage of housing markets registering annual price falls will start to moderate – more so in London than Southern England.

Fig. 5 – London price falls coverage - yoy and mom



Source: Zoopla Research, Hometrack HPI

Fig. 6 – S. England price falls coverage - yoy and mom

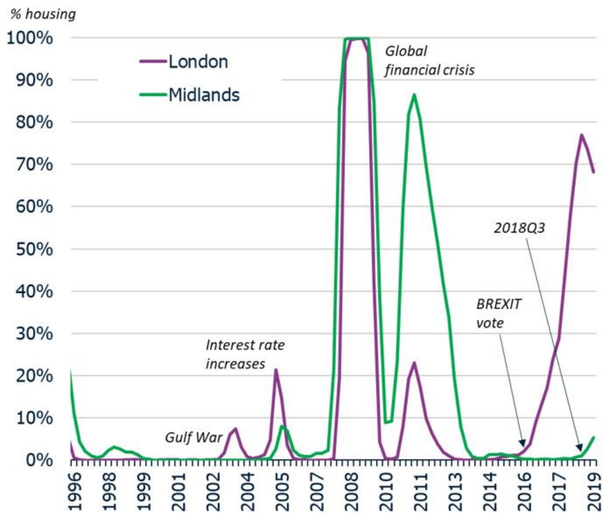


Source: Zoopla Research, Hometrack HPI

Are prices starting to fall further afield?

There is little evidence that the trends in London and Southern England are reaching further afield. Figure 7 shows the data for the Midlands where there has been a very small increase in markets registering annual price falls – again concentrated in higher value areas. We would expect any price falls to be modest in scope and size given that affordability levels are less of a constraint on housing demand.

Fig. 7 – Price falls - Midlands and London regions yoy



Source: Zoopla Research, Hometrack HPI

Unfolding of the UK housing cycle

This analysis has profiled the unfolding housing cycle through an analysis of markets registering price falls. Price falls are normally triggered by external economic factors. The current slowdown is a result of multiple tax changes, mortgage regulations limiting buying power combined with wider affordability pressures which have had the greatest impact in London.

Price falls are modest and there is a significant amount of equity in the housing market to absorb what are relatively small price falls. What is of greater importance to businesses operating in the market is the volume of sales and the willingness and ability of households to move.

Sales volumes have declined by 10% and 25% respectively in Southern England and London since 2015. In London, volumes have started to plateau and as the price between what sellers are prepared to accept and buyers are prepared to pay realigns so there is the prospect that sales volumes may start to increase later in 2019 and into 2020.

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