UK Cities House Price Index

October 2017

- UK city house price inflation increases to 6.1% with robust growth in regional cities.
- The house price to earnings (p/e) ratio in London is 14.5x. Three other cities have a ratio over 10x.
- There is further upside for house prices in large regional cities of up to 25% if affordability levels rise over the long run average. In London the p/e ratio is expected to drift lower.

Headline growth up to 6.1%

UK City house price inflation has increased to 6.1%, the highest rate of growth since September 2016 and above the UK average growth rate (4.7%). House price growth remains robust in regional cities where affordability levels remain attractive and unemployment continues to fall.

Manchester fastest growing city

Manchester (7.9%) and Birmingham (7.3%) are registering the fastest rate of growth. House prices in Aberdeen continue to fall (-3.1%) while the rate of growth across London continues to stabilise (3.0%) supported by tightening supply and lower turnover.

Table 1 - UK 20 city index summary, October 2017

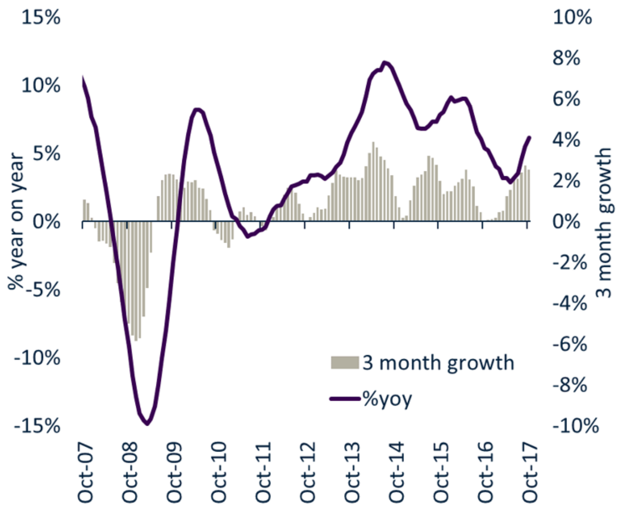
Month	3-month change	% year on year	Average price
May-17	1.6%	2.9%	£244,900
Jun-17	2.1%	3.2%	£246,600
Jul-17	2.1%	3.5%	£248,400
Aug-17	2.4%	4.5%	£250,800
Sep-17	2.7%	5.5%	£253,300
Oct-17	2.5%	6.1%	£254,700

Source: Hometrack House Price Indices

Price to earnings ratio in London reaches 14.5x

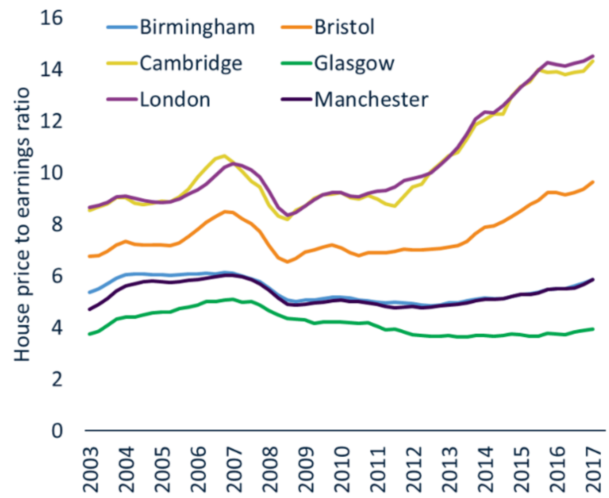
This month we have updated our annual analysis of housing affordability. This reveals the house price to earnings ratio in London has reached an all-time high of 14.5x (fig. 2). Oxford, Cambridge and Bournemouth also have double digit price to earnings ratios. Strong house price inflation in Bristol has pushed the ratio to 9.7x. These cities have affordability ratios that are 20% to 40% higher than the 15-year average (fig.3).

Fig. 1 – 20 City house price inflation (% yoy and 3m)



Source: Hometrack UK Cities Index

Fig. 2 – House price to earnings ratio – selected cities



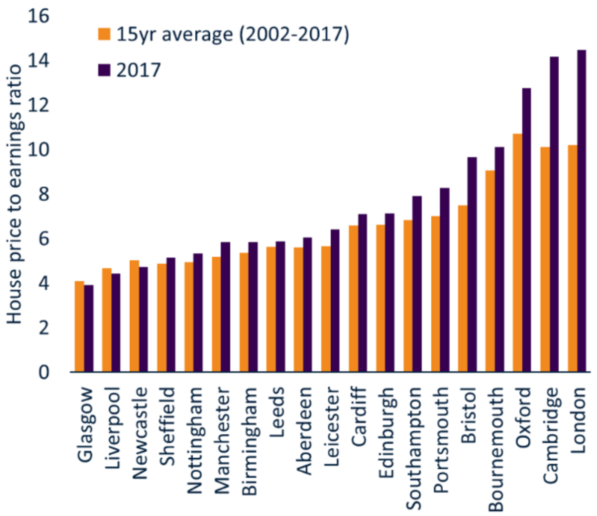
Source: Hometrack House Price Indices/ONS

Note: All price changes are quoted in nominal terms. Hometrack's House Price Indices are revisionary and not seasonally adjusted.

Three cities with ratio below long run average

Three cities have house price to earnings ratios below the 15-year average – Glasgow, Liverpool and Newcastle. These cities have registered well below average house price growth over the last decade, although house price growth has started to accelerate.

Fig. 3 – Price to earnings – current and long run



Source: Hometrack House Price Indices/ONS

Most cities have p/e ratios in line with long run

Most cities outside the south east of England have price to earnings ratios that are broadly in line with the long run, 15-year, average. Mortgage rates have fallen over this time, boosting the buying power of households. The strength of underlying economies influences the speed at which this buying power feeds into house prices. Our city indices have tracked this variation in growth with prices 60% higher than 2007 levels in London and Cambridge while prices in Glasgow and Liverpool are lower.

Upside for house prices in regional cities

Despite the recent increase in interest rates, we continue to believe that house prices in regional cities have further upside given the current position of housing affordability and the similarity of the current housing cycle to the last cycle. However, establishing a sustainable price to earnings benchmark at city level that is consistent with lower mortgage rates is complex. The London price to earnings ratio is 40% over its 15-year average, while it is 29% in Bristol.

Potential for 20-25% further house price growth?

Were cities such as Leeds, Manchester and Birmingham to see the price to earnings ratio reach 30% over the 15-year average, this would equate to a house price increase of 20% to 25%. We believe this is very feasible so long as mortgage rates remain low and the economy continues to grow. These increases are equivalent to 3 years of growth at current levels. Projections from the Office for Budget Responsibility for weaker growth in the economy and earnings mean the timing of these increases will simply be drawn out over a longer period.

Where next for the p/e ratio in London?

Conversely, house prices in London would need to fall by 6% in nominal terms to take the ratio to 30% over the 15-year average. For the ratio to reduce to 20% would require a 13% fall in prices.

While the London City index is registering price increases of 3%, this is being driven by outlying commuter areas. In central London prices are flat to falling in low single digits. The gap between asking and achieved prices is greatest in inner London at 8-10%.

House prices are in the process of adjusting to what buyers are willing or able to pay. Tax changes for investors and low yields have already reduced investor demand in London. Mortgaged first-time buyer numbers are also down 15% over the last 3 years. We expect Budget stamp duty changes to have limited impact in London as the greatest barrier remains the high level of income required to pass mortgage affordability stress tests.

Affordability ratio to drift lower

Greater realism amongst buyers and sellers will translate into sales prices being agreed at lower levels than might have been achieved in the recent past when market conditions were stronger. This will translate into single digit price inflation or small nominal price falls as prices re-adjust with the p/e ratio expected to drift lower as a result. One positive for London is that the strength of house price growth over recent years means there is a significant amount of equity in the London housing market that can absorb the impact of price falls.

Table 2 - City level summary, October 2017

City	Current price	%yoy Oct-17	%yoy Oct-16
Manchester	£158,800	7.9%	6.7%
Birmingham	£155,600	7.4%	6.2%
Leicester	£165,700	6.6%	6.1%
Bristol	£278,900	6.6%	9.7%
Leeds	£164,800	6.3%	4.7%
Portsmouth	£232,400	5.9%	7.8%
Liverpool	£117,700	5.8%	1.9%
Sheffield	£137,300	5.7%	4.1%
Bournemouth	£285,200	5.6%	5.9%
Glasgow	£120,200	5.3%	1.8%
Nottingham	£144,700	5.1%	5.4%
Edinburgh	£216,900	5.1%	3.4%
Cambridge	£443,300	4.2%	4.1%
Belfast	£129,900	4.1%	1.8%
Southampton	£222,500	3.5%	7.1%
London	£496,000	3.0%	7.7%
Newcastle	£125,200	3.0%	1.0%
Cardiff	£198,700	2.8%	6.0%
Oxford	£412,300	-0.6%	6.6%
Aberdeen	£169,700	-3.1%	-8.6%
20 city index	£254,700	6.1%	5.4%
UK	£213,300	4.7%	5.5%

Source: Hometrack House Price Indices