Has property run its course?

It is no surprise that Property investment has represented a ‘rose among thorns’ for many investors because of the healthy growth we have seen in the UK Property Market over the past five years. With more investors than ever before catching on to the buy to let property bug, can the gravy train ever come to an end? Well the answer, with some certainty, is yes, but when will it happen and how bad will it be?

The primary driver for the property market is investor sentiment, which quite predictably, is positive when property prices are rising and negative when property prices are falling. The physical signs of this trend are heavily delayed however because unlike liquid assets such as equities (that can be sold by the press of a button), property is an illiquid asset that cannot be sold until the right buyer is found, if the buyer is in a chain it could take some months for the transaction process to complete.

Because the sale price of a property is typically set at the start of the transaction process it is therefore generally accepted that the house price data published by lenders and by the Land Registry are typically three months out of date as the information relates to transactions that have just completed even though the transaction price will have been established some time previously.

It is for this reason that once a rising or falling trend is firmly established, it can take a long time for the market to turn again. Consequently we have seen an extended bull run on the property market that has been fuelled by positive sentiment and a continued appetite for ‘buy to let property’ whilst interest rates have been at a comparatively low level. The Bank of England’s Monetary Policy Committee (the MPC), has tried to quell the pace of the property market by raising interest rates in an endeavour to make property investment less attractive but in doing so the MPC is not just discouraging investors, it is also damaging first time buyers who have already struggled to amass enough money to get a foothold on the property ladder and any correction will leave the most vulnerable of homeowners in negative equity with unaffordable interest rates. The predictable repossession cycle will naturally follow and it is at this point when a considerable property correction is most likely to occur as repossessed, deep discounted properties are put back on the market.

When apportioning blame it is easy to cast an eye in the direction of financial institutions for aggressively marketing sub-prime mortgage packages that are generally offered at a premium rate to those who can least afford high repayments. In many cases these mortgage contracts are packaged up into bond deals that are sold on to institutional investors, thus mitigating any long term risk to the mortgage packager and arguably encouraging them to be more flexible with lending criteria. A simple search on Google will generate over two million webpages from the United Kingdom alone, many of which are from websites offering 100% mortgage packages to potential borrowers. It is this sector of the housing market that is most susceptible to even a minor property correction because of the minimal amount of equity they have in their homes coupled with the fragility of their personal finances.

Whilst most borrowers will reluctantly accept that it is necessary to control inflation rates by adjusting base lending rates it is equally important for the MPC to be wary that the interest rate decisions they are making are in part based on data that is at least three months old and that if rates remain too high for too long we will rapidly move from a position of a market cooling to a property crash. It is equally important for them to consider the fact that there is no need for MPC intervention to discourage property investors. We are already approaching the end of a cycle and the appetite for buy to let property will recede in line with the disparity between the cost of borrowing and achievable rental yields.

For first time buyers and 100% mortgagees, continued interest rate rises will spell doom for their finances for a decade to come and will have an enormous impact upon the housing market similar to crashes we saw in the early sixties, again in the early seventies and most recently in the early nineties.

Whilst it has been some time since we have been the recipients of one of Gordon Brown’s sermons on prudence, let us all hope that the Bank of England will take heed from the more than apparent warning signs across the Atlantic, that the property market is at a pivotal point and if not managed extremely carefully it is likely to go over a precipice.