UK house prices could fall by 30%. Such a comment will bring with it worries that we could see a repeat of 2008!

Many UK Property market analysts have recently predicted that house prices could fall as much as 30%. My comment on this would be that a move lower is to be expected, given that prices have jumped 28% since April 2019. The sharp spike in property values have led to valuations which are very often unrealistic, so the recent forecast of a UK property market downturn may not be out of sync, especially against the current backdrop.

For now, the outlook for UK house prices is negative. This is a market which is likely to see a correction and the downtrend will be amplified because the cost of borrowing has risen amid interest rate increases. There's also the perception that this could cause another financial crisis.

The above was to be expected as I certainly couldn't see any way that UK house prices can repeat their outperformance of the past two years.

Data from the Office for National Statistics show that since April 2020 the average house price has jumped 28%, although this does need to be put into context. If prices fall 20%, they'll be back around the £235,000 region, this then would be roughly where they were before the pandemic and the Bank of England's (BoE) zero interest rate regime, a valuation of £235,000 is more in line with true market reality.

History underlines the fact that falling house prices in certain market conditions is normal!

History has shown that UK house prices are just as dependent on interest rates as they are on other factors (such as supply and demand). If rates are low, people can borrow a lot more for less, and they're happy to fork out more for the same home. But if rates rise, and the cost of borrowing jumps, borrowing power declines and people have to settle with less.

The BoE base rate has jumped from 0.1% to 4% in January 2023, and this of course has had an impact on home buyers, it has had a very negative effect on the purchasing power of the average family. As a rough comparison, the last time the base rate was this high (2008) at that time the average UK house price was £170,000.

So if UK house prices fall 30%, will it cause a repeat of the 2008 financial crisis?

Armed with 30 years of experience in this market, I would confidently say that I do not see a UK house price correction of 30% causing a repeat of 2008. In fact, based on the current data even if house prices fall 30%, it's unlikely to drive lenders to the brink. According to the Office of National Statistics, at the end of 2020, there were 8.8 million homes owned outright and 6.8 million with a mortgage in place. The simple fact being then, today mortgagees are now in the minority.

It's also important to note that Lloyds Bank, the UK Markets largest mortgage lenders, has reported an average loan-to-value (LTV) ratio on its mortgage portfolio of around 40%. That leaves the primary lender with the necessary equity-to-debt ratio to sustain a downturn.

House prices will almost certainly be negatively impacted by higher mortgage rates.

This year there will be many people rolling over their two-year fixed-interest contracts, many were secured during mid to late 2020 a period when the housing market surged, and many buyers smartly locked in cheap credit. The best two-year deals on the market today for those with a 60% LTV ratio are in the range of 4.80%.

I would underline that this is far higher than many thousands of borrowers are currently paying. A homeowner with a mortgage of £400,000 will have to pay £2,300 a month at 4.8% compared to £1,500 at 1%. As always, some people won't be able to afford this increase. That said, the last thing banks want to do is repossess thousands of houses, which can be costly.

The knock-on effects from falling house prices.

The UK housing market accounts for nearly seven Trillion of the nation's capital or put another way 38% of the country's overall wealth. A slowdown in the property market will of course harm the overall economy. This may put further pressure on commercial property prices which had also suffered due to supply bottle necks, one example being during 2021/2 when the cost of timber almost doubled.

On a positive note, both office and commercial leasing in Aberdeen Scotland is on the rise.

The fact is that repossessions are inevitable, and as always lenders will approach investment specialists to offload any repossessed properties, these assets are then often sold at a significant discount to their market value. RIO has previously been able to acquire repossessed commercial and residential UK property assets at a 40-45% discount to market value (we have already been approached and stand ready).

There's also been good news from the rental market.

Take-up for the Aberdeen market totaled 385,000 sq ft spread across 56 completed lettings in 2022. This represented a 95% improvement in 2021 and it's perhaps even clearer when I stipulate that the total deal count had increased nearly 25% on the five-year average for the Aberdeen market.

The largest Grade A letting was the 100,000 sq ft acquisition by Shell at the Silver Fin building, which was the largest deal in Aberdeen since 2020.

Supply shortages are another plus.

Total supply decreased by 10% in 2022 the total stood at 2.5 million sq ft by year-end. The Grade A supply level for the market decreased by 53% during the same period.

The return on capital.

The Aberdeen market has seen no change in the prime rent in 2022, which currently stands at £32.50 per sq ft. But between 2016 and 2022, prime rent has grown by 3.2%.

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