



8 January 2009

Base rate cut is no longer an effective economic tool

Today's decision to reduce the base rate by 0.5% to an all time low of 1.5% was widely anticipated but base rate cuts alone are no longer an effective economic tool.

The direct impact of base rate cuts felt by borrowers is limited by lenders' collared tracker products and their unwillingness to pass on the lower rates in SVRs. This is seen particularly from lenders that are not government funded. However, today's fall does offer a degree of reassurance and stability.

Neil Young, CEO of property portfolio managers, Young Group, believes that with rates so low, and with little scope to fall further, lenders now have more certainty; *"with rates reaching a new low, there is a limit as to how much further they can fall. This enables lenders to increase the confidence of their forecasts when planning product for the year ahead and should lead to an increase in their willingness to lend."*

"This first MPC decision of 2009 is akin to the Bank of England giving its opening team talk of the season. Base rate is unlikely to fall much further, lenders know what's expected of them and the onus is now on them to go out there and perform." Neil Young, CEO - Young Group

In the current climate, base rate setting is no longer the economic tool that it once was and is becoming less effective the lower rates fall. Building societies are facing increasing difficulties; balancing being able to offer competitive rates to retain their savers with offering their mortgage lending to their borrower; yet another reason why rates are not being passed on to borrowers. Base rate cuts alone are not the solution.

Borrowers are increasingly savvy regarding the impact of base rate cuts and their focus is on availability of lending rather than base rate. The latest Young Index poll (Q4 2008) has identified that only 12% of respondents expressed a desire for a lower base rate, whereas 28% put the need for wider mortgage choice at the top of their wish list.

Young Index: Summary Results for Q4 2008

- 96% of investors intend to hold their residential property investments for the next 12 months. 37% intend to hold their assets for at least 10 years and more than 20% of buy-to-let investors aim to keep their property investments for the next 15 years or more.

- 33% intend to buy additional residential property investments within London within the next 12 months, whereas just 8% of investors intend to buy UK residential property outside of the capital.
 - The outlook for London property prices is 3 times higher than for the rest of the UK. 36% of investors believe that London prices will be at current levels or higher by this time next year, whereas just 10% expect the same to be true of UK property outside London.
 - Investors are focusing on mortgage finance; 50% now review their mortgage every 3-6 months and almost 1 in 4 are reviewing their finance options more than once a quarter.
 - 69% of respondents expect the Bank of England base rate to be at or below the current level of 2.0% at the end of 2009, and most predict it to stand at 1.0% at that time.
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Mortgage Choice the Key to House Price Stability

Rather than base rate cuts, wider mortgage choice and house price stability are seen as vital to getting the property market moving again. Young Index Q4 2008 shows that there is pent up demand for property purchases, but buyers are put off by the mortgage product available. These same potential buyers believe that base rate cuts are not the answer to unlocking the market.

No Evidence of Buy-to-Let Exodus

The Young Index results for Q4 2008 show no evidence of an exodus from buy-to-let. Indeed, 96% of investors indicated that they intend to hold investment property over the next 12 months. The survey shows that the majority of buy-to-let investors are looking to the medium to long-term. More than 1/3 of respondents intend to hold their property investments for at least the next 10 years and more than 20% expect to retain their portfolios for 15 years or more.

This should come as no surprise. By far the most common reason for people holding property investments is to provide for their future. Their long term aim is to build wealth to boost their pension provision. Neil Young points out; *"To a certain extent, short term market fluctuations aren't a concern to most investors as long as their property is financed appropriately and paying for itself in the short term."*

Buy-to-Let Yields Up

Investors who keep a watchful eye on the performance of their investments will have been buoyed by the Government's two rate cuts, totaling 2%. The 3 million people currently on tracker mortgages will have seen an immediate positive impact on their monthly income/expenditure schedule and an increase in their investments' yields as mortgage costs have been cut by approximately 40%.

Property Price Outlook

This quarter's Young Index shows a slight decrease in positive sentiment towards house prices across the UK as a whole, but most noticeably in areas outside of London. Young Group's quarterly market survey of buy-to-let investor sentiment indicates that 36% of investors believe that property prices in the capital will remain at current levels or above by this time next year showing a level of

confidence more than 3 times greater than for property outside of the capital (where just 11% believe the same to be true).

Confidence in the capital's property market remains around four times higher than the rest of the UK, with 33% of investors indicating that they intend to buy additional buy-to-let investments within London during the next 12 months.

Neil Young, CEO of Young Group attributes this to the inherent gap between supply and demand that exists in London; the capital has the advantage of strong demand for housing from a population that is expected to swell from 7.2 million to more than 8 million by 2020 and is also the city most affected by changes to the country's demographics. As a nation we're living longer, marrying later and more likely to live alone than ever before. This growing demand for housing is against a backdrop of falling construction levels. Despite the government's commitment to helping the industry deliver two million new homes by 2016, the credit crunch has limited the amount of bank finance available to developers to fund new housing projects. According to the Royal Institution of Chartered Surveyors (RICS), only 66,200 homes were built across the UK in 2008 and this quarter fewer than 25,000 properties are expected to be delivered.

The effect of supply and demand varies locally and in London property prices are cushioned from the downward pressure that is seen in many regional cities. This regional disparity is reflected anecdotally by professionals operating in the market. Neil Young, points out; *"Dealing with property and land agents, mortgage lenders and the major banks on a daily basis, it is clear that London stands apart from the rest of the UK and almost without exception, the sector is focusing on the capital."*

"The demise of Inside Track and Grant Bovey's Imagine Homes being handed to HBOS does send negative messages. But their business models did not focus significantly on the London market and their exposure in regional locations where there became an over supply of property driving down prices was not insignificant. At a time when property valuations at completion are vital to purchasers being able to secure funding to complete their transaction, the businesses proved unsustainable."

This does not mean that buy-to-let is dead. *"Investing in property to rent out is probably the world's second oldest profession. As long as investors approach property investment with the same analytical and practical mindset as they would any other asset class, there are good long term gains to be made,"* believes Young Group's Neil Young.