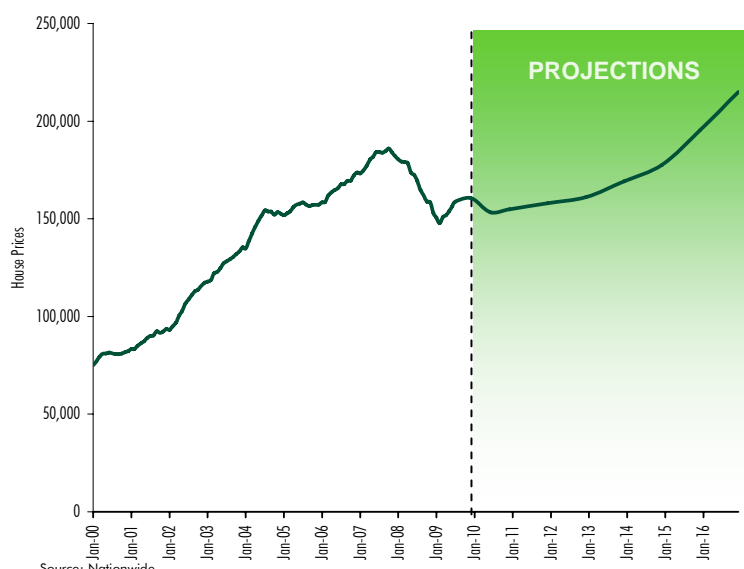


House Price Projections: Credit remains Key

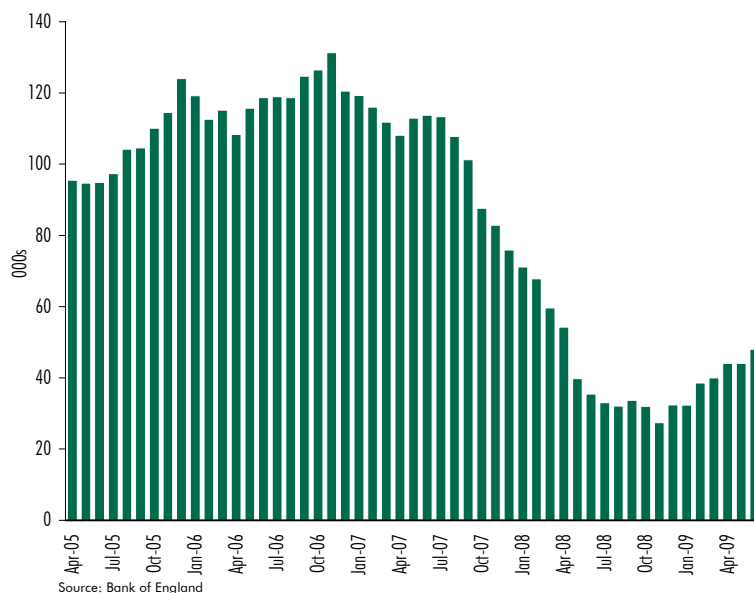
OVERVIEW

- Recent rises in house prices do not signal the beginning of a prolonged period of recovery. While the worst of the falls in house price are over, volatility continues to play a dominant role in the fragile housing market.
- A recovery is unlikely to be sustained in light of the current credit constraints and high level of unemployment. With no "quick fix" solution to these problems, we expect a slow and protracted period of recovery.
- By the end of 2010, house price are likely to be broadly similar, or marginally lower, than today's levels; a sustained and prolonged period of house price growth is unlikely until the beginning of 2012. We expect prices to return to 2007 levels by 2015.

UK House Prices



Mortgage Approvals



CONFIDENCE IN THE HOUSING MARKET HAS IMPROVED

There has been more encouraging news for the housing market this month. The RICS reported improved confidence in the housing market with further increases in new buyer enquiries. It also showed a positive net balance of surveyors expecting house price rises over the next three months. The HBF found a similar trend with house builders reporting a net increase in reservations in four out of the last five months.

This is reflected in house prices. Nationwide reported its fourth consecutive monthly increase in house prices, which now stand at £160,224. The annual decline in prices has fallen from 16.6% at the start of the year to now only 2.7%.

A SUSTAINABLE RECOVERY IS UNLIKELY TO START FOR SOME TIME

However, we do not think recent monthly house price rises signifies the start of a sustained upturn. Rather, as we discussed in last month's report, it reflects the current demand and supply imbalances in the market. Although we have probably passed the worst of the downturn, the recovery will be long, drawn out and faltering in its initial stages. The keys to a sustained recovery is the easing of current credit constraints and a pick-up in mortgage lending.

RECAPITALISING IS BEGINNING TO HAPPEN, BUT IT WILL BE A SLOW PROCESS

The tightness in the credit market limits the number of people with access to the housing market; this effectively restricts housing demand. Although we neither want, nor expect, a return to the heady lending levels of 2006, lending is currently well below trend. While banks are recapitalising, they remain reluctant to lend. This is reflected in first-time buyer loan-to-value ratios, which have fallen to 75% from 87% last year.

HSBC and Barclays recently announced encouraging headline results. However, the profits achieved have largely been driven by the investment side of the businesses and do not reflect the still high, and increasing, levels of bad debt in the retail and commercial sectors. These problems are likely to persist well into 2010.

The recent Treasury White Paper, 'Reforming Financial Markets' announced the FSA will place higher capital requirements on those banks that present greater risks to the financial system. As a result many banks are looking to significantly reduce their loan to deposit ratios. For example, RBS recently announced that it going to reduce its loan to deposit ratio (which currently stands at 156%) to parity by 2013.

Therefore, the easing in the credit markets is likely to be a relatively long and drawn out process, which has direct implications for the housing market.

RISING UNEMPLOYMENT WILL ALSO HAMPER THE RECOVERY

In the medium-term, continued unemployment will curb the housing market recovery. CB Richard Ellis forecast the unemployment rate will reach 10% by 2013. Those who face uncertain employment prospects are likely to put off any purchasing decisions; thus muting housing market activity.

In addition, redundancy effects home owners ability to service mortgage payments, which would increase repossessions. However, repossessions have remained lower than expected. This partly reflects lower interest rates, which has reduced mortgage payments for those on tracker and variable mortgages. Prior to the rate cuts mortgage costs were around 38% of the average post-tax labour income; it is now nearer 28%. This reduces the financial pressure on homeowners making repossessions less likely. In addition, lenders and borrowers are currently communicating and renegotiating payment plans. But, banks' leniency will need to be sustained for some time to come.

FUTURE PROSPECTS

Although house prices are likely to end 2009 marginally higher than the start, we may well see further falls next year. Our analysis suggests that by the end of 2010 house prices will be between 0 and 5% below the current levels. We do not expect house prices to return to a prolonged period of sustained house price growth until the beginning of 2012. As a result house prices will not return to 2007 levels until the middle of 2015.

B of E Base Rate Vs. Average 2 Year Fixed mortgage rate (75% LTV)



Source: Bank of England

HOUSE PRICE INDICES				
	M-on-M	Q-on-Q	Y-on-Y	Level
Nationwide (Jun)	0.9%	1.1%	-9.3%	£156,442
Halifax (Jun)	-0.5%	-2.7%	-12.5%	£157,713
Land Registry (May)	-0.2%		-15.9%	£152,497
Hometrack (Jul)	-0.3%		-10.1%	
CLG (May)			-12.5%	£188,991
Rightmove (Jun)	-0.4%		-5.5%	£226,436
Derivatives (Dec 09)	3.1%	7.6%	3.9%	£156,853

ECONOMIC INDICES				
	M-on-M	Q-on-Q	Y-on-Y	Rate
GDP (Q1)		-2.4%	-4.9%	
CPI (Jun)	0.3%		1.8%	
RPI (Jun)	0.3%		-1.6%	
Unemployment				7.6%

ACTIVITY INDICATORS				
	M-on-M	Q-on-Q	Y-on-Y	Level
Mortgage Approvals (Jul)	5.3%		52%	50,100
Gross Mortgage Lending (Jul)	26%		-36%	16,000
Housing Completions (Q1)		-22%	-27%	21,900
Housing Starts (Q1)		-9%	-52%	13,700

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