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House prices: How low can they go?

If you thought that house prices had hit rock bottom, you were wrong. The bad times are about to get worse, say the experts, who predict a drop in property values of more than 30 per cent. When will the misery end? Ross Clark seeks a distant glimmer of light in the gloom.

By Ross Clark

27 Nov 2008

Hedgerow Cottage, Barrington Ilminster, Somerset. Three-year-old thatched house with four bedrooms and garden. Was: £475,000 Now: £395,000 Greenslade Taylor Hunt (01460 57222)

As with many properties on the market this year, the sale of Hedgerow Cottage at Barrington, Somerset, has turned into an agonising Dutch auction. In the summer of last year, the four-bedroom detached house was on the market at just over £500,000.

That was always over-ambitious, says Andrew Perry of Greenslade Taylor & Hunt (01460 57222), who took on the property in April at what he regarded as a more realistic price of £475,000. Nevertheless, he never imagined that he would still be trying to sell the property in November, now with its price slashed to £395,000 – exactly the same price for which it sold for new in March 2005.

"It is typical of properties around here this year," says Perry. "We are terribly reliant on people coming down from London and the South East to buy these houses, and the confidence just isn't there. We have taken the price down in stages. In May we reduced it to £460,000 and then to £435,000 in June. Then, we had a sale agreed at £420,000, but it fell through. Since June, it has been reduced to £405,000 and now to £395,000.

"We are still selling properties, but nothing like as many as last year. And now the market seems to have gone into an early Christmas. I think it is going to be late next year before it turns round."

It is a similar tale all over the country. Charles Peerless, of Winkworth, has been trying to sell a two-bedroom flat in Bristol House, on Southampton Row in Bloomsbury, central London, since April – during which time the price has been reduced three times. Starting at £925,000, it came down to £875,000 in June and £795,000 now. And this, he says, is usually one of the easiest blocks to sell. "The market will bottom out when confidence comes back – and that might possibly be in the spring."

No matter how gloomy the economic news, there is – usually – one certainty in the property market: you can cheer yourself up by ringing an estate agent. Yes, prices may have "come off" a little, they will tell you, but don't worry, it won't be too long before your house is making you money again and the doomsters will be confounded.

So what to make of it, then, when even estate agents say they are expecting house prices to plummet next year? Last week, Savills forecast that the average UK home will be worth 11 per cent less by the end of 2009 than it is now. Compounded with a 16 per cent fall in 2008, this would mean that house prices had lost a quarter of their value in two years, wiping an astonishing £1 trillion from the wealth of British home-owners.

Alistair Darling's temporary 2.5 per cent cut in VAT isn't going to make up for that. It is as if the nation has collectively put its life savings on the favourite in the 3.20 at Market Rasen only to watch it stumble at the last.

But given that this time last year – after the run on Northern Rock – Savills predicted prices would rise by 3 per cent in 2008, it is worth asking, even now, whether the estate agency is being a tad optimistic.

One who thinks so is Jonathan Davis, chartered financial planner with Armstrong Davis and spokesman for the website www.housepricecrash.co.uk, where those who stayed out of the property boom go to gloat. A few months ago, commentators on the housing market were lining up to pour scorn on his dire predictions. Kirstie Allsopp even called his website "sick". Now, Davis admits he has been wrong about the housing market – but only in as much as it is in a worse state than he had thought.

"In April 2007 I said I thought prices would fall by 25 per cent from peak to trough," he says. "By October 2007, I increased that to 35 per cent. Now, I think prices will fall by 40 to 50 per cent, and the market will not reach a bottom until 2011."

Davis has come up with a new theory on property prices. "Historically, London property has tended to be advantageously priced when the average home is worth 300 ounces in gold," he says. "That has been true for decades. Take the early 1990s crash, for example. In 1993, when the market in London reached the bottom, gold was worth about £225 an ounce. Three hundred times that is £67,500, which is about the same as the average London property at the time. At the moment, gold is around £575 an ounce. Three hundred times that is £172,500."

By contrast, the average London property in October, according to the Land Registry, was £328,927 – suggesting that, according to this theory, prices have a long way to fall, unless, of course, the gold price rises. So should we all be waiting for the moment that the average London house price is aligned with 300 ounces of gold, and then pile in? It isn't that easy, he says, as gold prices tend to work on a 20-year cycle and property on an 18- to 20-year cycle. In any case, Davis believes, it might be worth hanging on to your gold. "In spite of the falls this autumn, the gold price is on a long-term bull run, which started in 2000."

Even among the so-called "pessimists" – from the point of view of frustrated first-time buyers they were, of course, optimists – none guessed that the Halifax house-price index would have fallen 15 per cent in just 12 months from its peak in October 2007. But there were plenty of clues that homes were horribly over-valued and were due for a severe correction. A graph produced by the Nationwide illustrates the long-term trend in "real" house prices – that is, adjusted for inflation. This shows a repeated series of booms, where real house prices have ventured above the gently rising long-term trend in prices, and busts, when prices have dipped below the trend. House prices last crossed the line in 2002, and in spite of the marked fall in the past 12 months, remain well above trend – suggesting the correction is far from over.

Anyone who argues that the lowest interest rates for over 50 years will make things different this time round misses an important point: house prices are governed not only by interest rates, but by the availability of credit. With the banks in desperate need of cash and the international credit markets – source of so much cheap lending over the past decade – still severely restricted, there will be a freeze on credit even if base rates go to zero. The only people who are really benefiting from low interest rates are the lucky few who took out Bank of England base rate tracker mortgages over the past couple of years.

There is also the matter of negative sentiment. Who wants to buy a house at any price, knowing that it is likely to be worth less in six months' time? The panic-buying that helped drive prices up as people worried they would miss their opportunity to buy has been utterly reversed. As Davis points out, the negative sentiment will only be corrected when once again it becomes cheaper to buy than to rent – and that is some time off, especially so since the latest survey by the Royal Institution of Chartered Surveyors confirms that rents are now falling across the country.

Another figure in the housing market whom one ignores at one's peril is Fred Harrison, a former investigative journalist who set up his own think-tank, the Land Reform Trust. His prescience has been impressive. Soon after Gordon Brown became Chancellor in 1997, he warned: "By 2007 Britain and most of the other industrially advanced economies will be in the throes of frenzied activity in the land market to equal what happened in 1988/89. Land prices will be near their 18-year peak, driven by an exponential growth rate, on the verge of the collapse that will presage the global depression of 2010." He repeated the forecast in his 2005 book, *Boom Bust: House Prices*, *B*anking and the Depression of 2010, which predicted that the collapse in house prices would be followed by a slump. So what does he see in his crystal ball?

"It is going to be two to three years before we reach any sort of bottom, and even then in most regions prices won't recover for at least a decade. In 2005 I predicted that house prices would fall by 20 per cent from top to bottom. Last year I revised that to 30 per cent. Now, it is clear they are going to fall further than that. Nothing is going to improve until our vast household debt has been eliminated."

The housing market, he believes, is governed by an 18-year cycle and bust – which can be traced back to the 18th century using data gathered from such things as brick sales. The last peaks of the housing market occurred in 1989 and 2007, so by Harrison's reckoning we are due for the next boom to reach its apogee in 2025.

No one is quite sure when it will be safe to buy property again – but at least we all know when we should next sell.

Property market by area

The latest quarterly house price survey suggests that nowhere has escaped the slump in prices. London prices, which had been slower to turn than elsewhere, are now falling faster than anywhere in the country with the exception of Wales – where deflation in house prices has hit 16.5 per cent. The least cold spot is West Midlands, though that is of little consolation to anyone who bought in 2007: prices there have still managed to fall by 9.5 per cent over the year.

Predictions that the prime London property market would remain aloof from the slump have proved wide of the mark: a separate survey by Savills estate agent suggests that prime London property prices will end the year 18 to 20 per cent down on their level at the end of 2007. Knight Frank's prime property index shows prices down 13.4 per cent over the 12 months to October, with a huge 3.9 per cent plunge in October itself.

London -16.5%

South East -12.2 %

East -13.3%

South West -12.9%

East Midlands -13.1%

West Midlands -9.5%

Yorkshire & Humberside -14.2%

North West -10.5%

North -9.3%

Wales -16.6%

Scotland -6%