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GOVERNMENT

Bank of England raises base rate, causing concern for luxury real estate owners

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With the rising base rate, luxury real estate owners will be paying higher mortgages. Image credit: Knight Frank

By DANNY PARISI

The Bank of England has raised the United Kingdom's base interest rate for the first time in a decade, in an effort to combat spiraling inflation in the country in the wake of the Brexit vote.

Over the last year, costs of living in the U.K. as well as the prices of goods manufactured in the U.K. have been growing at an alarming rate. The increased base rate was voted on by the Bank's monetary policy committee to keep inflation rates in check, raising concerns about the future of the U.K.'s economy.

"The question is, does this rate rise signal the start of a series of future base rate increases?" said Simon Gammon, managing partner at Knight Frank Finance, London. "While it could be actioned over a long period of time, is the country finally starting to move toward a normalization of the base rate away from ultra-low levels?

"Labor and swap rates, the money market rates which determine fixed-rate pricing, had risen in anticipation of the rate rise, and this may continue if further rises are anticipated," he said.

Higher base rate

While Brexit has undoubtedly had a huge effect on both the economic and psychological state of the U.K., the Bank of England's base rate increase will also send ripples throughout the country.

Most notably, the increase in interest rates will most notably be felt by property owners and the British real estate industry.

While interests are only going up from 0.5 percent to 1 percent, that small difference can add up to a lot, particularly on luxury real estate with mortgages in the hundreds of thousands of pounds.

For example, a mortgage of 500,000 pounds would be paying an extra 100 pounds every month under the new increase.

Mortgages will go up for luxury real estate owners. Image credit: Euromonitor

"As mortgage lenders adjust to this new landscape, home loan deals are likely be launched and withdrawn at a rapid pace," Knight Frank's Mr. Gammon said. "In a rising rate environment we can expect the mortgage market to become more volatile for a while.

"Mortgage lenders, keen to meet their lending targets, will continue to play with rates to ensure they are in the best-buy tables, resulting in some jostling' in the market," he said. "When rates are being launched and withdrawn so quickly, borrowers will want to make sure they have access to the most up-to-date information to enhance their opportunity of getting the best deals."

Brexit concerns

While Brexit negotiations still remain at a standstill, the possibility of a future "Light Brexit" is revealing to have a significantly positive impact on British affluent.

According to a report from Euromonitor, those with a disposable income of $75,000 or more will benefit from the healthy economy that a softer Brexit would create. However, the most severe "No-Deal" Brexit could open up the potential for a significant increase in poverty (see story).

"An increase in the base rate is often viewed with trepidation by the property industry, but this long expected move is unlikely to have a negative impact," said James Roberts, chief economist at Knight Frank, London. "I expect the Bank of England will follow the same strategy as the U.S. Fed, and gently apply the brakes while giving lots of advance warning, in order to balance the competing pressures of normalizing rates while not derailing growth.

"Consequently, I see a gradual rise ahead, partly to stockpile some future rate cuts should the MPC need to combat another downturn at a later date," he said. "Also, the Bank of England is showing some younger homeowners that rates do actually rise, given how long it has been since the country saw an increase - the last U.K. rate hike in 2007 came a few days after the first iPhones went on sale."

The overall U.K. market has stabilized in recent months, showing a comeback after the initial shock of the Brexit announcement.

The U.K. real estate market is improving. Image credit: Knight Frank

After a three-quarter-long price drop in the U.K., the market is stabilizing and experiencing a comeback with increasing prices during the first quarter of 2017, according to Knight Frank.

Knight Frank's Prime Country House Index Q1 2017 is showing a 0.6 percent increase in prices within the first quarter, after three consecutive quarters of decline. However, while the market is very active, there is a persistent shortage of stock (see story).

"For commercial property, it should be remembered that debt has played far less of a role in the market in recent years than was the case prior to the financial crisis," Knight Frank's Mr. Roberts said. "Commercial property yields are not strongly correlated to interest rates, so I do not see a small rate increase having much of an impact.

"Indeed, in some markets the re-emergence of rental growth, such as for offices in districts popular with technology firms, should keep investors active," he said.