Regional residential report
Post-Brexit

Residential market and economic overview

Strong market fundamentals remain, despite recent political events. Although some developers and builders appear to be taking a 'wait and see' attitude, others are progressing as usual. Forecast growth remains unchanged and current house price growth of 5.1% across the UK is encouraging.

Economic backdrop

On the whole, the tenets of the UK economy remain enduring and stable, despite recent turbulence in the markets. Latest GDP figures show the economy grew by 0.4% in the first three months of the year and, although sluggish, consensus forecasts predict 1.8% GDP growth by the end of 2016, similar to 2015 which finished the year with 1.9% GDP. Despite this, some downside risks to the overall economy remain. Recent events this year such as stamp duty changes introduced from 1st April, and the referendum vote to leave the EU, together with a continuing decline in housing affordability and a slump in consumer confidence which had been evident since April may weigh negatively on economic growth, even if evidence is only anecdotal at this point.

Following the 'leave' majority vote in the recent EU referendum, there has been some turmoil in the stock markets and currency markets. The markets were initially displaying volatility, although by early July this had stabilised somewhat. Nevertheless, both The Bank of England's Monetary Policy Committee (MPC) and Fiscal Policy Committee (FPC) have been strong forces of support, and are using various measures at their disposal in order to calm market fears, stabilise the economy and ensure that capital and liquidity buffers are used as needed, and inflation remains anchored.

Despite some short-term turmoil following the referendum, the UK still has otherwise very stable economic foundations. While the recovery in 2013 was largely driven by consumer spending, there are now encouraging signs of growth becoming more broad-based and coming from multiple sectors. Furthermore, London and the UK are still robust investment regions with a strong and established legal structure, favourable time zone, world-class education system, and a durable, settled, democratic political structure. Additionally, the labour market provides further signs of the UK's economic strength. The employment rate now sits at 74.2%, up from 73.4% one year earlier, with 461,000 more people in employment over the period. Subsequently, unemployment is now down to 5.0%, the lowest rate for over 11 years. Wage growth across the country has also continued into Q2, although growth is decelerating.

Inflation edged up slightly in June, to 0.5% from 0.3% in May, largely on the back of higher oil prices. The recent sharp depreciation of sterling since the referendum is likely to result in the acceleration of inflation through the remainder of the year, with consensus forecasts indicating that CPI could reach 1% by the end of the year, and Oxford Economics expecting it will breach the 2% target early into 2017.

Residential market overview

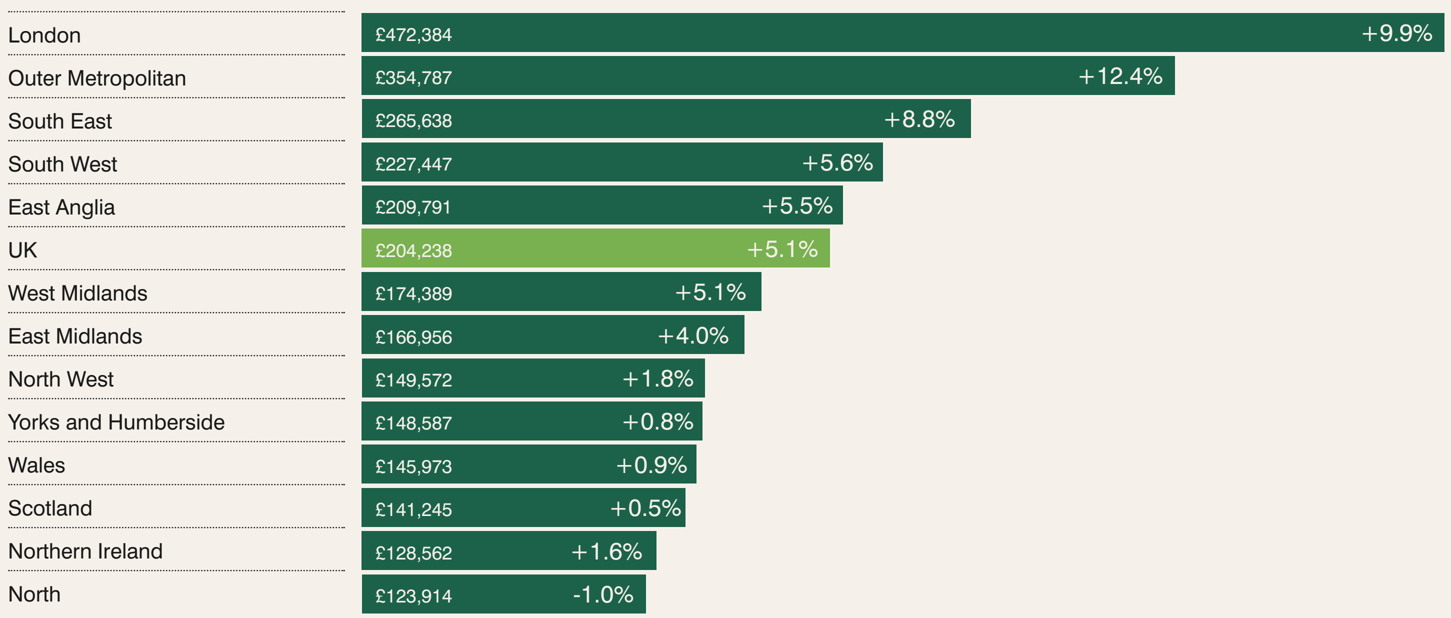
The rate of house price growth across the country has remained stable, with latest national growth of around 5.1% annually. In terms of volumes so far this year, it has been difficult to say with certainty what underlying demand is due to the surge in activity in the run up to the April deadline of the introduction of stamp duty on second homes. It therefore becomes difficult in the following months and quarters to determine whether, if there is a slowdown in activity, this is because purchases were brought forward or whether there is an underlying slowdown in demand. In any case, according to the Bank of England's latest figures, the first five months of 2016 have seen nearly 350,000 mortgage approvals, an increase of 11% over the same period one year ago.

Furthermore, there were 67,042 mortgage approvals in May alone (post stamp duty changes), which is also up 4% over May 2015. According to The Council of Mortgage Lenders (CML) recently published data (to May 2016), borrowing by homeowners increased 8% year-on-year in May, taking out 5% more loans than the same month one year ago. The majority of this rise has come from first-time buyers and movers, as Landlord borrowing was 4% down over the same period in 2015.

The sharp rise in activity prior to the tax changes in April, contributed to a 2.9% increase in prices in March alone (ONS index), and according to RICS, growth will remain around the same level in the months ahead before easing in the latter half of the year. RICS forecast an annual house price growth of 6% by the end of 2016.

Again this quarter it was the Outer Metropolitan area which has been the strongest performer, with prices up 12.4% in June (annualised), according to Nationwide data. This was closely followed by London, with growth of 9.9%, and the Outer South East region, posting growth of 8.8%. Conversely, the weakest performing region was the North, with prices down 1% year on year.

Regional house prices and growth



How are key land markets performing; the view from our agents

Central London

So far the first half of 2016 has been more subdued than last year. Although we have not seen much evidence of prices or transaction volumes decreasing significantly, there have been a greater number of opportunistic purchasers buying where developers have standing stock that they are looking to trade out of. The Help to Buy scheme has not appeared to have made any material impact on sales volumes in the Central London areas, likely due to the cap on assistance still not being in line with average London house prices and incomes.

The land market around London has so far been weaker than 2015, with prices generally around 10 – 15% down on last year. This year has been a buyer's market, with activity mainly concentrated on purchases subject to planning, Joint Ventures or structured deals. Furthermore, there are quite a few examples of sites which, while they have planning permission in place, are not selling as the owners are being overly ambitious on pricing. Sensibly priced plots are faring much better. Buyers in the Outer London Borough's seem to be focussed on the sub £5m level, particularly in areas where local developers and investors are prominent. There are some overseas developers who are prepared to look at larger lot sizes but again, the price point has to be sensible.

So far the fallout from the leave vote in the referendum has been unhelpful for the London market. Overseas capital has been stalling, as they appear to be trying to work out whether a short term hedge on the currency rates will outweigh any possible reduction in sales volumes and values. There are likely to be opportunities for cash-rich speculators however, where landowners become obliged to sell (i.e.: public bodies or non-property corporates).

Greater London

Sales volumes in the Greater London housing market have remained largely static through the second quarter, with some price rises but not at the scale we saw in the previous years. There are some reports of opportunistic buyers chipping away at pricing but this is not seen as a correction but rather parties trying to establish whether uncertainty exists within the market. So far there have been some sales that have fallen away after the referendum but not in large numbers. Both domestic and international buyers continue to be active in the Greater London market, with domestic purchasers taking advantage of the Help to Buy scheme, which is helping to buffer any negative effects from Brexit

Land prices have so far been holding steady through to the end of the second quarter, but are likely to decrease in the short term as housebuilders build-in slightly higher margins to account for uncertainty. Housebuilders continue to expand their order books, looking for more outlets in Greater London, largely driven by apartment opportunities, and indeed it is flats which have seen the most activity so far this year.

There has certainly been a more cautious sentiment within the market, as people have a wait and see approach. However, both housebuilders and prop co developers, are cautiously optimistic for several reasons including: the acute supply / demand imbalance which is not going to go away, interest rates are still historically low and potentially headed even lower, the Help to Buy scheme is supporting the right price points, the lower currency could play a positive role for sales to foreign buyers, and the potential for construction cost inflation to ease if construction in other sectors begins to fall away slightly.

South East

The Q2 2016 residential land market continued at a strong pace, similar to that which was seen through 2015 and the previous quarter. While this momentum continued into the second quarter, there was some slowdown in activity in the latter months of the second quarter. While this may have been referendum-related it is difficult to say for certain as the market was felt to be 'levelling off' in any case. Despite this slight deceleration we are still seeing growth in house prices, albeit at a more moderate rate.

Development opportunities for Permitted Development Rights continued to be favoured by established players and new entrants, looking to take advantage of the speedy planning process and limited risk. Following successful sales of a number of converted office schemes to owner occupiers and investors, this market has been well and truly established as viable.

In Q2 owner occupier demand continued to focus on traditional two-storey, detached / semi-detached / terraced family and starter homes while, as is the norm, local and UK investors showed more interest in the apartments segment of the market, within more dense town centre locations.

The land market in the South East has been steady through the first half of the year, with moderate rates of growth. There has been continued strong interest for traditional family housing schemes with exit values between £300 and £600 per sq ft and of medium density.

In the weeks following the UK's referendum vote to leave the EU, there has been a modest slowdown in PLC housebuilders committing to site acquisitions with detailed planning permission, ready to implement. We expect this slowdown may remain until September. This is clearly a reaction to the political and economic uncertainty although there is quite often a slowdown in the summer months, in any case. However, sites with outline planning permission remain in keen demand with CBRE placing a number of sites under offer across the South East in the weeks following the referendum.

Private housebuilders and property developers remain largely unchanged in their approach to acquisition, and indeed some see this window of uncertainty in the market as an opportunity. To date, we are aware of a number of sites which have exchanged since the vote, the largest of which totals 400 units.

South West

The supply / demand imbalance in the Bristol market remains a key driver of price and rental growth. While this is most prevalent within the city centre, prime suburban areas with good transport links or within walking distance to the central area also show signs of sustained growth. Early in the year we saw good levels of activity from all buyer groups, however there has been a reduction in demand from buy to let investors in the second quarter, as the prospect of growing rental returns diminishes and the increased stamp duty charges from 1st April dampens interest from these buyers. Help to Buy remains a good marketing tool for housebuilders and it is being consistently taken up by new entrants wishing to get a foothold in the market.

The land market has been gradually improving. Values have risen broadly in line with house price growth, albeit not as strong, which can be attributed to equally strong build cost inflation or the rising demands from planning authorities for provision of affordable housing. Housebuilders are generally seeking land which is in the early stages of the planning process rather than securing land with inherited permissions. Inherited consent often means that builders need to seek further variations which can be an onerous task.

While housebuilders are dominating the suburban markets, property companies and PRS investors are most active in city centre markets, and tend to secure the majority of these sites.

Since the referendum results in late June there has been a general undertone of a wait and see approach, particularly as the result has coincided with many housebuilders year-end. However, all of the strong economic fundamentals remain, as does the general supply demand imbalance, meaning that the investment of securing sites is unlikely to result in aborted sales, although deferment could creep in order to delay upfront costs. The continued uncertainty however may cause sellers to hold onto assets longer unless they are forced into liquidating. The impact is more likely to be felt in off-market discussions where parties may feel more confident that negotiations will result in acquiring or selling at a 'fair price'.

Midlands

The Midlands housing market has been performing well this year, and indeed activity to the end of the half year has been stronger when compared to 2015. However post-referendum it is still too early to identify the direction that the market will now take, albeit sales reservations of completed stock is holding firm in the region, with a number of developers reporting above-norm seasonal sales activity. All groups of purchasers have been active so far this year, with Help to Buy still an essential tool in this market for first time buyers and housebuilders. Housing is still the dominant product although there remains an undersupply of flats within Birmingham City Centre with an over-reliance on office to residential conversions for delivery of apartment stock.

In terms of the land market, again first half performance shows the market holding up well, with up to 10% price growth for easy-to-deliver, prime and near-prime postcode suburbs and commuter towns. Again, the leave vote has caused the land market to temporarily pause and evaluate land buying decisions. Banks are still lending, although development LTV's are expected to be even more cautious over the coming months.

Housebuilders in the area have been expanding, with Bellway opening a new sub-regional office this year, and IM Properties expanding its strategic land operations. Other equity-rich but non-property businesses have also been observing housebuilding operations in the region. We have also seen many funds showing real interest in city centre locations for delivery of PRS investments; however, there remains just one actual PRS completion – Bouygues (now Linkcity) and Rockspring's forward-fund of a 334 apartment development for £50m, the first purpose-built PRS investment in Birmingham City Centre, to be called 'The Beacon', and as advised upon by CBRE.

There have been further new entrants into the region, with London developers actively scouring the city centre, although with little purchase activity being achieved. In terms of regional specialists IM Properties, via their residential trading arm Spitfire, have committed to their first city centre scheme this year, with a block sale of private market unit sales under consideration. PRS remains the dominant market activity in Birmingham City Centre, with Birmingham still seen as one of the key target cities for institutional investment.

At a local and regional level, sales activity remains robust both for the city centre and traditional suburban and commuter markets, regional auction markets are holding up well and there is no evidence of BREXIT impacting on committed land deals. The macro-political event of late June will inevitably take time to permeate down into the Midlands property markets and the real effects may not be known until September when post BREXIT trends are more in evidence.

North

The trend of the last two years has continued into the second quarter of 2016. The quarter has continued to show modest house price rises and a focus on rate of sale, with many utilising the Help to Buy scheme and targeting first time buyers, with the result being gains in land value. There was a continued emphasis on lower value, £180 - £190 psf areas with good transport accessibility, where rates of sale could be driven forward, while robust interest was also being shown in prime sites. In the three months to mid-June, the market was showing a similar trajectory as last year, with a slight improvement in values, and a broadening of purchaser type. Following the EU referendum in late June sales are being watched very closely. Initial reports are suggesting there hasn't been a discernible slowdown as yet; the focus is shifting onto more affordable sites which can produce better-value product.

There is evidence that housebuilders are expanding, with continued expansion into this region and poaching of staff between firms as well as movement into new regions. Notably, Bellway has opened a new office in the North East and Storey Homes continue in an aggressive expansion into Manchester, Merseyside and Cheshire. We are also seeing a push into open market housing from some traditional RSL operators and developers such as Lovells and YourHousing.

This year we have seen some new entrants into the market, ranging from established developers and contractors differentiating into new sectors and regions, to smaller start-up firms targeting developments in the city centre and the suburbs. Generally, the smaller start-ups are concentrating on high-end luxury developments, often conversion opportunities, particularly in the city centre market.

There has been strong activity this quarter in Manchester City Centre, most notably at Allied London's St John's Quarter development where pre-sales have been extremely strong. The PRS sector remains active including Delph's recent purchase of 146 units from Fortis developments in the Green Quarter.

Following the EU referendum, there has not been a particularly noticeable slowdown from the PLC land market. Although some housebuilders have stopped making offers until the end of summer (at present), and Bellway have moved some offers from unconditional to conditional, other major housebuilders are continuing in an 'as was' trajectory, albeit keeping a careful eye on sales levels. Countryside, in their role as developer for Sigma, consider this a time of opportunity as they feel any potential economy insecurity will play into the hands of suburban PRS schemes. All PLC developers are paying close attention to their sales rates to assess the impact, but currently Barratt, Bellway and Morris are all reporting no downturn in the North West and we are unaware of any developers who have stated a specific downturn.

Scotland

The Scottish market is still seeing reasonable levels of activity, with transaction levels and prices in prime areas (Edinburgh, Glasgow and East Lothian) up in Q2 over Q1. Some evidence suggests that transactions were starting to taper off in the lead-up to the referendum vote as buyers chose to wait out the result before buying. However, on the whole the usual catalysts for buying and selling and the access to mortgage lending have seen the market perform well, particularly against a backdrop of limited supply in the prime areas.

The usual summer slow-down has seen slightly fewer transactions take place, but this has been no more than what we would normally see for this time of year. The low to mid-range end of the market (£150,000 – £500,000) is performing well, while the upper end of the market (£700,000+), is still rather slow due to the LBTT rates. The Help to Buy (Scotland) scheme has helped to buoy the low end of the market, and remains in place until 31 March 2019, providing 15% of the purchase price for eligible buyers. The purchase price for eligibility however will step down on an annual basis over the next three years.

The large housebuilders continue to focus on the traditional 2-storey family homes, however the pipeline in Edinburgh is seeing a number of large high profile apartment schemes. There are three large schemes already on site with strong per square foot rates already (Brunswick Rd, off Leith Walk (circa £330psf), Woodcroft, Morningside (circa £400psf) and Quartermile (circa £480psf), while a further four schemes are due to start, bringing around 489 new apartment units to the area.

The land market has seen price increases generally across Scotland, off the back of an acute lack of supply. This is particularly evident in the prime regions of Edinburgh and East Lothian, where values are now pushing £1.2m / acre. However, with six builders now on site in Haddington (one of East Lothian's key towns), this may begin to depress values.

The Aberdeen market remains slow but product is selling if sensibly priced. Aberdeenshire based housebuilders (ie: Dandara and Kirkwood Homes) who have capital are now looking at other regions such as Edinburgh, the Lothians and Glasgow, with Dandara in particular keen to place its stake in the Edinburgh market.

The usual family home locations and prime city centre apartment units are still where developers are most active in Scotland. The private rented sector (PRS) is starting to emerge more in this market (ie: a 241 unit development in New Wavereley is PRS proposed), and Dandara is due to complete around 240 PRS units at Stoneywood in Aberdeen, with completion due around October this year.

CBRE sold Heartlands on the M8 corridor to a developer in April 2016 before the referendum vote, on the basis of ongoing opportunities to sell off parcels of land for the new owner. The first plc land sale of 137 units to Bellway Homes has contracted and completed post-Brexit at the pre-Brexit agreed land price. This is not a prime location although a good family housing area, and provides early signs of a strong commitment to the Scottish housing market from the plc builders. The early indications from the plc and large private builders in Scotland is that they remain positive about the Scottish housing market however will keep a close eye on house sales to ensure that the buyer sentiment continues in the same positive way that it has since the vote on 23rd June 2016.

Residential outlook

With a period of uncertainty ahead, the UK remains in a strong position with high employment, low borrowing costs and a weaker sterling which will help boost exports. House prices are still expected to rise by an average of 3% this year, although buyer sentiment is likely to remain cautious.

Despite the outcome of the EU referendum, our current forecasts remain broadly unchanged. We expect UK house prices will grow by an average of 3% this year, with house price growth currently running at 5.1%, according to the Nationwide. There will be some variation across the country however, with southern areas performing better than northern areas. In contrast to previous years, we expect that outer London and the surrounding home counties growth will outperform and rise faster than central London.

Recent changes to stamp duty and the vote to leave the EU, together with the continuing decline in affordability, and a slump in consumer confidence, all remain downside risks to growth. Nevertheless, they have not, as yet, made a measurable impact beyond some anecdotal deceleration in growth and activity. Ultimately, it remains far too early to determine what the long term implications of Brexit will be, but the UK enters this period of uncertainty from a position of strength. The economy is fundamentally healthy, employment is high, borrowing costs are low, oil prices have fallen (UK is a net importer of oil) and the decline in the value of sterling will help stimulate exports.

Looking Ahead: Short-term

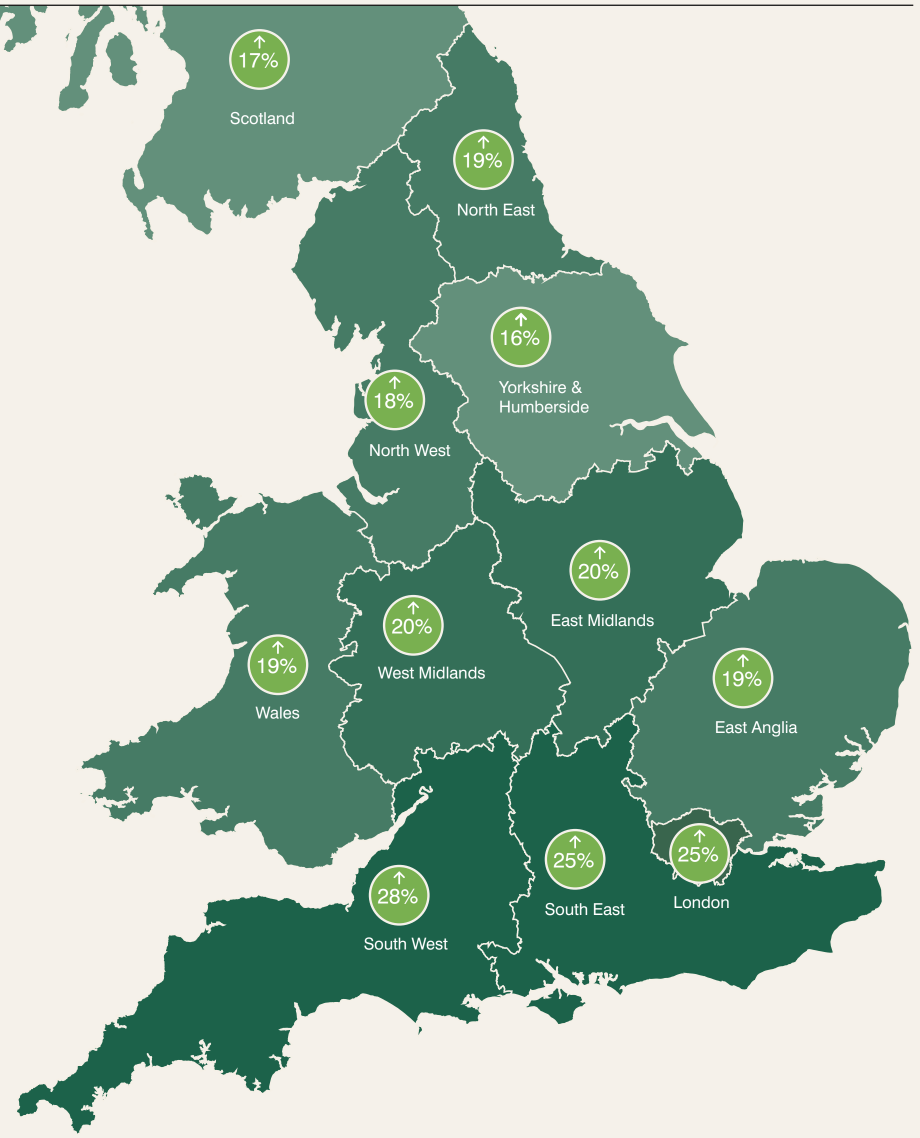
Following the UK's recent referendum vote to leave the EU, most of the immediate issues facing the UK will be political rather than economic, although it will undoubtedly add some economic and financial volatility. As recently as six months ago we had expected a rise in interest rates in the near-term however this now appears to have been put back for some time and as many had begun to anticipate, interest rates were lowered by a further 25 basis points to a record low 0.25 at the early August MPC meeting. A decline in rates will prop up some house price growth and make borrowing more attractive to some purchasers. In the lending market, it is as yet unclear whether stricter borrowing criteria will come into force. Buyer sentiment is likely to remain cautious, with the possibility of delaying major purchases, until such time as economic fundamentals are more fully understood and the political climate calms. It has already become clear that builder sentiment is cautious with many entertaining a 'wait and see' attitude, and certainly within the usual summer slowdown, this will be the case.

A summary of some market commentator views:

- In a recent PWC report (19 July), they have forecast that while house price growth may decelerate this year and next, they are still forecasting a 3% house price rise by the end of 2016. They go on to say that they do not expect a crash in the housing market at all, nor do they anticipate the kind of recession as that which followed the financial collapse back in 2008.
- According to the Bank of England's recent Agents' Summary of Business Conditions report, it notes that many firms are having to formulate new business strategies following the referendum vote, and thus seeking to maintain a 'business as usual' in the meantime. According to the report, the majority of firms surveyed did not expect a near term impact from the result on their investment or staff hiring plans.
- A recent Bloomberg survey of leading economists found that on average, they did not anticipate a recession but rather a deceleration in growth, dropping their GDP growth expectations slightly, from 1.8% to 1.5% in 2016, and from 2.7% to 0.6% in 2017.

House Price Growth

	2016 (%)	2017 (%)	2018 (%)	2019 (%)	2020 (%)	Total 2016–2020 (%)
London	5	2	4	6	6	25
Prime Central London	3	3	5	6	6	25
South East	5	4	4	5	5	25
South West	4	4	5	6	6	28
East Anglia	3	3	4	4	4	19
East Midlands	4	3	4	4	4	20
West Midlands	4	3	4	4	4	20
Wales	4	3	3	4	4	19
North East	3	3	4	4	4	19
North West	2	3	4	4	4	18
Yorkshire and Humberside	2	2	3	4	4	16
Scotland	2	3	3	4	4	17
UK	3	2	3	5	5	19



Mainstream house price growth 2016–2020

Our house price forecasts are based on the Nationwide house price index (excluding Prime Central London which is based on the Land Registry house price index). As a result they reflect the whole market and new developments may outperform.

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Sources

The Nationwide, HMRC, DCLG, Land Registry