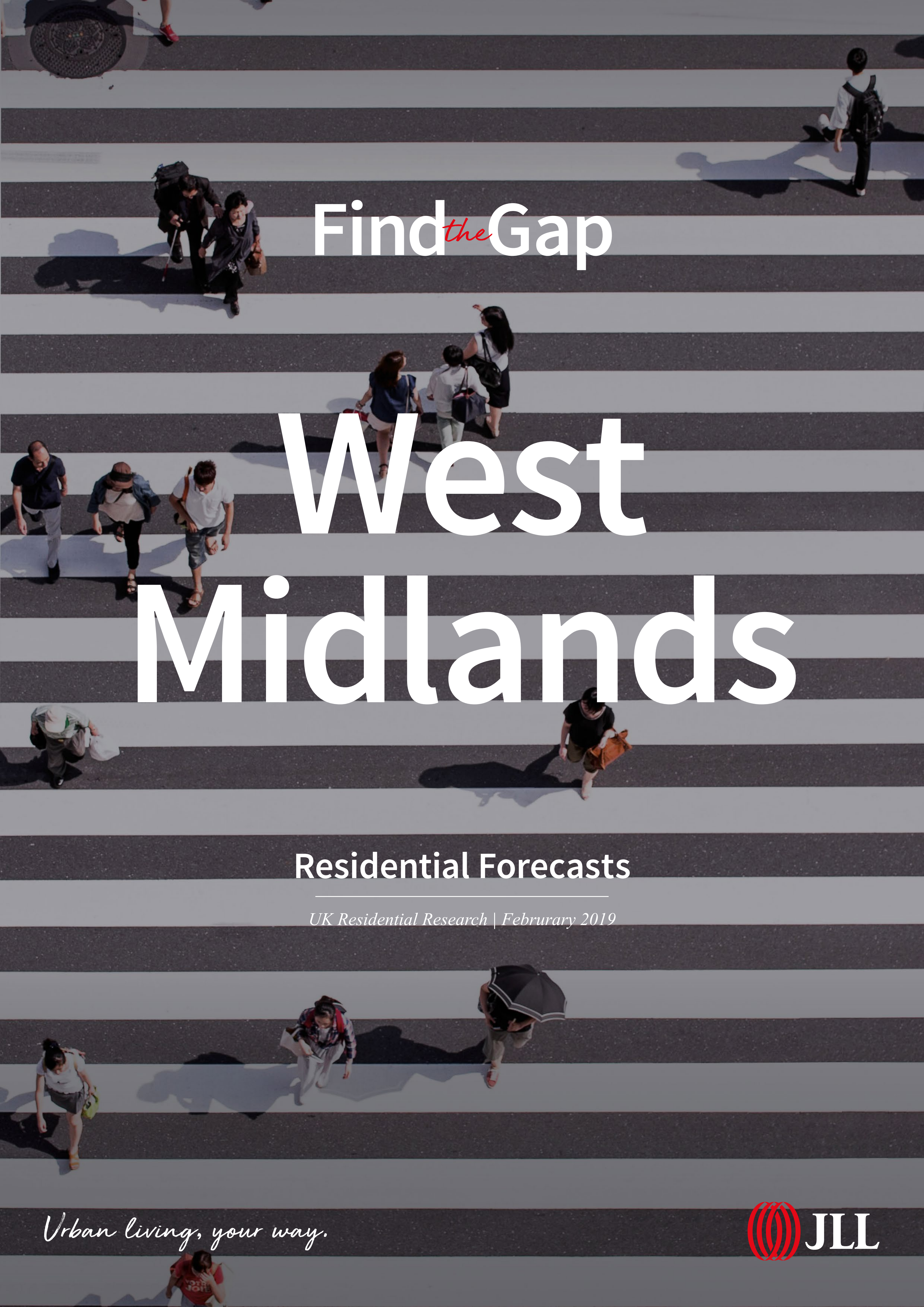

Find *the* Gap

West Midlands

Residential Forecasts

UK Residential Research | Februrary 2019

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West Midlands Residential Forecasts

The UK economic and political landscape has been dominated by Brexit over the past 2½ years. The next 2½ years are likely to be similar, albeit dealing with a different phase of the process.

Inevitably, the UK will collectively refocus attention on domestic policies as the sphere of influence from Brexit diminishes.

And there are plenty of housing issues that need addressing. These include affordability, taxation, regulation in the private rental sector, affordable homes, housing supply, lack of skilled labour and digital construction.

Our housing market forecasts for the next five years assume that a Brexit deal is hammered out over the coming months and that we have a transition period until the end of 2020.

The Birmingham City Centre housing market is expected to perform strongly over the next five years with several notable catalysts for change.

The redevelopment of the former wholesale market at Birmingham Smithfield is one of UK's largest city centre regeneration projects. The former Birmingham City University campus is also being developed to provide an Athletes' Village for the 2022 Commonwealth Games.

However, political headwinds have stifled that growth story somewhat. This has left some sectors of the residential market presenting more inviting opportunities than others.

So, it will be important to 'Find the Gap' rather than to blindly back residential in the broadest sense.

Neil Chegwidden
Residential Research

Nick Whitten
Residential Research

Simon Horan
Regional Residential

"Since HS2 was given the green light, demand for city centre living in Birmingham has far outpaced supply."

West Midlands housing market forecasts

West Midlands

For the majority of the decade since the Global Financial Crisis house price movement in the West Midlands has been relatively flat, until recently.

Over the past 10 years, house prices increased by 31% to Q3 2018, however two thirds of this growth took place in the past three years.

The average house price in the West Midlands was £198,000 as at Q3 2018 – an increase of 5.3% in the past twelve months. To put this growth into context, the UK saw house price growth of 3% over the same period and London saw prices reduce by 1.7%.

Affordability is one of the key factors influencing the housing market across the UK. The stagnant price growth in the West Midlands until recently has meant that house prices in the region are relatively affordable compared to the national average. This dynamic means the West Midlands is well-positioned to outperform many of the other UK regions in terms of house price growth over the next five years.

Birmingham

Recent months have been notably eventful for Birmingham. In November 2018, Lendlease was chosen as principal contractor to build the £350m Athletes' Village for the 2022 Commonwealth Games. Circa 1,400 homes will be built on the former Birmingham City University campus, providing a home to the 6,500 participants and officials over the two week period of the Games in summer 2022. Planning permission for this development was granted in December.

Meanwhile, in January 2019, Lendlease secured a key role in another of Birmingham's most significant residential developments after being chosen by the City Council as development partner for the redevelopment of the former wholesale market at Birmingham Smithfield.

This £1.5bn 42-acre site will comprise over 2,000 new homes alongside a new public square and community facilities. The site is adjacent to the Bullring shopping centre and a short walk from the new HS2 terminus scheduled to open in 2026.

After several years of minimal development activity, these new major schemes are very welcome. Since HS2 was given the green light, demand for city centre living has far outpaced supply.

Demand has largely been comprised of young professionals, with 75% of city core inhabitants being under 35-years old. Birmingham has a high graduate retention rate, retaining 50% of its 67,000 full time students. Birmingham is also the most popular location in England for Londoners moving out of the UK Capital, according to new statistics from the ONS. In addition, there is an international dimension to the demand profile, particularly from overseas students at one of the four universities in the city.

New build pricing typically ranges from £340 to £500 psf, with smaller 'bespoke' schemes achieving values in excess of this. Average one bedroom flats are achieving circa £170,000 and two bedroom flats circa £230,000. Pricing in prime schemes is notably higher, with one bedroom flats achieving up to £250,000 and two bedroom flats around £380,000.

The price of an average two bedroom apartment has increased by 5.2% during 2018.

Birmingham lettings market

Subdued development activity for the past few years has only exacerbated the demand for rental accommodation in the city centre. Rental values in the city centre are typically £750pcm for a one bedroom flat and circa £950pcm for a two bedroom flat. City centre rents have risen due to a lack of available stock, with two bedroom flats increasing by 2.7% in 2018.

The prime rental market is even more starved of available stock, and rental values for two bedroom flats have increased by 7.1% as a result. Prime one bedroom flats are typically around £1,050pcm, with two bedroom flats showing rents of £1,600pcm.

This is a big year for multifamily private rental development as Birmingham's first purpose-built schemes are expected to complete in the next 12 months.

The first phase of Exchange Square, totalling 603 units, was acquired by Lasalle Investment Management in April 2016 and construction is expected to complete in 2019. Rockspring's The Forum will also be completing this year, releasing 336 units to the market.

This much needed new supply is a positive step. However, rental demand in the city is so high that these schemes are unlikely to fully satisfy the need for new rental product in the area. There are several thousand purpose built private rental units in the development pipeline, equating to almost 30% of the entire development pipeline.

Birmingham development market

Developable land is scarce. There are currently around 5,000 units under construction in Birmingham, the majority of which are spread across the western part of the city.

The Birmingham Smithfield redevelopment of the former wholesale market will not only act as a catalyst for further development in the immediate area, but it will also broaden the boundary of what is deemed to be city core. It will draw in south eastern villages such as Digbeth.

Nearly a third of all units at application stage in Birmingham are in close proximity to the former wholesale market. The combination of these schemes has the potential to make Digbeth the new residential and leisure location of choice for both first-time buyers as well as renters.

Looking forward

The outlook for Birmingham is extremely positive. Development activity has remained below demand levels for some time, which has created fierce competition for new homes in the city.

The development pipeline has picked up, with a pipeline of over 17,000 units. To put this into context, this pipeline equates to a near doubling of the current number of homes in the city centre.

With both Birmingham Smithfield and the Athletes' Village anticipated to start in 2019, this will help alleviate some of the pressure for new housing but will also highlight Birmingham as a strong investment opportunity.

Despite construction beginning imminently on these developments, Birmingham still faces a supply/demand imbalance. JLL forecasts that new build values in the city will continue to rise on the back of this imbalance, increasing by a projected 15.9% over the next five years.

Birmingham's first purpose-built private rental schemes will complete this year. This, coupled with renters becoming more discerning, will put pressure on buy-to-let landlords to improve their offering if they want to compete with well-designed, professionally-managed, purpose-built rental product.

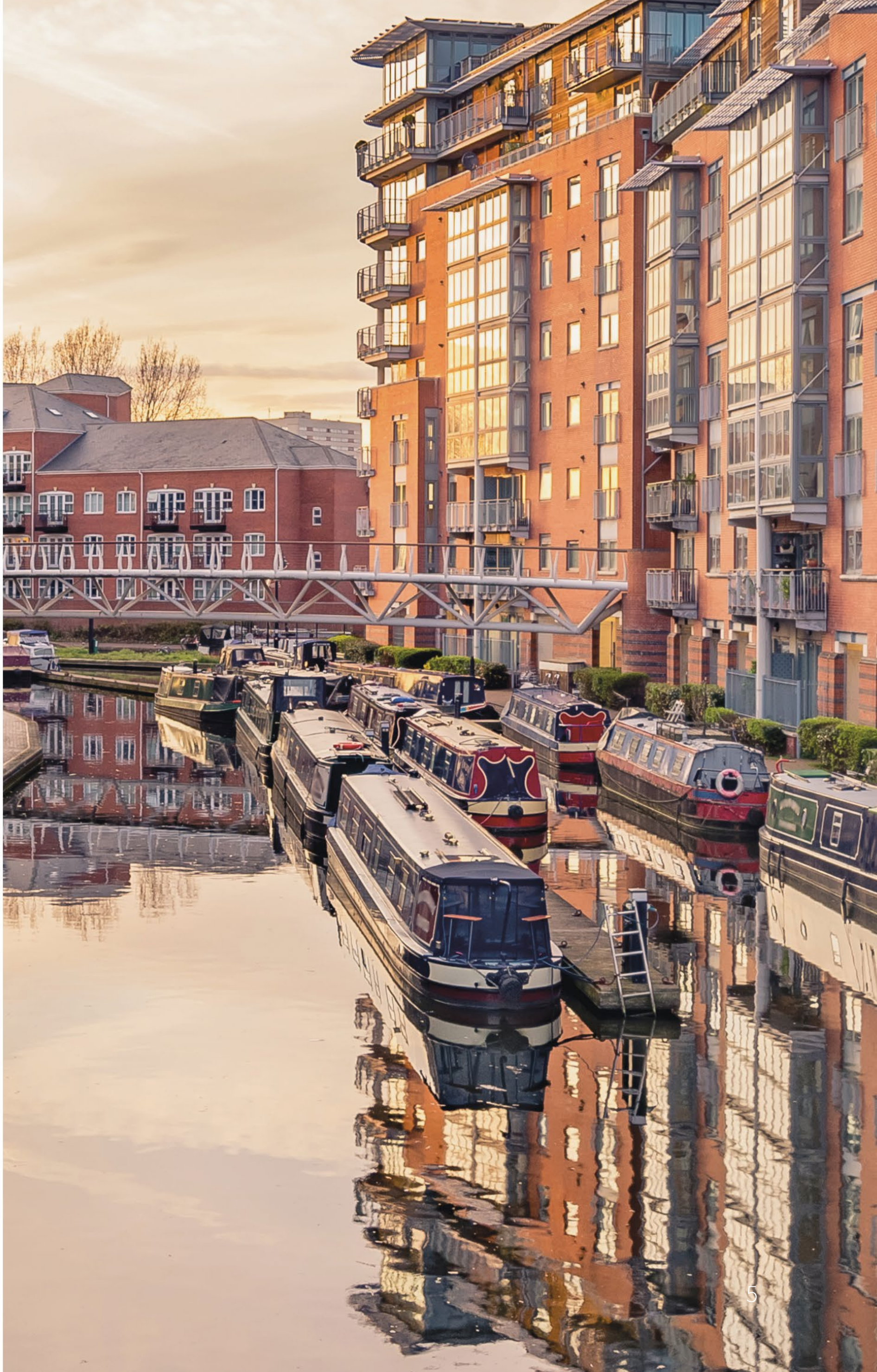
Although there will be a larger number of new homes to rent in the city centre, it is anticipated that demand is far greater than what will be delivered in the next few years. This will underpin rental value growth in the city centre. JLL expects rental value growth of 16.5% between 2019–2023.

Birmingham

Average sales price (2018 % change) 2 bedroom flat	*Average rent £pcm (2018 % change) 2 bedroom flat*	*Build to Rent net yield (typical yield range)*
£230k (4.5%)	**£950** (2.7%)	**4.75%** (4.50-5.00%)

	2019	2020	2021	2022	2023
House price growth forecasts	2½%	2½%	3%	3½%	3½%
Rental growth forecasts	3%	3%	3%	3½%	3%

Source: JLL



Brexit risks & assumptions

Battling through Brexit

With so much uncertainty, so many potential stumbling blocks and a myriad of possible outcomes, the economic and political outlook is not clear.

Here we set out the most likely outturns, discuss the hoops that need to be jumped through and settle on the Brexit assumptions we will make in our economic and housing market forecasts.

A deal most likely

While there are several potential scenarios and routes, as well as the possibility of a 'no deal', we believe that the most likely outcome is that the UK does agree a deal with the EU.

The main reasons for this are that it is in the interests of both the EU and the UK, and that the 'cliff-edge' or 'no deal' route is highly undesirable for all concerned, but particularly for the UK. Polls continue to suggest this is the most likely of the range of outcomes on the table.

What kind of deal?

The two most likely possibilities represent opposite ends of the deal scale.

The first is a soft Brexit whereby the UK accepts the four freedoms of the EU, continues to trade with the EU similar to today, but has no say in the regulations that it needs to abide by. The current Chequers plan would fall under the 'Brexit in Name Only' (BINO) heading, albeit a plan that the EU has rejected.

The other most likely scenario is that the UK and EU agree to trade under WTO (World Trade Organisation) rules after the transition process. Ultimately this is similar to a 'no deal' outcome, but in this scenario, there is a transition period during which many potential issues are ironed out, thereby avoiding a 'cliff-edge' situation.

Obstacles

There are many obstacles to overcome before any kind of decision can be made and agreed – deal or no deal.

Without contemplating exactly how each might arise, the hoops to jump through are Conservative Party approval, Parliamentary consent and EU agreement.

Depending on the outcome of each, other hoops and obstacles might arise. These could include a Conservative leadership contest, a General Election and a second referendum.

Timetable disruption

With all of these issues at play, and the lack of progress to date, it is quite likely that the current timetable will be disrupted.

This could be a postponing of the March 2019 exit, an altering of the length of the transition period or the EU delaying the approval of the proposed plan.

If any of these outcomes were to be realised, the prolonged uncertainty would drag on the UK's economic performance.

JLL assumptions

For the purpose of generating a base case housing market forecast, we assume that the UK will agree some kind of deal with the EU. The implications are that UK economic performance will recover reasonably well over the course of the next five years.

We also assume that UK economic weakness lasts for much of 2019, but is in recovery mode during 2020. This would arise as greater certainty returns, but does not necessarily mean there are no delays to the existing timetable.

Forecast risks

The main risk to our assumptions is that UK economic weakness is prolonged by a year or two. This would result in lower UK GDP growth in 2020 and perhaps also in 2021. Sterling would also remain weaker for longer.

The second most likely risk is that the Brexit deal negotiated and approved is not as favourable for the UK as we assume. This would still result in an economic recovery, but a weaker upturn after 2019 compared with our base case assumptions.

The third risk is that the UK exits the EU with no deal. And whilst we deem this to have a probability of less than 10% at present, it would result in a far weaker UK economy over the next five years.

JLL base case forecast assumptions

JLL assumes
Brexit deal negotiated

>90%
probability*

Brexit deal options

BINO
Brexit in Name Only

WTO
World Trade Organisation

FTA
Free Trade Agreement

UK deal obstacles

- Conservatives approval of proposal
- Parliament approval of proposal
- Possible Conservative leadership contest
- Possible General Election
- Possible second referendum

Possible delays

- Leaving EU in March 2019 deferred
- Transition period extended
- EU approval delayed

EU approves deal

* Probability of no deal estimated at <10%, JLL estimate

West Midlands economic forecasts

West Midlands growth

The performance of the UK economy will be highly dependent on the outcome of Brexit. Although the Brexit pathway is still very uncertain, our economic forecasts assume that a Brexit deal will eventually be agreed and approved by Parliament, and that there is a transition period until the end of 2020.

The greater certainty delivered by the deal will fuel improved confidence. Economic output in the form of business output, expenditure and investment as well as higher consumer spending will all drive an economic revival.

However, because any deal will not be as favourable for the UK as the existing trading conditions, economic output growth will be slightly below the norm and lower than typical economic recovery growth rates. Economic performance is expected to be notably stronger in Birmingham – the West Midlands' economic capital – when compared with the UK.

GVA growth in Birmingham is expected to average 2.6% pa compared with UK GDP growth forecasts of 2.0% pa.

Population and jobs

Population growth is expected to be strong in Birmingham with an extra 50,000 people forecast to be living in the city by 2023, equivalent to a population growth rate of 0.9% pa over the five year period. One factor driving the population growth is the availability of jobs.

The job growth story is expected to continue over the next five years with employment growth averaging 1.1% pa in Birmingham, well above the national average of 0.5% pa.

Earnings and interest rates

UK earnings growth is forecast to return to a more normal rate of 4.0% pa following several years of subdued growth. The improved employment and wages outlook will be important for housing market confidence and affordability.

The heightened wage growth is predicted to be even more influential for the housing market over the next five years because CPI inflation is forecast to be around 1.6% pa during the next three years before rising to 1.9% pa by 2023. This will give households greater disposable income and spending power.

With the economy on the road to recovery over the next few years, the bank rate will increase steadily and incrementally.

The bank rate should rise to 1.00% by the end of 2019 once the Brexit outlook has become clearer.

By the end of our forecast period in 2023 the bank rate is still only expected to be at 2.75% as rate rises are contained in order to encourage and boost economic growth and stability.

Exchange rate

The strength of sterling will be keenly watched over the next five years as a bellwether to how the UK is viewed post-Brexit.

The pound is expected to strengthen to circa US$1.41 by end-2019 before rising to US$1.50 by end-2023. Against the Euro, the pound is forecast to strengthen and then remain at €1.20 through to end-2023.

Source: Oxford Economics

Birmingham

2019–2023 forecasts

GVA growth	*Employment growth*	*Population growth*
2.6% pa	**1.1% pa**	**0.9% pa**

UK GDP growth (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.5%	2.0%	2.2%	2.1%	2.0%

UK CPI inflation (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.6%	1.6%	1.6%	1.8%	1.9%

UK unemployment rate (%)

2019	*2020*	*2021*	*2022*	*2023*
4.0%	4.0%	4.0%	4.0%	4.0%

UK earnings growth (% pa)

2019	*2020*	*2021*	*2022*	*2023*
3.2%	4.0%	4.1%	4.1%	3.9%

Bank rate (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.00%	1.50%	1.75%	2.25%	2.75%

Exchange rate (£/US$)

2019	*2020*	*2021*	*2022*	*2023*
1.41	1.46	1.50	1.50	1.50

Source: JLL, Oxford Economics. Note GDP and GVA forecasts are annual averages, all other forecasts are end-Q4 each year.

UK housing market forecasts

Forecast rationale

The assumptions used to generate our base case UK housing market forecasts are that the UK agrees a deal with the EU on Brexit and that the UK economy recovers to circa 2% pa GDP growth during 2020-2023.

Within this broad Brexit and economic environment there are several other factors that will influence the UK housing market.

Consumer confidence is key

Consumer confidence is a critical driver of the housing market. The uncertainty surrounding Brexit has dented consumer confidence while also casting a shadow over the job and personal financial prospects of millions of people. Such uncertainty is not conducive to big ticket purchases and has therefore impacted the UK housing market.

Other factors such as negligible real wage growth and, more recently, higher interest and mortgage rates are also not supportive of a thriving housing market. A lack of affordability, especially for first-time buyers, is also hampering transactions and house price growth, despite support from Help to Buy and the Bank of Mum and Dad.

Investor influence fading

Government initiatives to dampen the role that investors play in the housing market look to be working. Although only a part of the story, the number of loans to BTL landlords has fallen by 46% between the Referendum and July 2018.

The principal disincentive is the less favourable income tax regime, with higher stamp duty an added financial deterrent. We expect investor appetite to remain muted while house price growth prospects remain both uncertain and relatively weak.

This shift is important because it means that owner-occupiers, and therefore fundamental affordability, are even more important than before.

The consequence of all these influences has been a slowdown in UK house price growth and housing transactions since the EU Referendum. Annual UK house price growth has eased from 8.2% to 3.1% by July 2018, while UK transactions have declined by 7.4% from 1.29m to 1.20m.

Supply boost easing

A further consequence of the uncertainty and the relatively weak economic and consumer confidence backdrop, is that new housing supply, which was in the midst of a five-year surge, has slipped back over the past year.

New housing starts in the UK were running at 196,000 pa in Q1 2017 but have dropped back to 179,000 by Q1 2018.

Base case housing forecasts

As a consequence of these combined factors, our base case forecasts are for UK house price growth to weaken further during 2019, fading towards 1% pa from 3% pa now. We expect transactions to slow too, down to around 1.12m pa from 1.20m today. Housing starts will also slow.

Assuming the Brexit process continues along the current proposed timetable, the economy and consumer confidence will improve during the second half of 2019 and into 2020. This greater certainty will lead to a marginally improved UK housing market. We expect house price growth to rise to 1½% pa with London and south-eastern markets first to react. Housing starts will initially remain subdued.

From 2021 we expect greater certainty to lead to an economic recovery and improved business and consumer confidence. This will lead to a brighter UK housing market with house price growth and the number of transactions increasing – especially in London and south-eastern markets. Housebuilders should also feel more confident, increasing housing starts gradually.

Forecast risks

The main risk to our base case assumptions is that UK economic weakness is prolonged by a year or two. This would result in lower house price growth and transaction forecasts in the early years of our outlook, pushing the housing market recovery into 2022 or 2023.

The second most likely risk is that the Brexit deal negotiated and approved is not as favourable for the UK as we assume. In this scenario our house price growth and transaction forecasts will be slightly weaker over the forecast period.

The other risk is that the UK exits the EU with 'no deal'. This would result in a far weaker UK economy and housing market over the next five years.

UK house price growth forecasts

% change in house prices pa

2019	½%
2020	1%
2021	3%
2022	3½%
2023	3%

Source: JLL

UK housing transaction forecasts

Number of transactions pa

2019	1.15m
2020	1.18m
2021	1.23m
2022	1.28m
2023	1.32m

Source: JLL

UK housing start forecasts

Number of units pa

2019	175k
2020	180k
2021	185k
2022	195k
2023	205k

Source: JLL

Find the Gap

Reasons to be cheerful

It's easy to be cynical these days in the UK and no doubt many housing market participants have been spending a disproportionate amount of time this year modelling downside risk for the years ahead.

In a world of uncertainty, more so than normal, it would be easy to wallow with indecision and pull back on development programmes. So, credit where due, the housebuilding community has stepped up production. Net new additions in England increased by 15% in the year 2016-17. In London the increase was 30%.

However, the outlook for development is not as positive. Development starts in Greater London during Q3 2018, for example, slowed to their lowest level since 2012.This is bad news for just about everyone. But, rather than join the gloom it is worth taking a contrarian position for a moment. Not just because being optimistic is an agent's prerogative but because, when the mist clears, the market backdrop should present more positives than negatives.

Make no mistake, JLL sees every reason to expect a hard couple of years for the industry. The confluence of factors we noted in last year's forecast statement – with upward pressure on costs to both builders and buyers, and very little escape through rising prices or incomes – will plague the 'business as usual' approach to delivery. But land values will adjust, real incomes will nudge upwards and the majority of the industry will solemnly trudge forward.

Yet, there are also reasons to see a more optimistic picture, too.

Homes England

The Government's housing delivery unit is really beginning to ramp up activity. It is determined to help to build 300,000 homes a year by the mid-2020s while the majority of the £1bn initial short-term fund to assist SMEs has already been allocated. A further £1.5bn of short-term funding has been added to complement the £2bn long-term fund.

It will invariably be plagued by public criticisms for Help to Buy, but will have no choice other than to carry on with a more refined version of the programme.

The industry has an unhealthy addiction to 'Help to Buy induced demand', yet for all the criticism it has been undeniably successful in getting more homes built more quickly.

More importantly, Homes England has been retooled and is pushing on with the hugely ambitious supply programme that is underpinned by the three pillars of quality, quantity and pace.

It is more nimble and innovative with solutions, with an emerging track record of doing some big and creative deals.

This really is a golden age for the organisation and the industry should be beating down the doors at Windsor House to bring ideas forward.

Infrastructure

The UK is creeping towards a new era of infrastructure. HS2, HS3, Crossrail 1, Crossrail 2; these are all important catalysts for new housing sites and induced demand. Where tied to a structured housing delivery outcome, or linked to delayed/lower land payments, things will get done.

Despite their scale however, none of these will be as important to housing delivery as CaMkOx, or the Varsity Arc, that connects the UK's two great institutions of higher learning. Over one million homes are planned for this region, connected by both rail and dual carriageways. In truth, the arguments for connecting Oxford and Cambridge are weak, but the local and regional linkages with London will drive a wave of sustained community building for several decades.

Digital disruption

This is a bit of a catchall for the wave of 4th industrial revolution technologies that will gain both momentum and adoption over the next five years. Digital construction will mainstream. BIM will transform the relationship between supply chains, contractors and developers.

Smart technologies will enable better, more nuanced relationships with buying customers and renting residents. These are all statements of the obvious and if you are still a sceptic, just think back to what any of this meant to you only five years ago.

> "It is less about stepping off onto the platform and more about stepping on board."

But we believe the big changes will come towards the end of the forecast period, when off-site manufacturers achieve scale, when multi-family operators have built genuine brand-driven followings, and when consumers have normalised the benefits of these technologies. To get there, adoption and investment starts now.

The 52%

Lest it hasn't been said enough times, the end of the Article 50 period and beginning of the UK's brave new, independent world, will be welcomed by a majority of the population.

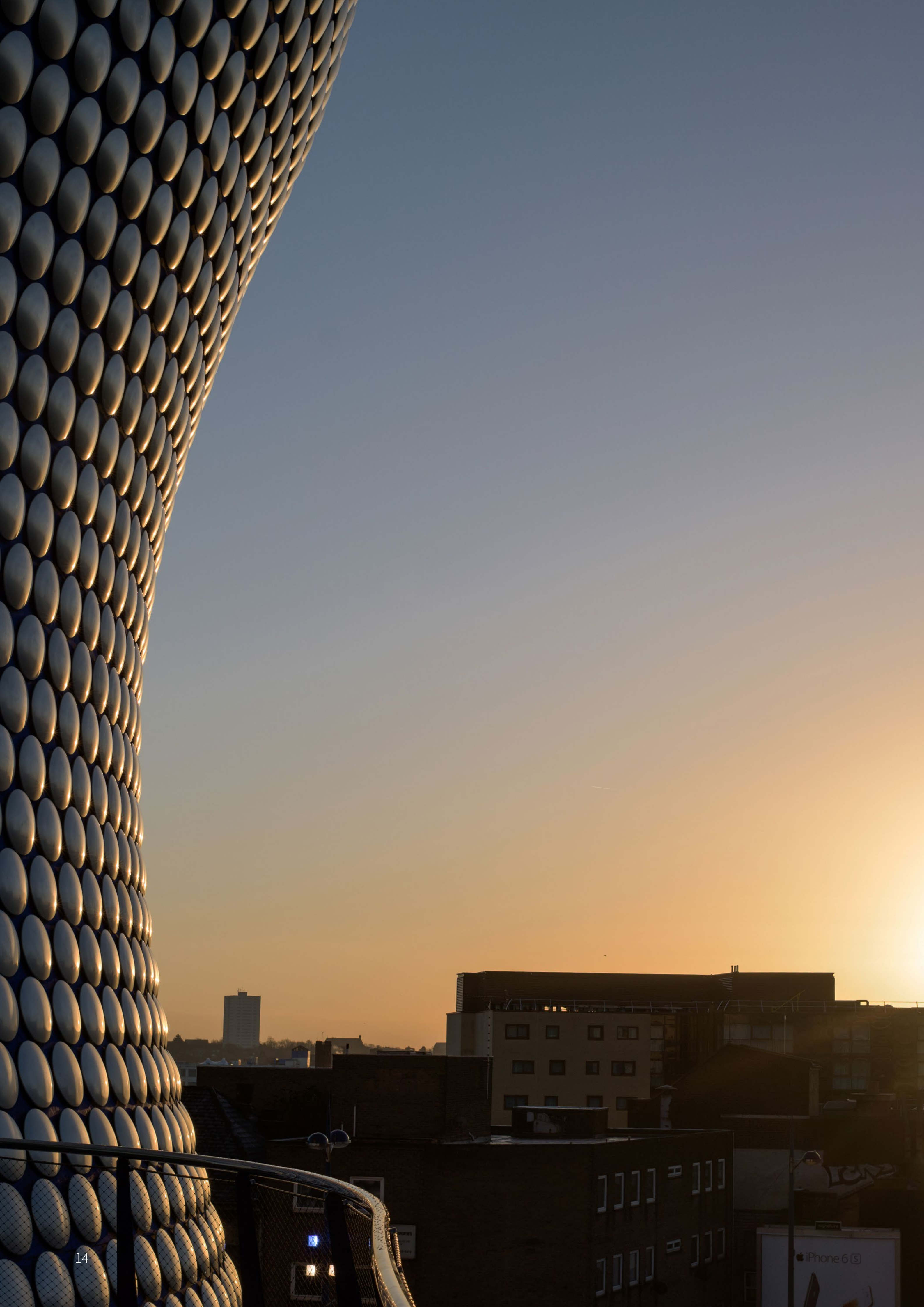
This is not just relief that the cross-channel tit for tat is over, but across major swathes of the UK and away from the London bubble, it will be welcomed as a good thing. Do not underestimate that shift in sentiment. You don't need to like it to want to make the best of it and the implications remain at this stage, largely an unknown.

However, it is worth stating again – a majority of the population (or at least a large minority these days) is looking forward to independent Britain and this may well trickle into stronger consumer sentiment. Stranger things have happened.

Find the Gap

These are all big, structural changes for the housing industry. So, Find the Gap is a way of reframing the risks of a Mind the Gap perspective. The challenges are broad-based and well-known.

At the same time, there are several very large pillars to support new opportunities for the housing sector. They may require a shift out of traditional comfort zones to embrace new markets or new technologies, but they are undoubtedly there for the taking.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Our forecasts 2019 – 2023

House price growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Birmingham	2½	2½	3	3½	3½	15.9

Rental growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Birmingham	3	3	3	3½	3	16.5

House price growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Greater London	½	2	4	4	3½	14.8
South East	0	1	3	3½	3½	11.4
East of England	½	1	3½	4	3½	13.1
South West	1	½	2½	3½	3	10.9
East Midlands	0	½	2½	3½	3	9.8
West Midlands	1	½	1½	3	3	9.3
Yorkshire & The Humber	1	½	2	3½	3	10.4
North West	1	1	2½	3½	3½	12.0
North East	0	0	1	2½	3	6.6
Wales	1	0	1½	2½	3	8.2
Scotland	2	1	2½	3	2½	11.5
UK	½	1	3	3½	3	11.4

Activity and development	2019	2020	2021	2022	2023
UK transactions (m)	1.15	1.18	1.23	1.28	1.32
UK starts (000s)	175	180	185	195	205
UK completions (000s)	190	180	175	180	185

*Source: JLL   * cumulative growth*

Residential services

Investment

Affordable Housing

Estate Agency & Lettings

Funding & Corporate Finance

Land Sales & Acquisitions

Research

Valuations

Mixed Use Development

Planning

New Homes Sales

International Agency

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