Real value in a changing world

on.point

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UK Residential Market Forecasts

Nationally residential prices finished 2010 up 0.7% annually with growth rates weakening from a Q2 peak of 9.5%. Activity levels, new-build volumes and exchanges are running behind the long-term average. On the whole, London (up 2.7%) and Southern markets (up 2.2%) continued to outperform other regions.

As a national average we see limited positive momentum for house prices during 2011. Pending any significant macroeconomic developments we expect prices to decline 1%. This however masks stronger performance in London, up 2%, and Prime London markets, up 5%.

Forecast risks most certainly remain on the downside, with the full impact of government cuts and public sector job loses still to flow through the system. Growth is expected to be highly location and asset specific.

UK Residential Market Forecast

Summary

- UK house prices – annual price inflation peaked at 9.5% in Q2, the remainder of 2010 was subdued as prices fell in the face of weak buyer sentiment. Average UK prices closed 0.7% higher than 2009. Regionally, London continues to show solid performance, up 2.7% annually.

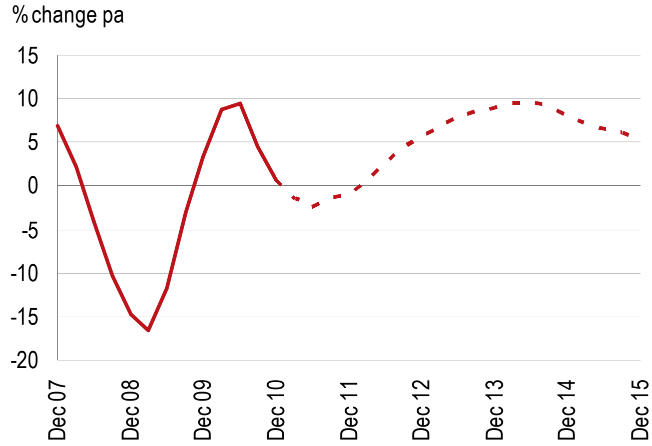
- Supply and demand – nationally new instructions coming to the market have consistently fallen for the last four months on the RICS measure. The net balance of new vendor instructions fell in January albeit at a slower rate than December, -3% as opposed to -14%. Buyer demand has also been falling since June 2010. January has not witnessed a strong seasonal upswing. London again sits at odds, with significantly stronger levels of activity.

- Transaction volumes – the total number of exchanges recorded by HMRC increased 4% during 2010. This was despite a 19% decline in the fourth quarter (compared to 2009) resulting from the December 2009 rush to complete before the stamp duty holiday ended. Volumes lag the five-year average by 28%.

- Construction – new-build starts are expected to surpass 100,000 for the first time in three years when statistics are confirmed for 2010. With development liquidity proving challenging, economic concerns continue to hold the market back. Starts lag the long-term average by around one-third.

- Outlook – volumes continue to be weak. Price inflation (or deflation) is only moving marginally as a result. Wider market confidence has been shaken by mixed economic indicators. Short-term we do not expect a wholesale correction, but UK prices are expected to deteriorate. Estimates for 2011 see prices down 1%, before the recovery takes hold in 2012 and markets move towards the long-term average, circa 6.5% pa.

Forecast of UK residential prices



Source: Jones Lang LaSalle; Nationwide

Dec % Chg YoY	2010	2011	2012	2013	2014	2015
UK	1	-1	5	9	8	5

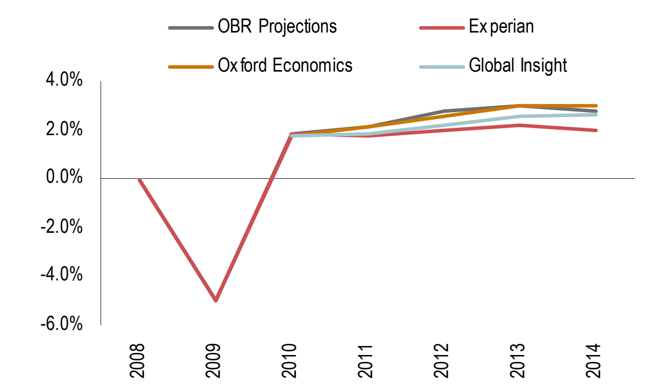
Economic background

Near-term prospects for a buoyant economic revival are weak. The government austerity package has a number of frontloaded measures aimed at cutting the fiscal deficit. Provided the economy is robust enough to cope with this short-sharp-shock method, then the prospects for the medium to long term are far brighter.

Q4 GDP suffers in poor weather

Although expecting weak growth, the 0.6% decline in Q4 GDP took most by surprise, and was well below the median market forecast of 0.4% growth. The Office for National Statistics release blamed "extremely bad weather in December" for most of the fall. But even if there had been no disruption from the snow, they estimate "GDP would be showing a flattish picture". The Q4 decline lowered UK GDP growth in 2010 to 1.4% from previous consensus estimates around 1.7%.

GDP Forecasts



Source: OBR; Oxford Economics; Experian; Global Insight

Inflationary concerns

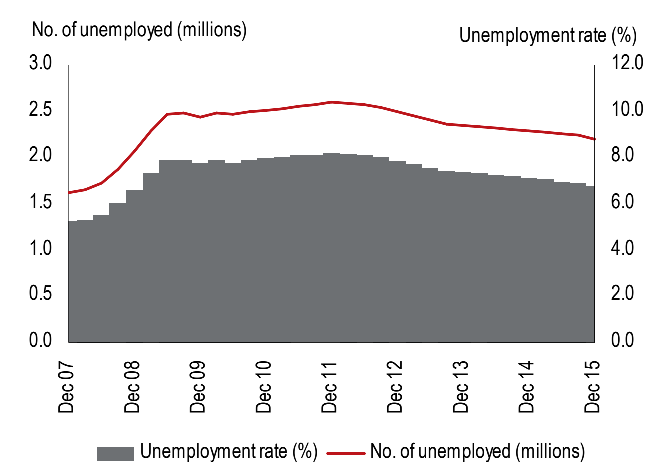
Headline CPI hit 4% in January, up from 3.7% in December and twice the Bank of England target rate of 2%. Many of the factors driving up inflation: commodity prices (particularly fuel), the VAT hike and the increased cost of imports sit outside the realms of Bank of England control. Over the longer term, the MPC maintains that inflation is likely to fall towards its 2% target.

Adverse outlook on employment

Unemployment increased marginally in the three months to December 2010, reaching 7.9%. That reflects total unemployment nearing 2.5 million. More than one-in-five in the 16 to 24 age category is unemployed. This has a knock-on effect for the rental market and serves to illustrate why the average age of a first-time buyer, with no financial assistance from their family, is now 37.

There is no immediate light at the end of the tunnel for improving employment prospects, and remains one of the heaviest anchors weighing on house price growth. Expectations are that unemployment will peak at 8.2% in Q4 2011, on the Oxford Economics forecast, before improving throughout 2012.

Employment Forecast



Source: Jones Lang LaSalle; Oxford Economics; ONS

Balancing the base rate

The UK base rate remained at 0.5% in February for the 23rd consecutive month; however, more questions are being raised about an appropriate level for the base rate to counteract building inflationary pressures. Given the fragility of the recovery we still place a high probability on the Bank of England maintaining low rates while the impact of the austerity measures are absorbed. That said, the recent Bank forecast suggest the base rate might rise to 0.75% by May this year, and is likely to be at 1.00% by the end of the year.

Forecasts for the UK Economy

	2009	2010	2011
GDP	-5.0	1.7	2.1
Household Consumption	-3.4	1.2	1.1
Inflation (CPI)	2.2	3.3	3.3
Short term interest rate*	0.7	0.8	1.5
10 year Gilt Yield	4.0	3.5	3.8

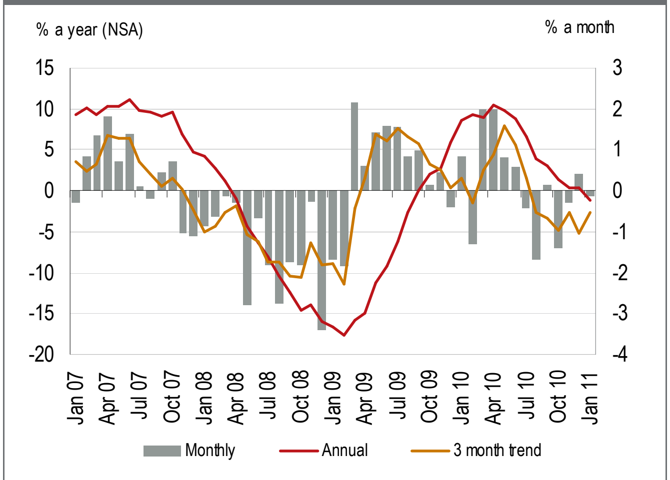
Source: Consensus Forecasts (Jan-11); *3 month interbank rate

Current UK housing market

Price changes

By the close of 2010 prices finished broadly flat, up 0.7% on the previous year. The projected contraction in activity continues to play out, with wider economic concerns weighing heavily on price inflation. Volumes have stagnated in a similar fashion, down 19% year-on-year in the final quarter. This can partially be explained by the rush in 2009 to complete before the stamp duty holiday expired. However, recent volumes lag the five-year average by 28%.

Nationwide UK house price growth (monthly)

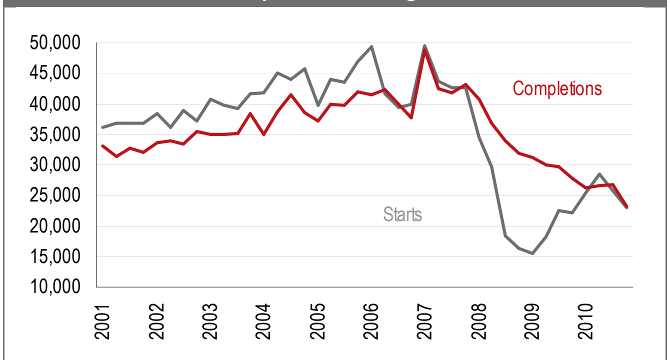


Source: Jones Lang LaSalle; Nationwide

Housebuilding: government statistics on 2010

Recently released DCLG statistics show the chronic shortage of new-build completions delivered in 2010. As highlighted by the HBF, the lack of housing starts throughout the housing recession of 2008/9 hit home –England delivered the lowest number of completions since 1923. A total of 102,570 new homes completed in England last year, down 13% against 2009.

New-build: starts & completions in England



Source: Jones Lang LaSalle; DCLG

This places even more emphasis on the government's New Homes Bonus, aimed at incentivising Local Authorities to accept more new homes and enhance local housing stock. The government recently confirmed £200m has now been allocated, and that the bonus will also apply to any empty properties brought back into use. On current projections for household formation the market requires 232,000 new homes to be built in England each year through to 2030 to meet demand.

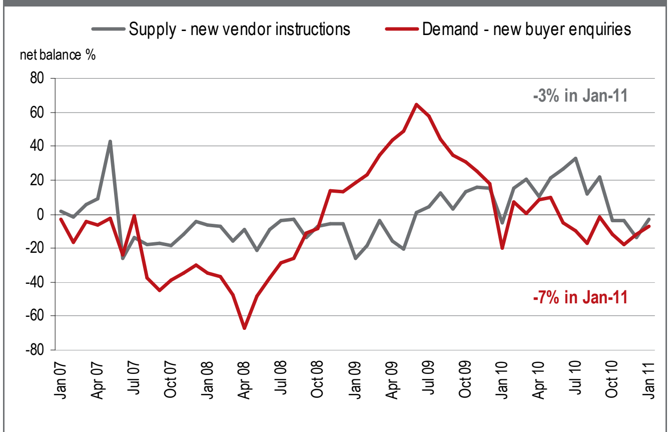
Supply and demand dynamics

Seasonally, the start of the year is typically a busy time across the residential sector. However this January new buyer enquiries and new instructions continued to trend down. According to the RICS housing market survey, the number of properties coming to the market has declined for four consecutive months. January recorded a net balance of -3% while December was down -14%.

The number of would-be buyers declined for the eighth consecutive month, with a net balance down 7% against a figure 12% down in December. So the rate of both buyer and seller enquiries continues to fall; only at a slower rate than the closing months of 2010. This segment of the market is heavily sentiment driven, so expect a sharp improvement as economic fundamentals improve.

As a result of weakening demand, the average time on the market has risen by more than two weeks during the last nine months, according to Hometrack. Similarly, with a lack of competition for properties, the gap between asking price and achieved price is growing. On average 91.9% of the asking price is being achieved.

Market competition



Source: Jones Lang LaSalle; RICS

UK house price forecasts

Expectations for house price growth in the UK have not changed markedly. The 3-month trend in house prices improved marginally, but still remains in negative territory, down 0.5%. Nationally the forecast for 2011 sees house prices declining 1% annually before stabilisation in 2012. It is likely that this will be followed by growth comparable with the long-run average, around 6.5% between 2013-15.

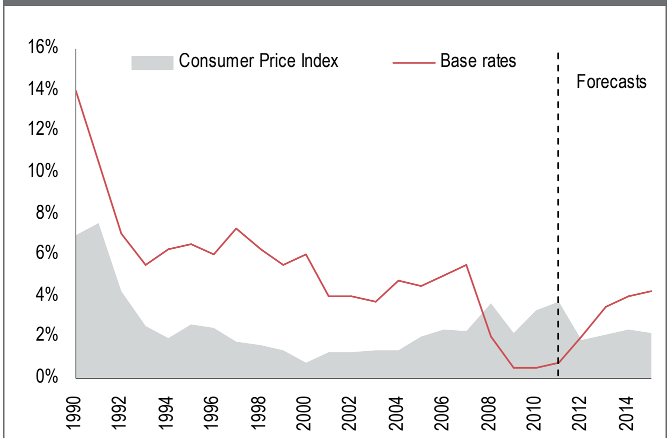
In the short term: demand, transaction volumes and activity levels are not expected to recover. The market remains highly asset specific and price sensitive. There are equity rich investors looking to enter the market, but it has to be the right opportunity.

The polarisation between prime assets and mass-market housing remains stark. Most housing market stakeholders remain risk averse: speculative, debt-dependent schemes in fringe locations are, on the whole, losing out. Neither banks nor buyers are willing to gamble that this segment of the market will recover quickly.

Inflation and base rate expectations

Focus is turning to the implications of a rising base rate to counteract persistently above target CPI. Any interest rate increase would be damaging for the housing market, depressing volumes and squeezing potential price growth. Limited wage growth will ensure that household incomes remain under pressure and servicing borrowing liabilities will become a challenge for many.

Inflation and base rate forecasts



Source: Jones Lang LaSalle; Global Insight

Mortgage market projections

The Council of Mortgage Lenders showed that net lending (stripping out redemptions and repayments) totalled just £8.15 billion during 2010 – the lowest level since Bank of England records began in 1987. Forecasts for 2011 do not expect the situation to ease, with only £6 billion in net advances projected for the year – barely a patch on the £40 billion of 2008.

Banks look set to face a further crunch in 2011 as highlighted by the Bank of England. With £500 billion in debt maturing over the year, many institutions will focus on balance sheet consolidation rather than a drive towards new lending to would-be home owners.

Forecasts for UK Housing

Weak lending and pressure on limited disposable income continue to dissuade would-be buyers from entering the market. Transaction levels are down by more than one-quarter against the long-term average; throughout 2011 we expect volumes and price growth to remain flat, with more risk on the downside.

Recent Q4 statistics illustrated new-build starts picking up marginally; largely as a result of more private sector activity, up 9%, whereas RSL starts were down 19% - their lowest level in more than five years. Anaemic provision of development funding since 2008, leaves any improvement in completions very unlikely in the short-term.

	Actual YoY %	Current	Short-term	Long-term
Average House Prices*	0.7%	▲	▼	▲
Transaction Volumes**	-19%	▼	►	▲
Housebuilding Starts***	4.2%	▲	►	▲
Housebuilding Completions***	-16%	▼	▼	▲

Source: Jones Lang LaSalle; HMRC; Nationwide; DCLG
* Quarterly prices (Q4-10)
** Quarterly volumes (Q4-10)
*** Quarterly housebuilding (Q4-10)

London house price forecasts 2011-2015

Price growth

Price growth in London continues to outperform the wider UK market average. The average annual price gain in London was 2.7%, while the UK rose a marginal 0.7%. Measured on a quarterly basis, prices in London suffered in Q4 during the seasonally slow pre-Christmas period. Prime Central London markets continued to benefit from international capital and the potential of year-end bonus money, gaining more than 5% in 2010. Market cooling measures, particularly across Asia continue to focus money on PCL. Likewise, geopolitical unrest across Africa and the Middle East illustrate the dependable, safe-haven nature of investment in the London market.

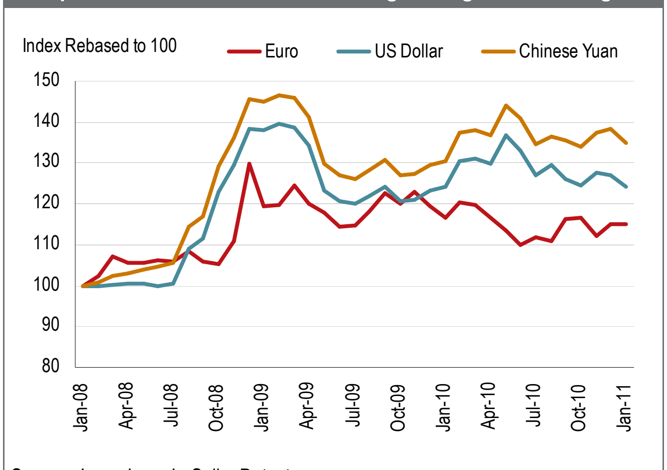
Quantifying London's global appeal

The attraction of London as a global hub was underlined by a recent report describing it as the shopping capital of the world – with retail sales last year totalling £62.4 billion. This edged out Tokyo (£61.4bn) and New York (£47bn). London attracts around 14.1 million overseas tourists – four million more than its nearest rival according to the Centre for Retail Research.

How long will favourable exchange rates persist?

International buyers of London real estate are still able to capitalise on the weakness of sterling to acquire assets at a favourable rate. The purchasing power of sterling is nearly one-third weaker against a basket of 10 international currencies compared with three years ago. Sterling currently lags its ten-year average exchange rate by 15% against the same currency denominations.

Comparative: International investor gains against Sterling



Source: Jones Lang LaSalle; Datastream

Overseas investors contemplating a purchase in London might want to act while this window of opportunity remains. Recent comments from the Bank of England's MPC note that in order to combat inflation, one of the advantages of a rising base rate would be the strengthening of sterling; this would help offset the rising cost of imported commodities. However, it would simultaneously erode the favourable entry point for international purchasers in the UK. Following this logic through, an international buyer might see an interesting arbitrage at the moment. Acquiring now, they might retain the asset and await an inevitable increase in the base rate – benefiting from the concomitant strengthening of sterling prior to crystallising their gain.

Mapping London's gains

The Jones Lang LaSalle/TDPG London heat map illustrated growth in asking prices of 1.8% when comparing Q4 against Q3. Average asking prices were £731psf in the final quarter of the year moving up from £718psf in the third quarter. Despite illustrating overall growth, of the 116 postcodes analysed, prices declined in excess of 3% in 24 postcodes – this continues to illustrate the point that price growth in 2011 will be acutely location specific.

The latest mapping data bears out the ongoing strong rental market story, with average rental prices climbing 2.1% from £37.87psf per annum to £38.66 psf per annum in the final quarter.

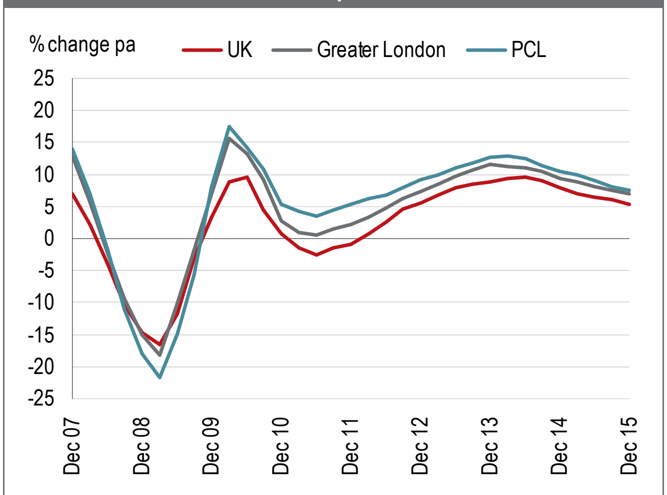
Average gross investment yields were 5.29% pushing out only marginally towards the end of 2010. The stronger rental market was the key proponent of this push.

London house price forecasts

Dec % Chg YoY	2010	2011	2012	2013	2014	2015
Greater London	3	2	7	12	9	7
Prime Central London	5	5	9	13	11	8

Our central forecast continues to see price growth in London markets surpass the UK average. Greater London house price growth is expected to be around 8.5% pa during 2012-2015.

Forecast of London residential prices



Source: Jones Lang LaSalle; Nationwide

Regional house price forecasts 2011-2015

Price growth

Price growth in regional markets outside London and the south of the UK continues to deteriorate. This two-tier market shows no sign of synchronising any time soon, with the dynamics and development of the markets remaining polarised.

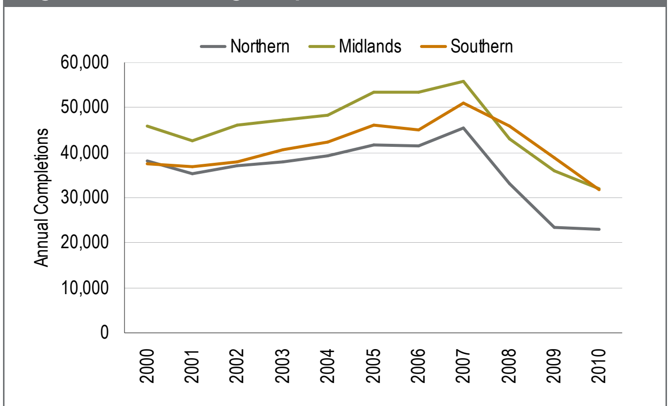
More than a dozen regional centres rely on the public sector for more than one-third of all employment; comparatively London's dependence is closer to one-fifth.

Typically house price growth across the south continues to outperform northern areas. Expectations are for this north/south divide to widen next year. In Q3, price growth in the Midlands and Northern market was flat while Southern areas of England gained 0.8%.

Regional completions

Despite being a historical analysis rather than forward-looking projection it is worth analysing the latest regional new-homes completions. It is important to understand the impact of the low number of new homes supplied to the market last year. Completions across Northern areas during 2010 were 36% below the ten year average, likewise in the Midlands lagged by 30%, even in the fractionally more robust Southern market it was 23% behind.

Regional new housing completions



Source: Jones Lang LaSalle; DCLG

Looking at the forecast, this picture is not improving, with the HBF reporting that planning applications were down 22% in Q4-2010 compared with 2009 – this was the third successive quarterly fall in permissions with an inevitable knock-on effect for construction.

Freeing up public assets

The government is looking to make more public property available for development, including exploring sale-and-leaseback options. The DCLG recently published a list of 1,900 pieces of land across the country where development potential may exist. Those with a consortium capable of taking sites forward are being encouraged to get in touch. The scale of the opportunity is outlined by a Scottish government review highlighting £25 billion of public sector assets where capital could be released and sites could be regenerated, developed or asset-managed. Unlocking public property could bring some significant opportunities; a few of the key concepts are outlined below.

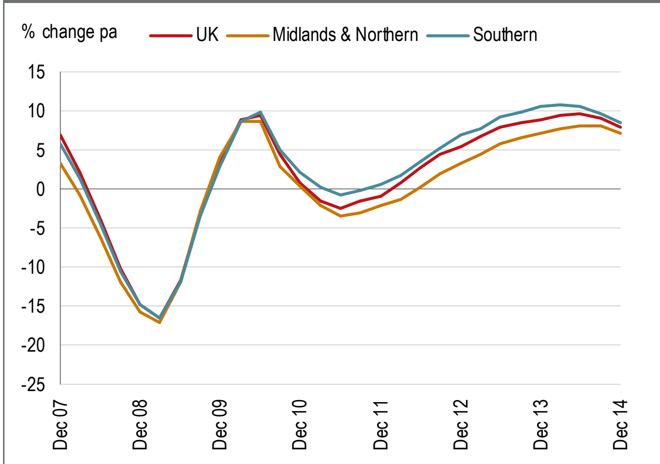
- Push sale-and-leaseback of public property
- Leverage the private sector for infrastructure funding gaps
- Encourage tax increment financing
- Simplify planning to fast-track appropriate applications
- Introduce long-term empty property rates relief
- Convert empty housing into private mid-market rental stock

Regional house price forecasts

Prices are forecast to drop 2% in Northern and Midlands markets during 2011, before recovering towards a longer-term sustainable average of 5% (2012-15). Prices are expected to be equally weak in Scotland, Wales and Northern Ireland. Average growth in Southern markets is expected to be stronger by virtue of the greater store of wealth and diversified employment base. Price growth in 2011 is expected to be 1% with the 2012-15 average 7%.

Dec % Chg YoY	2010	2011	2012	2013	2014	2015
Southern	2	1	7	11	8	6
Midlands and Northern	0	-2	3	7	7	5

Forecast of regional residential prices



Source: Jones Lang LaSalle; Nationwide

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UK Residential Market Forecasts – February 2011
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