Jones Lang LaSalle®

Real value in a changing world

on.point

UK Residential Market Forecasts November 2011

UK housing market – banks hold all the keys

UK house price growth will be 0% in 2012 but stronger growth will return from 2013. London will continue to outperform.

Restricted mortgage conditions will persist, dampening first-time-buyer activity, but low interest rates will support house prices. Crucially, transaction levels will remain well below the 10 year average.

The shift towards renting will continue and private professional investors will become increasingly important and command a larger share of new and second-hand home purchases. Buy-to-let finance will be key.

The supply of new housing will remain worryingly low for several years until it becomes clearer who will be buying the new homes of the future. Development finance will be severely constrained, so only well capitalised developers will be able to build.

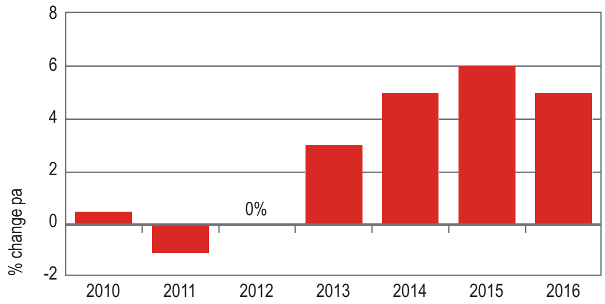
The lack of new development, given rising population and household numbers, will put a strain on UK housing and create upward pressure on both prices and rents.

UK residential market forecasts

Summary

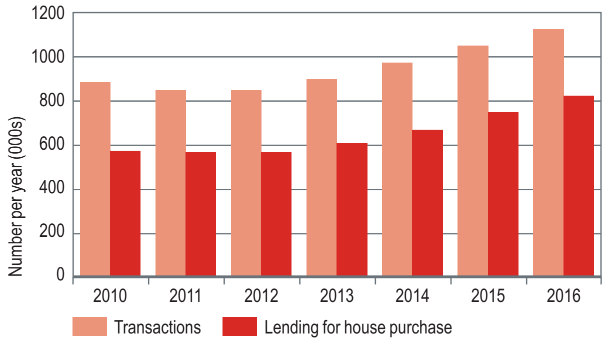
- UK house price growth is forecast to be 0% in 2012. Prices may fall early in the year but rise later.
- UK households should become more confident as 2012 progresses as the Eurozone debt impact diminishes and negative domestic influences such as high inflation also fade.
- 2013 will be a brighter year for UK, Eurozone and global economies and the UK housing market will become stronger and more active. UK house prices will rise by around 3%.
- In the medium-term stronger house price growth will return pushing towards 5% pa.
- London, and to a slightly lesser degree the south, will see a more robust housing market in the short-term and faster house price growth in the medium-term.
- Continued restrictive banking conditions mean that mortgage lending will remain low for several years with notable interest rate differentials dependent on LTV ratios.
- First-time-buyer activity will remain constrained with parental support a key feature.
- Transaction levels will pick-up only gradually in the next five years and will remain well below the long-term trend.
- The shift in housing market activity from the owner-occupier market to the rental sector will accelerate as more people are locked out of owner-occupation.
- Upward pressure on rents will continue, especially in London, although the main realignment of rents over the past two years has already taken place.
- With first-time-buyer activity restricted housebuilding levels will be highly constrained until it becomes clearer who will be buying the new homes of the future.
- Private professional investors will become increasingly important and will command a larger share of new and second-hand home purchases. Buy-to-let finance will be key.
- The UK housing market is entering a new phase in several respects. Consumers, housebuilders, developers and lenders will all have to adapt to this changing landscape.

Figure 1. UK house price forecasts



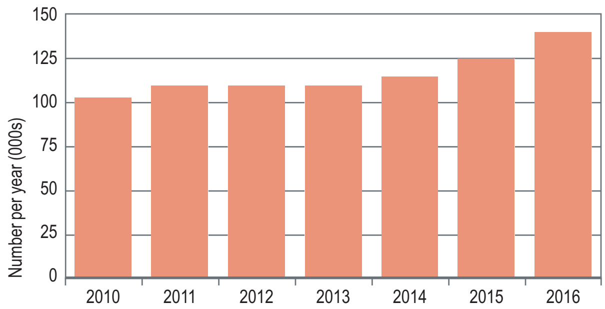
Source: Jones Lang LaSalle, Nationwide

Figure 2. Transactions and lending to remain subdued



Source: Jones Lang LaSalle, HMRC, BoE

Figure 3. England housebuilding well below need



Source: Jones Lang LaSalle, CLG

Figure 4. Jones Lang LaSalle housing market forecasts

House price growth	2012	2013	2014	2015	2016
UK	0	3	5	6	5
Prime Central London	4	6	8	7	6
Best new central London developments	4	5	8	7	6
London	2	4	7	6	5
South	0	2	5	5	5
Midlands & north	-2	1	3	5	7
Rental growth	**2012**	**2013**	**2014**	**2015**	**2016**
UK	5	4	3	3	3
Prime Central London	8	7	6	5	4
Best new central London developments	7	6	5	4	3
London	7	6	5	4	3
Other forecasts	**2012**	**2013**	**2014**	**2015**	**2016**
UK transactions	850,000	900,000	975,000	1,050,000	1,125,000
UK mortgage lending	570,000	610,000	670,000	750,000	825,000
England housing completions	110,000	110,000	115,000	125,000	140,000
London housing completions	20,000	22,000	23,000	24,000	24,000

JLL forecasts based upon data from JLL, Nationwide, HMRC, BoE and CLG

Economic background

Eurozone debt issues create uncertainty

The sovereign debt crisis in Greece, possible contagion and the potential consequences, are creating huge uncertainties for UK, Eurozone and global economies. The outlook is heavily dependent on finding a satisfactory solution to the whole Eurozone debt crisis rather than just addressing problems in Greece. The most recent rescue package, late-October, goes some way towards this, but it is likely that further measures will be required to reassure financial markets.

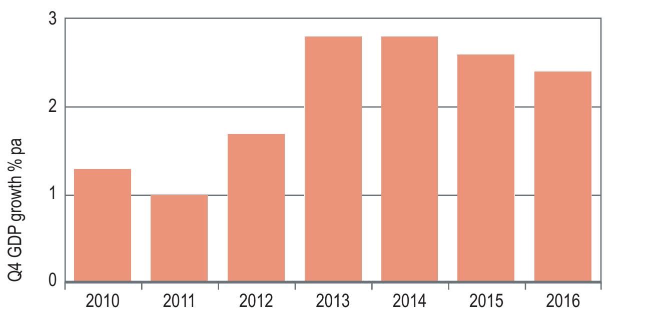
Our housing market forecasts assume that a lasting solution is implemented, allowing economic recovery in the Eurozone to resume later next year. The impact of recent events and the subsequent stockmarket turbulence has, broadly speaking, deferred stronger economic growth by around a year. UK, European and global economies are all predicted to grow more sluggishly in 2012 than previously forecast, but all are expected to pick-up more strongly from 2013. Global economic growth of 2.8% in 2012 is forecast to be similar to 2011 but should improve to circa 4% pa from 2013.

The uncertainties surrounding the Greek debt crisis have clearly increased the downside risks to all economic forecasts and although forecasts have been downgraded the downside risks still outweigh the upside possibilities.

UK economy ahead of Eurozone

The UK economy will clearly be affected by these events but will be insulated to some extent as we are not part of the Eurozone. The UK economic recovery has already proved weak with GDP growth in the order of 0.9% in 2011. Although the headline GDP forecast for 2012 is only a little better, at 1.1%, according to Oxford Economics, the picture will be improving significantly as the year progresses with growth in the year to Q4 expected to be a notably stronger 1.7%. Importantly, by the end of 2013 UK GDP growth is forecast to be as high as 2.8% pa and is expected to remain above trend until 2016.

Figure 5. UK GDP growth above trend by 2013



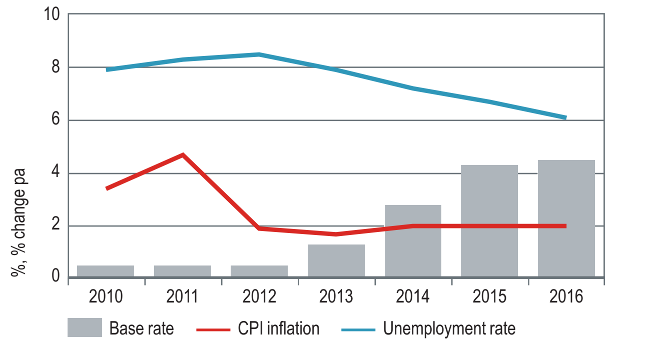
Source: Jones Lang LaSalle, Oxford Economics

High inflation to fall back, base rate to stay low

The economy and households will get a boost as early as 2012, but also throughout our forecast period, as inflation heads back towards 2% pa. CPI inflation is expected to slow considerably from its current 5.2% (September) to 1.9% by end-2012 as the VAT rise and higher commodity price rises fall out of the annual calculations. This will be a welcome relief to households who have had their disposable incomes eaten away by rising living costs, especially over the past year.

The UK base rate is forecast to stay at its historically low 0.5% throughout 2012 and for at least part of 2013 in order to support the relatively weak UK economy. Although the base rate is likely to increase steadily towards 5% over the following 2-3 years mortgage rates should not increase as sharply as margins are scaled back. Importantly, relatively low interest rates should remain supportive of house prices throughout the next 5 years.

Figure 6. Return to economic norm will take time



Source: Jones Lang LaSalle, Oxford Economics

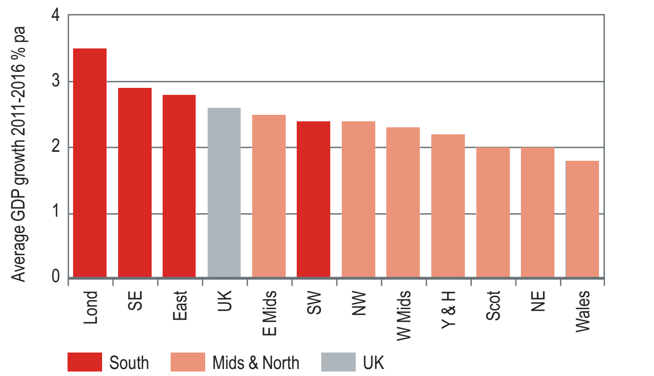
Unemployment to rise before falling back

One dark spot for the UK economy in 2012 is that unemployment is forecast to increase slightly. The unemployment rate is set to increase to 8.5% from 8.3% but should be falling again by the end of the year. Some further public sector jobs losses are expected as austerity measures continue while there could also be some additional private sector casualties. But the employment losses will be far more mild in 2012 than in 2011 while in the medium-term unemployment should fall to a far more healthy 6.1% by end- 2016.

London to lead economic recovery

An important feature of the UK economic recovery, and indeed a consequence of much of the government austerity measures, will be the relative robustness and outperformance of London and the South. Figure 7 shows the average annual GDP growth forecast in each region during the period 2011-2016.

Figure 7. London and south will lead economic recovery



Source: Jones Lang LaSalle, Oxford Economics

Current housing market trends hold key to future

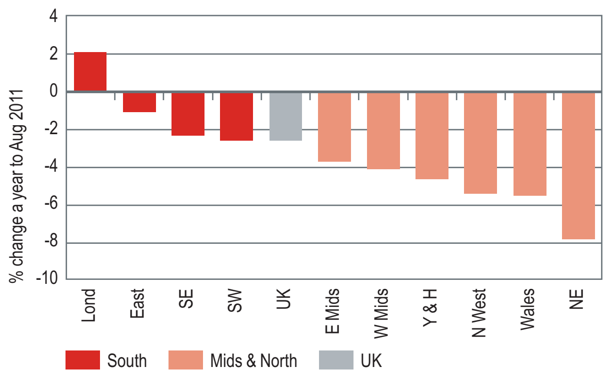
There are a number of key trends that are defining current housing market conditions. These are identified below and are discussed in greater detail later in the report. The trends are of vital importance as they imply we are entering a new era for the UK housing industry.

House price growth

The various house price data providers disagree on the quantum of house price changes although they do agree on the general trends. Our usual preferred data provider, Nationwide, claim that UK house prices have increased by 0.8% in the year to October 2011 whereas the Land Registry say that prices fell by 2.6% in the year to August.

One of the key features of the UK housing market is a difference in house price growth dependent on location. Broadly speaking London has seen slightly positive house price growth over the past year, southern regions slightly negative growth and midland and northern areas slightly greater price falls (Figure 8).

Figure 8. House price growth better in the south



Source: Jones Lang LaSalle, Land Registry

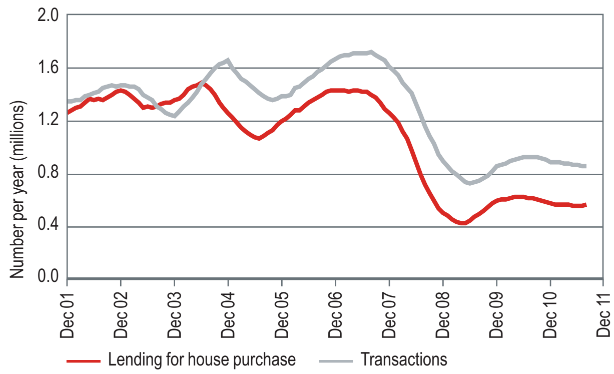
There are two main reasons behind the brighter picture in the south. These are better economic conditions and greater affluence.

Transaction levels & mortgage lending

Undoubtedly the most critical features of the UK housing market at present are the low level of housing transactions and the highly constrained mortgage lending conditions. Figure 9 shows how weak current levels are by historic comparison. Furthermore, latest figures on transaction levels reveal that the number is falling rather than rising and although there have been minor increases in lending for house purchase in recent months, the improvements are relatively minor.

The tighter mortgage lending conditions since the onset of the credit crisis are well documented. Higher deposits are now required as fewer high LTV mortgages are available and even when they are they carry a significantly higher interest rate. Lenders have also been far more selective, turning down applications when an exemplary credit history is not provided.

Figure 9. UK transactions and lending at new lows



Source: Jones Lang LaSalle, BoE, HMRC

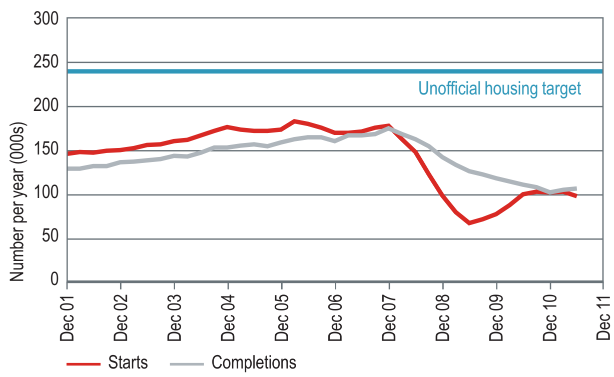
The result has been notably lower volumes of first-time-buyers and other lending for house purchase. This trait has also had the impact of restricting house buying activity to more affluent areas where parental support is more readily available and higher housing equity makes it easier for existing home owners to move. So, not only are house prices more robust in London and the south, transaction levels have also been more resilient.

Housebuilding

The other key feature of the current UK housing market has been the significant drop off in house building. With mortgage conditions and transaction volumes as they are it is unsurprising that housebuilders and developers have reined back their development activities. The credit crisis has also impacted on the availability of development finance so even when developers are keen to build they can often not obtain finance.

As can be seen in Figure 10, housing completions are currently running at under 110,000 homes a year. Although there is no longer an official housebuilding target, the fact that we are building significantly less than the 240,000 unofficial homes target a year is the most important medium-to-long-term issue for the UK housing industry.

Figure 10. Housebuilding in England significantly below need



Source: Jones Lang LaSalle, CLG

2012

Backdrop & drivers

Although we assume that the Greek rescue package is successful, does not lead to other European bail-outs and settles financial markets, the overhang from these events will linger into 2012. Underlying business and consumer confidence will be shaky at the start the year but a very important aspect of the UK economy in 2012 will be the gradual traverse from uncertain and weak beginning to a more stable and optimistic perspective by the year-end. A successful and lasting resolution to the Greek and Eurozone debt issues will allow all aspects of the economy to look forward rather than over its shoulder as the year progresses.

UK GDP growth is forecast to be 1.7% pa by Q4, notably higher than the circa 1.0% at end-2011. The unemployment rate will rise marginally by mid-year before falling back to circa 8.5% by end-2012. Disposable income growth in the region of 3.6% will translate into the first real increase in incomes in four years as the fall in inflation also boosts household finances and confidence.

Housing market forecasts

There will be a number of factors at play in the UK housing market during 2012. These are summarised in Figure 11. We expect the housing market to be far stronger in the second half of the year than the first.

We believe that weak economic and consumer confidence conditions will mean that UK house prices will continue to fall early in the year. But the scale of the falls should be quite shallow. Greater stability should build as the year progresses with some house price gains being achieved, especially in London. Midland and northern regions will continue to suffer the most in terms of employment declines and will not benefit from wage increases as much as southern regions. The squeeze on household incomes and the demand for housing will therefore be weaker in these regions. Prices in London and the south will be supported to some extent by greater parental support and also by buy-to-let investors. A similar regional divide in transaction levels and mortgage lending is also expected.

One notable milestone in 2012 will be the closing of the first-time-buyer stamp duty holiday on properties worth less than £250,000. When a similar holiday closed at the end of 2009 there was a notable increase in turnover but transaction levels simply fell right back again early the following year to effectively nullify the impact. Unfortunately, given the weak underlying market conditions, any boost in transaction levels is unlikely to lead to a more meaningful and longer lasting incline.

With mortgage lending conditions still difficult, the problems for first-time-buyers will persist in 2012 and will dent the potential to increase transaction levels. We forecast UK transactions will remain at circa 850,000 in 2012. We are also predicting no rise in mortgage lending for house purchase; this should hold at around 570,000 loans in England.

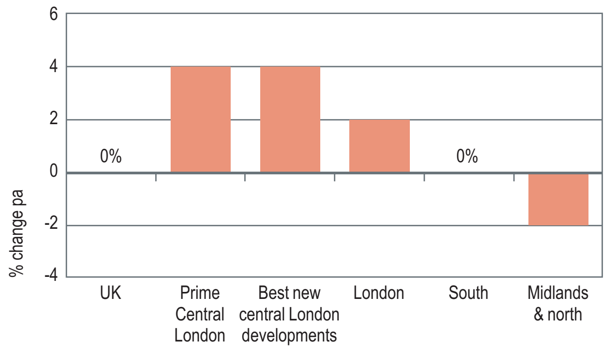
Figure 11. 2012 UK house price factors

Negative
1 Weak economy
2 Uncertain outlook
3 Low household confidence
4 Affordability issues
5 Restricted mortgages

Positive
1 Enough 'assisted' buyers
2 Low interest rates
3 Improving economy
4 Improving household confidence
5 Undersupply of housing

Source: Jones Lang LaSalle

Figure 12. 2012 London and regional house price forecasts



Source: Jones Lang LaSalle

Figure 13. Recent history and housing market forecasts

House price growth	2009	2010	2011	2012
UK	3	1	-1	0
Prime Central London	12	6	7	4
Best new central London developments	7	5	3	4
London	7	2	2	2
South	5	3	-1	0
Midlands & north	1	-1	-2	-2

Other forecasts	2009	2010	2011	2012
UK transactions	859,000	886,000	850,000	850,000
UK mortgage lending	597,000	575,000	570,000	570,000
England housing completions	119,000	103,000	110,000	110,000
London housing completions	20,200	15,800	19,000	20,000

JLL forecasts based upon data from JLL, Nationwide, HMRC, BoE and CLG

Housebuilding levels are unlikely to increase in 2012 given these relatively weak and uncertain conditions. We expect housing completions to remain at around 110,000 although housing starts may push upwards slightly as the outlook for 2013 -2014 brightens later in the year.

2013-2016

Backdrop & drivers

Global and UK economies should be on a far safer footing as we enter 2013 although expansion in the Eurozone will still be sluggish.

The UK economy is forecast to expand by 2.8% in 2013 and by 2.7% pa during 2013-2016. Unemployment should begin to fall back as private sector employment expands while public sector job losses diminish. Inflation will be back close to the target 2% pa and this will mean lesser household cost pressures and real increases in disposable income but it will also mean that the base rate and interest rates will start to move up towards more neutral levels.

The UK economic recovery will initially be biased towards London and the south but will be progressively more broad based as the recovery becomes established.

Housing market forecasts

A stronger economy, a more positive outlook, improving job prospects and higher pay will all help fuel greater housing demand. These conditions will also release some of the pent-up housing demand built up over the previous few years. With employment conditions initially better in the south, this is where housing demand will be strongest.

However, we are not expecting a quick liberating of the mortgage market despite heightened desire to buy. This will stifle first-time-buyer activity with continued bias towards those with parental support. Overall transaction levels will therefore remain subdued by recent standards with the knock-on effect that housebuilding will not return to any significant effect during our forecast period (Figure 16).

The impact of these trends in mortgage lending, transaction levels and housebuilding mean that we will have a quite different housing market compared to 10 years ago, as discussed later, but it also implies greater pressures building. The most significant impact is that the level of housebuilding will be well below that required given population and household formation projections and this will create pressures for the housing market as a whole and in prices and rents.

So, although the number of house purchases will not return to pre credit crisis levels, there will be significant upward pressure on house prices as the economic recovery takes hold. The British aspiration to own your own home together with the parental support factor means there will be sufficient numbers of people able to jump onto the housing ladder. Further up the housing chain, fewer people moving will keep available supply low across all echelons of the housing market.

Given these strong, albeit quite constrained, demand factors as well as the restricted supply outlook, house prices will undoubtedly be forced up during this period. There will be greater pressures in London and the south and we expect house price growth in the order of 5-7% pa for much of this period. With lower wealth and less housing equity in midland and northern regions together with weaker job and pay prospects, house price growth will be lower in these regions until the end of the forecast period (Figure 15).

Figure 14. 2013-2016 UK house price factors

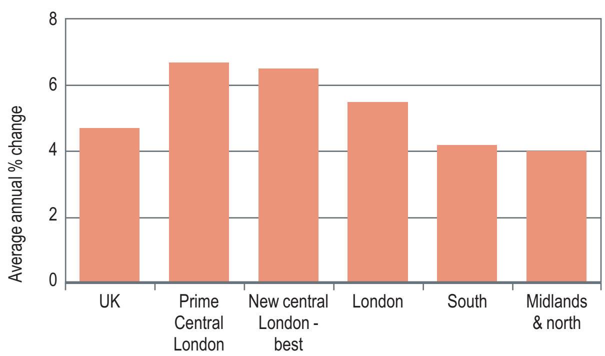
Negative price growth
1 Restricted mortgages
2 Unbalanced economic prospects
3 Stretched household finances
4 Poor housing affordability
5 Higher interest rates

Positive price growth
1 Stronger economy and confidence
2 Undersupply of housing
3 Population and household growth
4 Pent-up housing demand
5 Aspiration to own home

Source: Jones Lang LaSalle

Importantly, these characteristics mean that there is a real possibility that house price growth will be stronger than forecast here. The possibility that house prices will spike upwards in 2014 or 2015 is a distinct possibility. The other consequence of these conditions is greater pressure and importance for the rental sector. This is discussed more fully later in this report.

Figure 15. 2013-16 London and regional house price forecasts



Source: Jones Lang LaSalle

Figure 16. 2013-2016 housing market forecasts

House price growth	2013	2014	2015	2016
UK	3	5	6	5
Prime Central London	6	8	7	6
Best new central London developments	5	8	7	6
London	4	7	6	5
South	2	5	5	5
Midlands & north	1	3	5	7
Other forecasts	**2013**	**2014**	**2015**	**2016**
UK transactions	900,000	975,000	1,050,000	1,125,000
UK mortgage lending	610,000	670,000	750,000	825,000
England housing completions	110,000	115,000	125,000	140,000
London housing completions	22,000	23,000	24,000	24,000

JLL forecasts based upon data from JLL, Nationwide, HMRC, BoE and CLG

London

Backdrop & drivers

There are a number of reasons why London house prices will rise more strongly than elsewhere over the next five years and also why transaction levels, mortgage lending and housebuilding in the capital will be more robust.

Despite sovereign debt issues, London's economy is forecast to expand quite strongly throughout 2011-2016. GDP growth of 2.5% next year will be better than the 1.7% UK average and the 3.5% pa five year average should be well ahead of the 2.6% UK figure.

Largely due to the preferential economic growth profile, London attracts significant numbers of migrants both from within the UK and internationally which increases the demand and need for housing in both the owner-occupier market and the rentals market. Furthermore, because the capital's households are generally more wealthy and have greater housing equity this means that the difficulties in the mortgage market are less pronounced while financial assistance from parents is also more prevalent and viable.

London also benefits from international purchasers. Many of these are pure investors while others buy for their own use or for their children when they come to study in London. London is often seen as a safe haven for international investment and with the global economy in uncertain times London should see more than its fair share of overseas money, especially in the medium-term. At present, foreign demand is focusing on more central and core areas of London, but as the economic recovery picks up, demand should also spread to outer core areas too.

This stronger demand profile has led to a firmer rebound in construction levels (Figure 18). In London housing completions, at around 18,000 units pa, are just 7% below their 10 year average and 16% below 2006-2007. In England completions are 25% below the 10 year trend and 36% below 2006-2007. However, the level of completions is still significantly below the circa 32,000 additional homes a year required to house London's growing population.

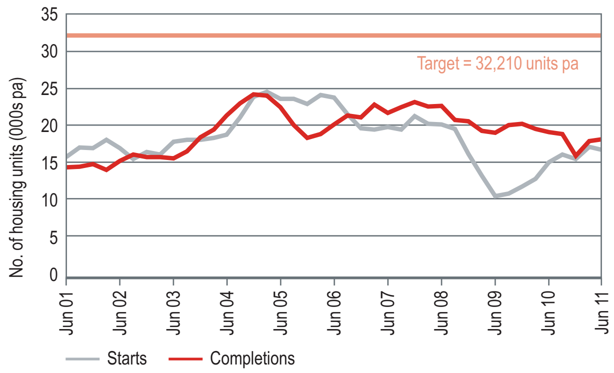
Figure 17. Central London house price factors

Negative
1 Initial weak economy and confidence
2 High prices
3 Restricted mortgages
4 Higher interest rates

Positive
1 Safe haven & international demand
2 High occupational demand
3 Greater affluence
4 Strong London and global economies
5 Insufficient new & existing supply

Source: Jones Lang LaSalle

Figure 18. London development well below target



Source: Jones Lang LaSalle, CLG, London Plan

Figure 19. London housing market forecasts

House price growth	2012	2013	2014	2015	2016
Prime Central London	4	6	8	7	6
Best new central London developments	4	5	8	7	6
Other new central London developments	2	4	7	6	5
London	2	4	7	6	5
UK	0	3	5	6	5
Other forecasts	**2012**	**2013**	**2014**	**2015**	**2016**
London housing completions	20,000	22,000	23,000	24,000	24,000
Prime Central London rental growth	8	7	6	5	4
New Central London rental growth	7	6	5	4	3
London rental growth	7	6	5	4	3

JLL forecasts based upon data from JLL, Nationwide, HMRC, BoE and CLG

Housing market forecasts

We are forecasting both a more robust housing market in London in the short-term and a stronger performing market in the medium-term. Furthermore, we believe that more central and affluent areas will see even higher price growth as well as greater demand from occupiers, developers, renters and investors.

We forecast that Prime Central London will see positive house price growth of circa 4% in 2012 before it leads the recovery from 2013. Price growth should push up towards 8% pa by 2014.

New Central London Apartments should also see both positive price growth in 2012 and stronger growth from 2013.

We believe that development in London will remain robust compared to other areas of the UK but completion levels of 20,000-24,000 pa will still fall well short of required targets and will do little to alleviate the upward pressures on house prices and rents.

Importantly, at some point over the next few years, we see a real possibility that sales price growth will spike in excess of 10% pa given the tight supply and strong demand dynamics expected.

Rental demand is set to increase even further over the next few years and we anticipate that rental growth will be forced significantly higher. However, the rate of rental growth will probably slow from the circa 12% in 2011, to 7% in 2012 and then towards 5% pa by 2014.

The 'new normal'

Mortgage constraints will persist

The shock caused by the withdrawal of a wide range of mortgage products in the aftermath of the financial crisis is still reverberating around the British housing market. Although the average loan-to-value ratio – which was 90% or more for over two decades before 2007 – has risen from 75% in 2010 to around 80% now, loans remain in short supply, particularly for those without large deposits or requiring high income multiples. Parental help has become all-important for those seeking a foot on the ladder.

It is tempting to dismiss these problems as temporary, and assume that the market will gradually return to normal. This is unlikely to be the case. After decades of financial liberalisation, the pendulum has begun to swing in the opposite direction. This is encapsulated by Basel III, the international regulatory package which sets new, higher rules for the reserves of capital that banks must hold in respect of "riskier" loans.

As higher LTV mortgages fall into this category, banks need to put substantially more capital aside when lending to someone who has, for example, a 10% deposit, compared to another applicant with a 30% deposit. In other words, higher LTV loans are now significantly more expensive for the bank to provide.

The regulations only start to be phased in in 2013, but their impact is already being felt as banks begin to build up their capital reserves – already depleted by the problems of the past few years – in preparation. The fact that the average first-time buyer deposit has decreased from 25% in 2010 to 20% in recent months might seem to contradict this. However, the increased availability of higher LTV loans has come, literally, at a price.

Higher LTV loans now come at a price

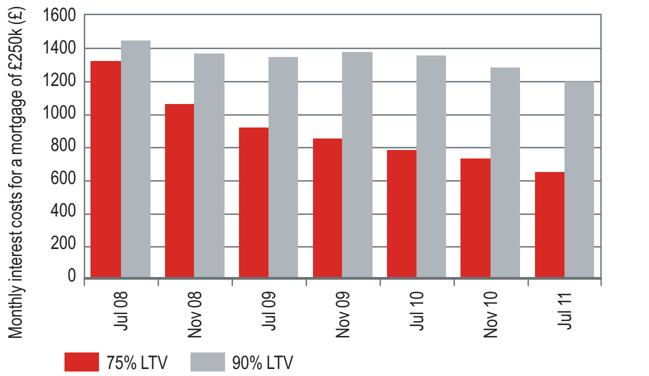
As of October 2011, according to figures published by the Bank of England, there are huge differences in the average interest rate charged to those who have different sized deposits, as the diagram below shows.

2-year fixed, 90% mortgage, £250,000	2-year fixed, 75% mortgage, £250,000
Interest rate 5.28%	Interest rate 2.91%
Monthly interest cost £1,100	Monthly interest cost £606

This 'gap' has been steadily growing for the past few years, despite the increasing availability of higher LTV products (Figure 20).

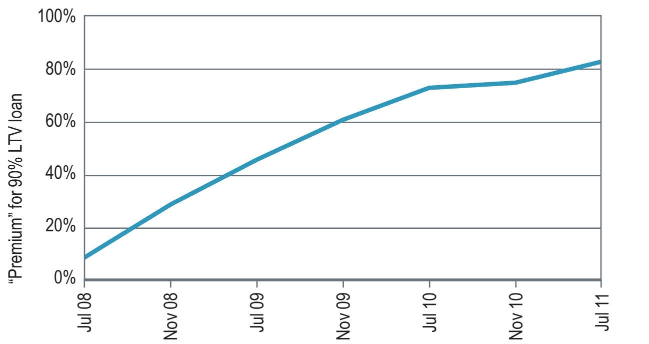
As a result of the shift in regulation, this gap is likely to persist, and could grow. Indeed, as the problems in the Eurozone have intensified, so has the pressure on banks to build up buffers in anticipation of future haircuts or default. If such events occur, there will be impacts on British lenders – it will reduce the amount they have to lend to first-time buyers, further constraining housing market activity.

Figure 20. The Effect of Basel, paying more for smaller deposit



Source: Jones Lang LaSalle, Bank of England

Figure 21. Premium for higher LTV loan has escalated



Source: Jones Lang LaSalle, Bank of England

The end result will be that access to capital, rather than income levels, will continue to be more important in influencing market activity – meaning that investors, both international and domestic, may continue to trump first-time buyers.

Implications for developers too

These lending issues apply just as much to development finance. In this arena, as well, high loan-to-value ratios, if they return at all, will be significantly more expensive for the foreseeable future. The funds available for funding land and construction will also be further constrained if events in the Eurozone intensify. Regulation implies that there will be no return to trend for the way housing is built or bought in the UK. The 'new normal' will continue to present significant challenges to lenders, developers, investors, policy makers and home buyers alike. All must innovate if they are to thrive – and if the country's underlying housing shortage is to be tackled.

The effects on the housing market

A low transaction world

The most immediate effect of the reduced size of the mortgage market has been on transaction volumes, which remain around 40%-50% below the long-term trend. While there may be some improvement with time, it is extremely unlikely that they will reach the levels seen before 2007 in the immediate future. There are several reasons for this:

- Constraints on the mortgage market will prevent first-time buyers entering the market and many recent buyers from moving;
- Owner-occupation is increasingly concentrated among those aged 45+ who are in a life stage where people move less frequently;
- Rapidly increasing numbers of 25-45 year olds – who move the most as they change jobs or form families – are in the rental sector;
- Low inflation and wage growth will keep mortgage payments high compared to income, making it difficult for many to move house. The experience of most older owner-occupiers has been that the burden of paying mortgages has reduced sharply with time, increasing their disposable income and allowing them to move up the ladder. This will not be as much the case in the near future.

Meanwhile, the lower interest rates and greater choice available to those with large deposits has shifted the entire market towards those with access to housing equity. Over the past two decades, this has become even more concentrated among the 45-65 year age group, who have benefitted most from low interest rates and rising house prices, with many now owning outright and/or possessing second homes. Their ability to pass this wealth on to their children to help them onto the housing ladder is increasingly important.

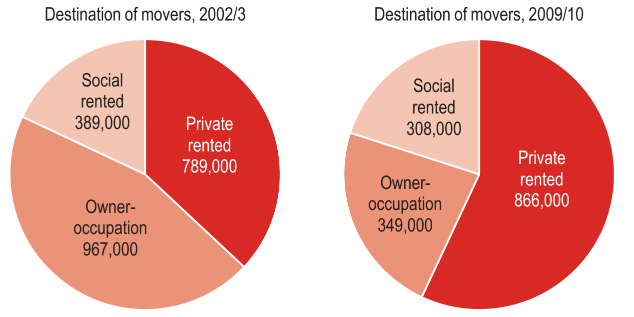
A market of contrasts

This wealth is also more pronounced in the south than in the north and in outer suburbs and rural areas than in cities. Income, which, before 2007, was the main 'gauge' to the mortgage you could access, has become less important. Instead, access to capital – or housing equity – has become most important, and this is more pronounced in these areas.

There is reflected in transaction volumes – in and around the capital, sales rates have been more robust than elsewhere. Those active in the market are likely to be older, more southern, and/or have richer and more generous parents than before the crisis. There has also been a shift upmarket in terms of value; volumes are more robust at higher price bands and in richer, more affluent areas. Prices have followed a similar pattern.

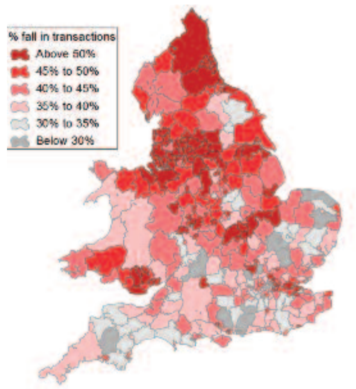
Influxes of capital from the fast-growing emerging economies, which generally have high savings rates and income growth, have also become instrumental, particularly in London. As growth rates in the developing world continue to outstrip those in the West, the emerging wealthy will continue to search for yield and markets in which to invest.

Figure 22. Owner-occupation has become a minority option



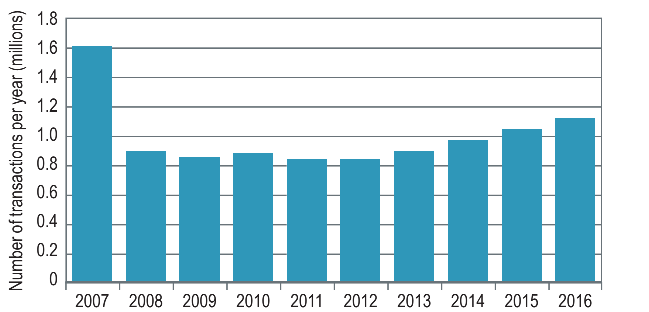
Source: Jones Lang LaSalle, English Housing Survey

Figure 23. A polarised market



Source: Jones Lang LaSalle, DCLG

Figure 24. A low volume world?



Source: Jones Lang LaSalle, HMRC

The shortage of housing stock in the capital, in particular – where the economy is forecast to be stronger than elsewhere in Western Europe – will attract international interest. Domestic investment interest will also increase, as older buy-to-let investors with access to wealth and/or housing equity find that they are able to obtain far more competitive interest rates than first-time buyers.

The rental market becomes mainstream

The default tenure

The decrease in sales transactions does not mean that households have stopped moving. According to the English Housing Survey, in 2009/10 some 1.75m moved, compared to a more typical figure of 2.2m. While this is a decrease, it is not a sharp as for sales transactions. The reason for this is that most household moves – 62% – involved the private rented sector. This trend is nothing new.

Even in 2004/5 there were more moving within rental accommodation than homeowners moving house. The trend in new households is even starker; in 2009/10, 70% of new households moved into privately rented accommodation, compared to 40%-50% before the crisis. Clearly, privately rented accommodation is now the norm for many – and particularly younger or London-based households. Owner-occupation is increasingly only for a wealthy minority.

Increasing demand and low supply

These trends were in place before the crisis, and were only partly driven by increasing difficulties in affording housing. The fact that younger people are more likely to attend university and start families later in life, together with the expectation that their careers will be geographically mobile, also tends to reduce owner-occupation levels.

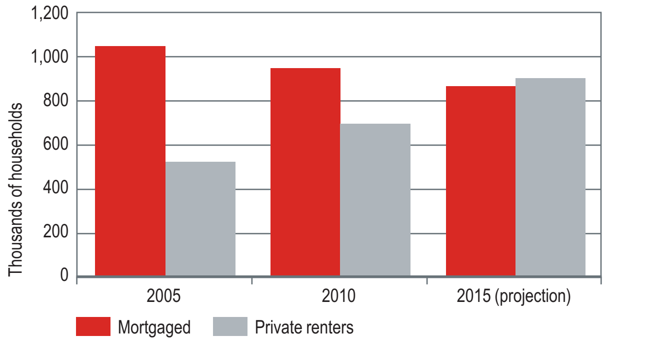
However, the problems in the mortgage market over the past few years have accelerated these trends. Between 2007 and 2009, the percentage of UK households in the PRS increased form 12.7% to 15.6% – and from 19.9% to 23.0% in London. It is now likely that more than a quarter of households in the capital rent privately, a figure that will undoubtedly continue to grow.

The main constraint will be supply. With construction at the lowest level since the Second World War, and buy-to-let volumes still depressed, the supply of rental stock has not increased at the rapid rate seen before 2007. This explains why rents in many cities, and particularly London, have begun to rise. According to Digital Property Group, asking rents in September 2011 were 12.7% higher than the same month in 2010, and are now 27% above December 2007 levels.

Given the continuing attractions of London's employment market both internationally and within the UK, and the constraints on mortgages, it is likely that demand will continue to rise amid static supply. This suggests rents will continue to rise, although affordability issues may begin to dampen this with time.

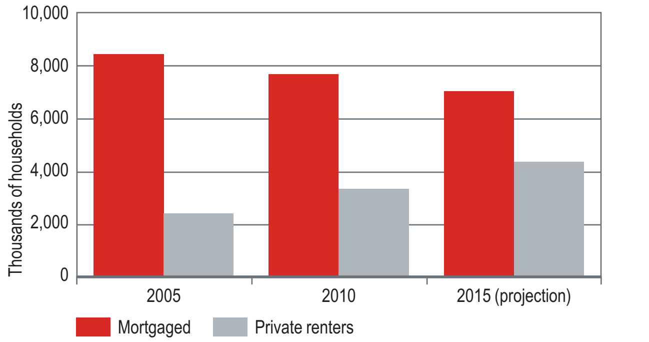
The injection of international investment into London will help increase construction volumes and rental supply with time, which will help to stabilise the market. The emergence of institutional investment, even in 'build to let' may also help, although the sector is deterred by low yields and management issues. It seems more likely that domestic investors – equity-rich landlords with several properties and low gearing, rather than one-off speculators – will become more prominent.

Figure 25. Tenures in London



Source: Jones Lang LaSalle, DCLG

Figure 26. Tenures in England



Source: Jones Lang LaSalle, DCLG

As they have access to equity or other sources of wealth, they will be able to access the mortgages, rates and conditions that are denied to first-time buyers, enabling them to outbid them. This is most unfortunate for aspiring young homeowners, who will see housing wealth and ownership increasingly concentrated among the old and affluent. It will be an unintended consequence of the increased requirements for capital reserves and liquidity buffers enshrined in Basel III, a situation complicated by the ongoing problems in the Eurozone.

What does this mean for developers?

Innovative funding

As stated above, development finance will be subject to the same constraints as the mortgage market. While loan-to-value ratios may increase, developers will still have to find substantial equity to fill the gap between their borrowing capacity and the costs of the scheme. Clearly, this is a particular issue for large regeneration or strategic sites where the upfront costs are most significant.

It also means that, where equity is not available, developers will tend to opt for smaller, house-orientated schemes where costs can be more easily managed. However, there is not a huge supply of such sites – although planning reform and the 'presumption in favour of sustainable development' may increase it.

Nevertheless, there will continue to be a focus on securing equity investment. Interest from sovereign wealth and private equity is set to continue to be strong, and it may be joined by institutional investment. As values for smaller and 'oven ready' sites rise above the market average, the potential profits involved in promoting strategic sites and packaging them into units suitable for house builders will rise.

However, investors will be aware of the risks involved in this strategy, given the costs of infrastructure and the timescales required. Public land, provided through 'build now, pay later' arrangements, will provide a more secure route – although there is no guarantee that these sites will be in locations suitable for developments or within markets that will sustain large-scale schemes. Partnership working, or land-as-equity arrangements, will be the only way forward in many cases. Meanwhile, those developers with access to resources will exert a greater dominance over the market.

New Planning Tools

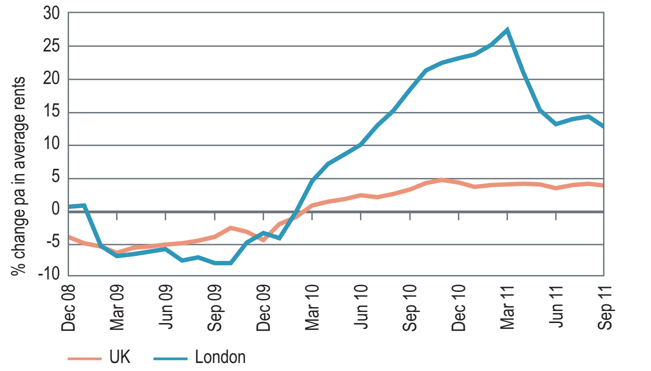
Local authorities are becoming more flexible in section 106 agreements, and this is set to continue. However, this is likely to be through more testing of local viabilities and the use of toolkits, with councils attempting to set affordable housing and other requirements at the level that 'just' makes schemes viable. Reduction in affordable housing grant, which higher rents may not entirely compensate for, also complicates this picture.

Viability is likely to continue to be less of an issue in the south, and volumes are likely to be biased towards these markets. Housing demand is also most pronounced here – population and employment growth has been strongest in towns such as Oxford, Cambridge and Milton Keynes, rather than the larger provincial centres. Reforms to the planning system, such as the 'Presumption in Favour of Sustainable Development', could make more sites available in areas where viability is stronger.

Adapting to the new world

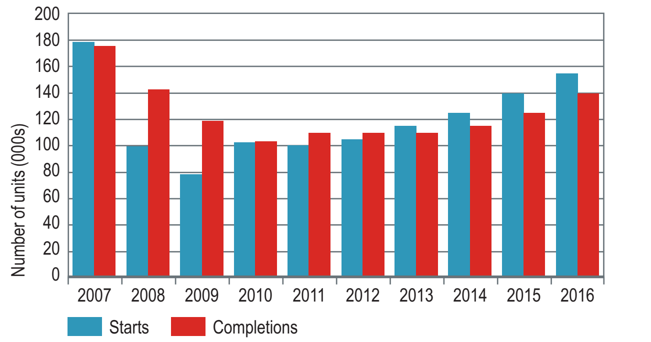
Alongside such issues, developers will also have to contend with sales rates that may remain lower than long-term averages – meaning a continued drive for margin rather than volume. On larger sites at least, a wider range of tenures will also have to be provided.

Figure 27. Rents have been rising, especially in London



Source: Jones Lang LaSalle, FindaProperty.com

Figure 28. England housing start and completion forecasts



Source: Jones Lang LaSalle, DCLG

This may mean building and selling specifically to investors, be they overseas, domestic or international, as well as holding stock for rent.

A wide range of 'alternative' home owning options may also have to be included. These could include co-ownership, where a third party investor buys a portion of the property and lets it to the occupant, or equity rent, where tenants pay a slightly higher rent and build up a share of the property which can be used to reduce the required LTV of the mortgage at the appropriate time.

London will remain a case apart, increasingly behaving as a 'city state' with very different characteristics to the rest of the country. With a much stronger economy, and ongoing international interest, both housing demand and development viability and volumes will remain more robust than elsewhere. The gap in wealth and income between the capital and the UK will increase, particularly for Inner London.

Nevertheless, it will also be the place where the growth of the rental market is strongest. Indeed, London is becoming more like other world cities such as Paris or New York, where wealth is concentrated in inner districts and most people rent. Whichever market they specialise in, developers will have to accept that there will be no return to 'normality'. The most successful will have to adapt and innovate in order to thrive.

Jones Lang LaSalle

Real value in a changing world

Contacts

Neil Chegwidden
Director
Residential Research
+44(0)20 7087 5507
neil.chegwidden@eu.jll.com

Jon Neale
Director
Residential Research
+44(0)20 7087 5508
jon.neale@eu.jll.com

Andrew Frost
Director
Valuation
+44(0)20 7087 5566
andrew.frost@eu.jll.com

Richard Petty
Director
Affordable Housing
+44(0)20 7087 5971
richard.petty@eu.jll.com

Peter Murray
Director
Investment, Agency
& International
+44(0)20 7087 5530
peter.murray@eu.jll.com

Tim Wright
Director
Development Consultancy
& International
+44(0)20 7087 5544
tim.wright@eu.jll.com

James Thomas
Director
Development Land, Agency
& Consultancy
+44(0)20 7399 5584
james.thomas@eu.jll.com

John Callander
Director
Development Consultancy
+44(0)20 7087 5540
john.callander@eu.jll.com

UK Residential Market Forecasts – November 2011

OnPoint reports from Jones Lang LaSalle include quarterly and annual highlights of real estate activity, performance and specialised surveys and forecasts that uncover emerging trends.

www.joneslanglasalle.co.uk