Residential Market Outlook

UK Residential Market Update

- House prices set to rise by 6% in 2015
- Shortage of stocks driving prices higher and keeping activity levels subdued
- Northern Ireland expected to outperform all other UK areas

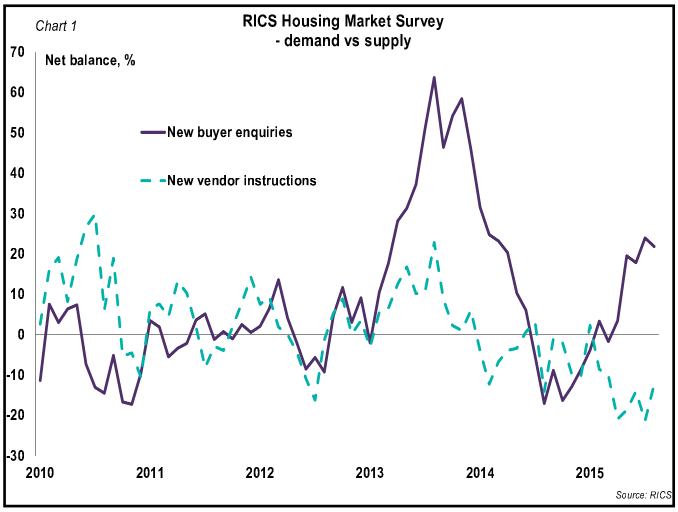
While the UK housing market has seen some substantial volatility in demand over the past 18 months, the most consistent feature of the market over this period has been a distinct shortage of new instructions (see chart 1 showing buyer demand growing strongly in early 2014 before contracting through the second half of the year). Indeed, at the time of writing, average stock levels on surveyors books (with reference to the August RICS survey) are at lows not seen for at least three decades.

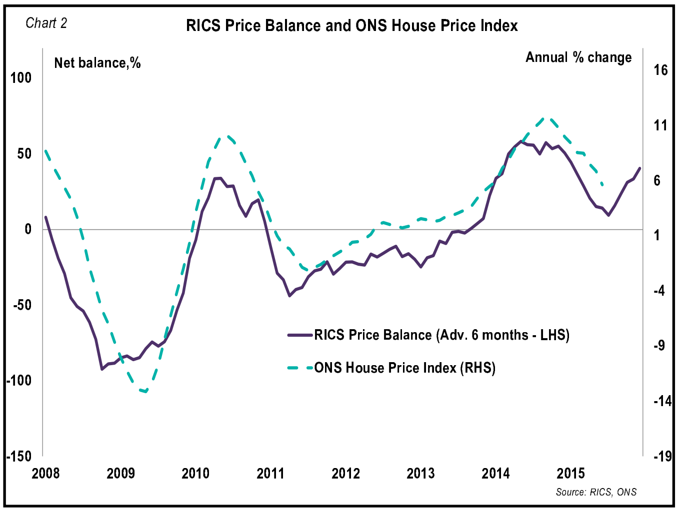
With supply remaining so tight following the general election, and demand recently beginning to grow as the jitters that ensued in the wake of the introduction of the Mortgage Market Review (MMR) fade, we have decided to revisit our forecast for the UK residential property market. A key element of our approach is to draw heavily on the feedback we receive from members in the RICS Residential Market Survey. Significantly, the RICS price balance reached a 15 month high of 53% in August with surveyors in all parts of the UK reporting results consistent with rising prices (see chart 2 which points to a rise in price growth over the coming months). On the back of this analysis, and our quantitative models, we now envisage price growth in the region of 6% over the course of 2015, compared with 3% previously.

The number of people employed on a full time basis is now at a record high (since the series began in 1992) and employment remains on an upward trend, despite some recent falls in the headline UK measure. We envisage employment continuing to increase, albeit at a slower pace than previously, over the coming quarters, leading housing demand to rise, on average, throughout the rest of the year.

With some key mortgage rates hitting post-crisis lows in recent months, the lending environment is providing further support to demand and the Bank of England's Credit Conditions Survey suggests a desire on the part on mortgage lenders to increase credit further in the coming months.

With employment rising across most parts of the UK in the





year to June, growth in buyer demand has been equally widespread in recent months. The South East has had the weakest demand profile of any region over the course of the last year but in the three months to August buyer enquiries picked up in each part of the UK.

Just what has been holding back supply has been the subject of much discussion but a variety of factors are probably to blame with different elements being more or less prevalent in different regions during the last year.

In some of the more expensive areas of the South East and London, transaction costs (particularly in light of recent stamp duty changes) are making home improvments and extensions a more economical choice than moving house. Across the Northern English regions, 30% and 17% of contributors respectively report continued economic uncertainty and availability of mortgage finance to be holding back the market in general and resulting in fewer properties coming up for sale.

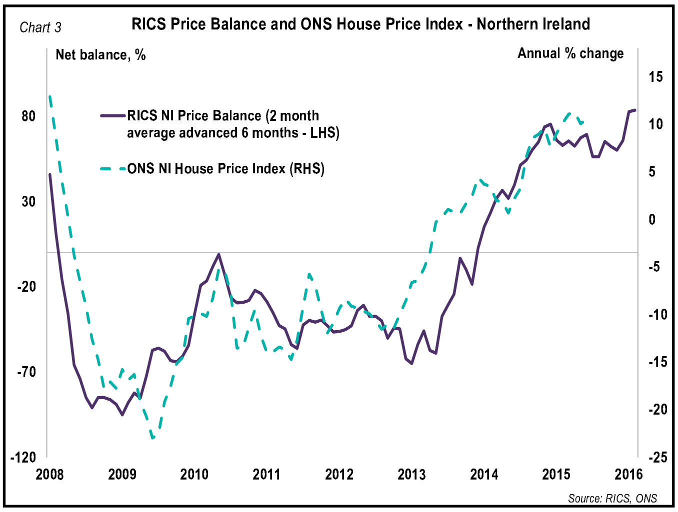
However there appears to be a consensus across all parts of the UK that the supply shortage is, to some extent, self perpetuating, with the lack of stock on the market deterring buyers from listing their own home for sale as there is not sufficient choice available to make their next purchase. We suspect that the market will require a sustained period of growth in demand supported by firm economic fundamentals to encourage a more normal flow of new stock to the market.

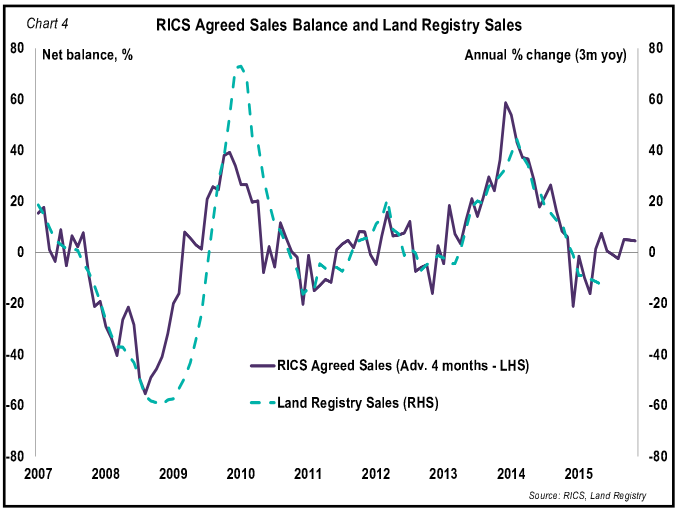
Of all the English regions, East Anglia has seen the firmest price momentum through the first half of this year. Despite having recorded the strongest price growth of any region outside of London over the course of the last few years, prices relative to rents remain lower than any other English region and the RICS Price Balance suggests that price rises across the area have become more widespread in recent months. It is for this reason that we envisage this region outperforming the other English regions over the course of 2015 with growth of around 9%.

Although the Northern Irish economy has been sluggish with employment falling marginally in the year to June, buyer demand has been growing firmly and consistently since late 2012. Over this period there has been a slow but steady upward trend in the number of properties changing hands, however, market volumes still remain roughly half of the pre-crisis level. With the majority of respondents to the RICS Residential Market Survey reporting price rises through the first half of this year and with momentum building more recently, we expect prices to rise by around 11% over the course of 2015 (see chart 3 indicating that price momentum should remain firm through the rest of the year).

Transaction levels have been on a gradual upward trend in recent months (see chart 4 which suggests that sales will continue to grow modestly in the coming months) but remain subdued relative to pre-crisis levels and have still not reached the levels of mid-2014. Anecdotal evidence from contributors to the RICS survey indicates that the lack of stock is substantially restraining transactions levels. With respondents reporting a fall in appraisals in August, we have no evidence to believe the stock shortage is going to subside in the near term and so, despite the fact that demand has been picking up in recent months, we have slightly lowered our forecast for transactions in 2015 to 1.2 million from 1.25 previously.

In the lettings market, tenant demand has been rising across all areas for two consecutive quarters and has significantly outpaced the slight increase in new landlord instructions over this period. The ONS index of private housing rents has shown growth picking up recently and RICS Rent Expectations series remain positive in each part of the UK. We had previously forecast 2% growth in rental values over the course of 2015 but with RICS lead indicators pointing to an acceleration in growth over the rest of the year, we now think growth will be much closer to 3%.





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