



# Lack of stock set to remain key driver of UK housing market for now

- Transaction activity in 2017 set to stabilise after slipping through the past year
- Prices and rents to continue to be underpinned by supply constraints
- Government initiatives promise medium term uplift in the development pipeline

The past twelve months has seen some seismic changes in both the political and economic landscape with inevitable consequences for the mood music in the real estate market. Yet for all this, the essential theme of supply (or lack of supply more accurately) that we dwelt on in last year's forecast remains very much to the fore in any analysis of the outlook. Whether looking at the new build or second hand market, the sale or rental sectors, the market or sub-market tenures, the shortfall of stock continues to dominate the agenda. Indeed, the holistic nature of the underlying problem regarding housing in the UK has been reflected in the re-crafting of the government's strategy on this issue in the wake of the post-referendum change of leadership. The previous very heavy focus on home ownership (designed to reverse the sixteen year downward trend in its share as a tenure) has been replaced by a more balanced approach to delivery with aggregate supply being very visibly promoted as the number one goal. Significantly, this shift in rhetoric has been accompanied by a raft of policies designed to lift the development pipeline across all sectors of the market.

## Supply still the critical issue

Arguably the best measure of new build homes is the net additional dwellings data which is unfortunately only produced on an annual basis. Nevertheless, the latest figures covering the twelve months to the end of March (2016) actually show a more positive trend with the number of new units, highlighted in chart 1, climbing from 163,940 to 189,650 for England alone (the highest number since the onset of the Global Financial Crisis); significantly, the biggest driver of this increase was change of use conversions. Meanwhile, the more timely new starts figures are running around 10% higher for the first two quarters of the current financial year compared with the first half of 2015-16. So some comfort can clearly be drawn from an improving trend even if the numbers are still short of meeting the most widely regarded estimates of household formation.

Critically, however, the legacy of years of building on an insufficient scale remains very visible in the second hand market where RICS data, depicted in chart 2, shows average inventory of estate agents hovering close to historic lows. This picture is also reflected in the RICS New Instructions (of property for sale) series which is measured in a net

Chart 1: Annual Housing Supply for England

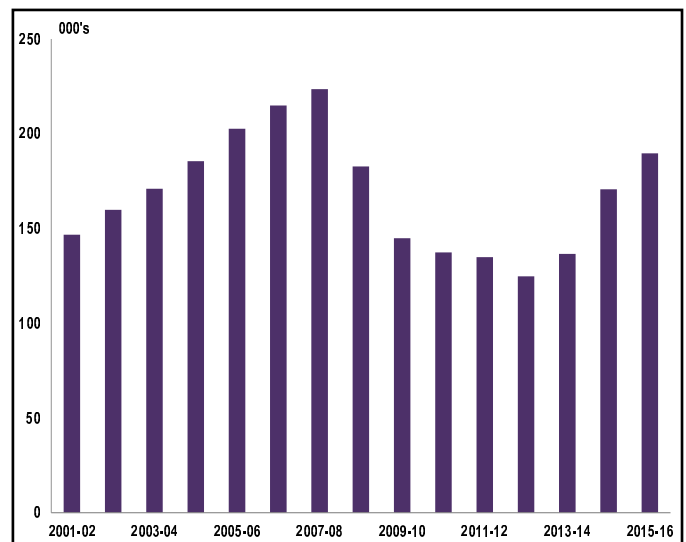
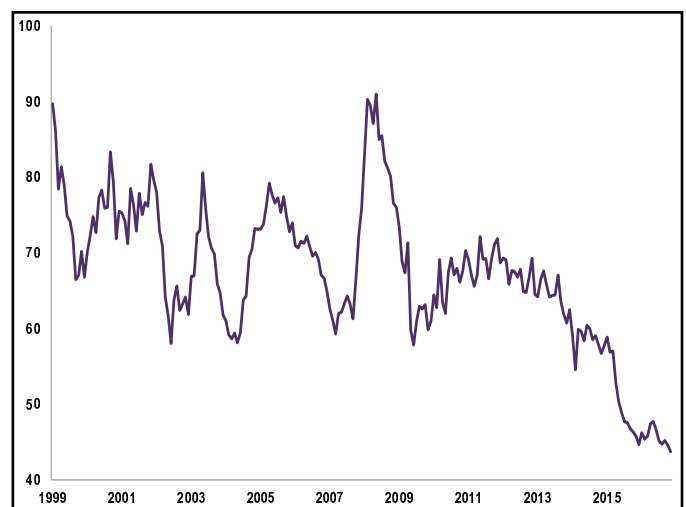


Chart 2: RICS Stock of Property per Surveyor (per branch)



balance format. It shows that the number of respondents to the survey suggesting that they have seen an increase rather than a decrease in instructions has only been positive in three months since August 2014 and on each of those occasions, the net balance was only marginally so.

The welcome trend in the development pipeline has been given a further boost by recent government announcements including the additional funding for affordable housing, the Accelerated Construction Scheme and the Home Builders Fund. However, it would be a mistake to believe this will have an early impact on the second hand market even if other measures put in place in recent years (with more to come) serve to discourage investment purchases of real estate.

**Sales transactions to stabilise**

The total volume of sales for 2016 looks likely to come in just short of the 1.25 million mark (HMRC basis) which is broadly in-line with level of activity over the previous two years. However, the calender profile of sales over the past twelve months has been heavily distorted by the stamp duty change which took effect in April making it harder to gauge the underlying strength of demand and how this is likely to play out in terms of transactions in 2017.

The RICS New Buyer Enquiries series, shown in chart 3, suggests the level of interest from potential purchasers has stabilised (in net balance terms) over the past few months. Significantly, the indicator captures the change compared with the preceding month which suggests that new enquiries although a little higher than where they were in the summer are still materially lower than they were at the back end of last year let alone the first quarter of 2016. The chart also demonstrates a much larger element of the decline in buyer enquiries was concentrated in parts of London, a picture that was backed up by hard data on transactions. Stripping out the capital and the wider South East, the series would point to a much shallower dip.

In order to understand which part of the market might be responsible for the shift down in buyer interest, an additional question was included in the RICS Housing Market Survey. The results are contained in chart 4, once again in net balance format, and they are unequivocal. A net balance of almost 60% of respondents pinpointed the Buy to Let sector as seeing the most pronounced fall in new potential purchasers registering at estate agents. The negative results for both first time buyers and existing owner occupiers were much more modest. This picture clearly highlights the impact the stamp duty surcharge had on the market bringing forward buying plans to the early part of the year. Subsequently, the approach of the EU referendum, and the unexpected outcome, also appears to have had some, albeit relatively short-lived, impact on buyer behaviour.

Looking forward, key RICS indicators of transaction activity suggest that the sales trend is now settling down and that it could begin to edge upwards during the first half of 2017. The Agreed Sales net balance has been in positive territory, even if only modestly so, for the past three months as highlighted in chart 5 while the New Buyer Enquiries *plus* Instructions indicator is also pointing to a gentle recovery in sales. For the sake of completeness, we also look at the Sales Expectations indicators contained in the RICS Housing Market Survey both at the three and twelve month time horizon. The November readings for both series were in positive territory with the longer term net balance at +31 but there is a tendency for the responses to both these

Chart 3: RICS New Buyer Enquiries - change against previous month

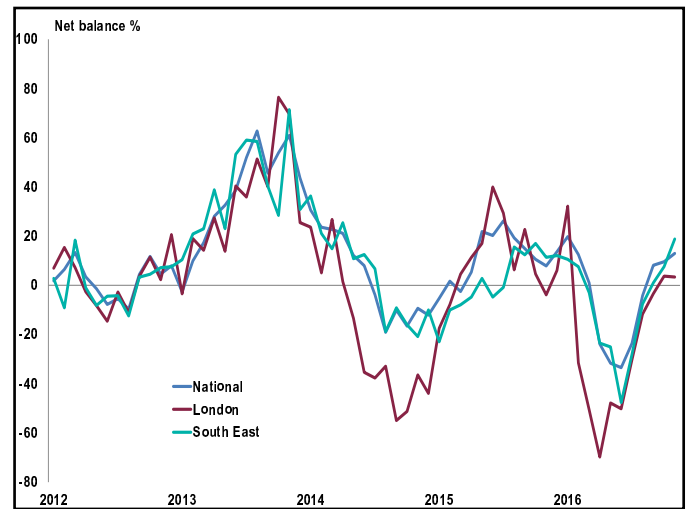


Chart 4: RICS New Buyer Enquiries - drivers for the fall

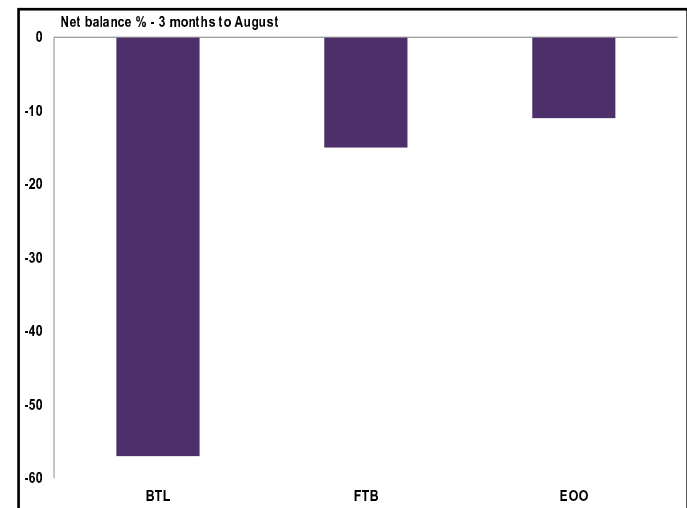
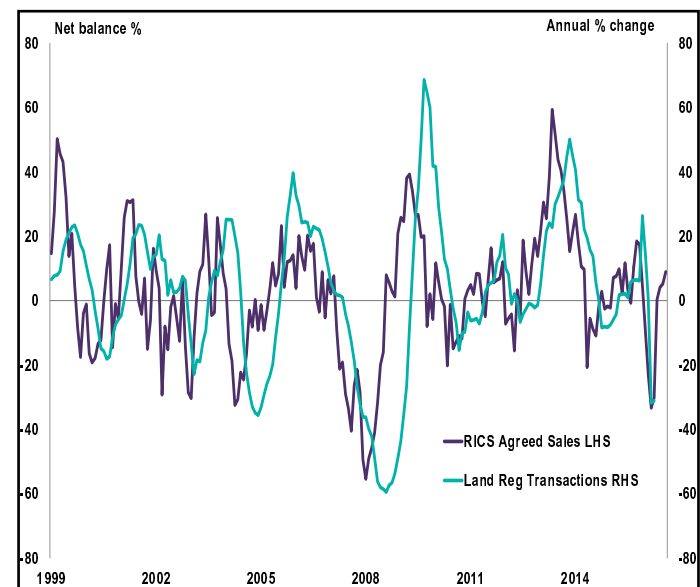


Chart 5: RICS Newly Agreed Sales and Land Registry Sales



questions to overstate likely volumes if not the direction of travel.

While the first quarter comparison for sales will inevitably look poor (compared with a year earlier), the underlying tone to the RICS data is consistent with activity at least matching the recent performance if not proving a little stronger. As result, our central scenario envisages the total volume of transactions for the whole of 2017 coming in somewhere between 1.15 and 1.2 million which is only slightly down on the 2016 likely out-turn. However, we would acknowledge that there are significant risks attached to this projection with the skew largely on the downside reflecting, amongst other things, a continuing drop in the amount of stock on the market, the widely anticipated slowing in economic growth, the prospect of slightly higher borrowing costs and the possibility of a further period of uncertainty linked to negotiations surrounding establishing a new relationship between the UK and the EU.

**Prices to remain firm**

We have already highlighted the feedback we are receiving regarding the demand supply imbalance in the form of the RICS New Buyer Enquiries and New Instructions series. In very crude terms, the net balance for the former has still recorded a stronger reading than the latter in five of the last eight months, and that follows the advance of some buyer interest to the first quarter. Moreover, over the past few months the gap between the two series has widened out back towards the levels pertaining through the latter part of 2015. Another way of examining the same issue is to look at the RICS Sales to Stock ratio which is shown in chart 6 against the Land Registry house price index. Once again, the on-going tightness in the market is clearly visible and, while we would want to caution against small increases in the ratio, it is worth noting that it has begun to edge upwards over the past few months.

Meanwhile, two other price indicators that we closely monitor are telling a broadly similar story. The headline price balance which typically has a lead over the major house price indices at turning points in the cycle of around six to nine months has been picking up again since hitting a low of 5 in July. Chart 7 highlights the relationship which strongly suggests that, on the basis of the available information, house price inflation will begin to edge upwards as 2017 wears on. In addition, and acknowledging its limitations, it is noticeable that the response to the question on five year projections for house prices has also begun to increase once again since the summer with contributors to the housing market survey envisaging a further increase of around twenty percent over the period despite the initiatives announced by the government to boost supply.

In terms of our headline projection for 2017, we are anticipating that for good or ill that prices across the country increase by a further three per cent although the caveats around this point estimate are greater than would normally be the case. Looking at the regional breakdown, we suspect that East Anglia will continue to see relatively strong momentum backed up by a solid macro story with the North West and the West Midlands also likely to record gains ahead of the national average. By way of contrast, prices in central London are likely to stabilise after recent declines. Support will be provided by the weaker exchange rate which is already encouraging some overseas buyers to revisit the opportunity to either enter the market or add to existing portfolios.

Chart 6: RICS Sales to Stock and House Prices

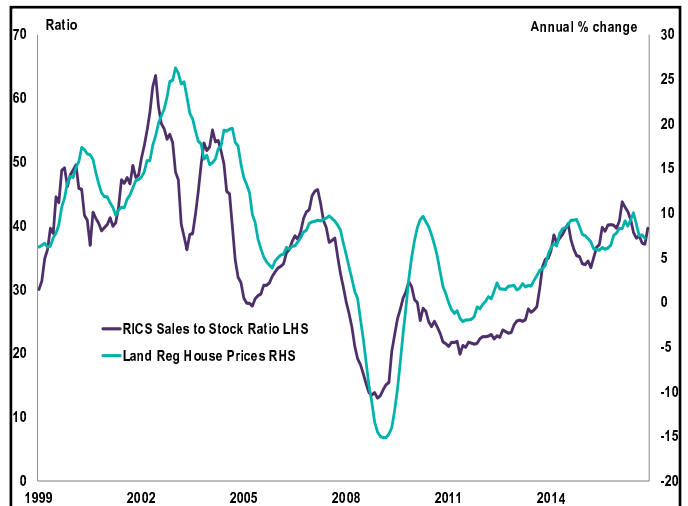


Chart 7: RICS Price Balance and House Prices

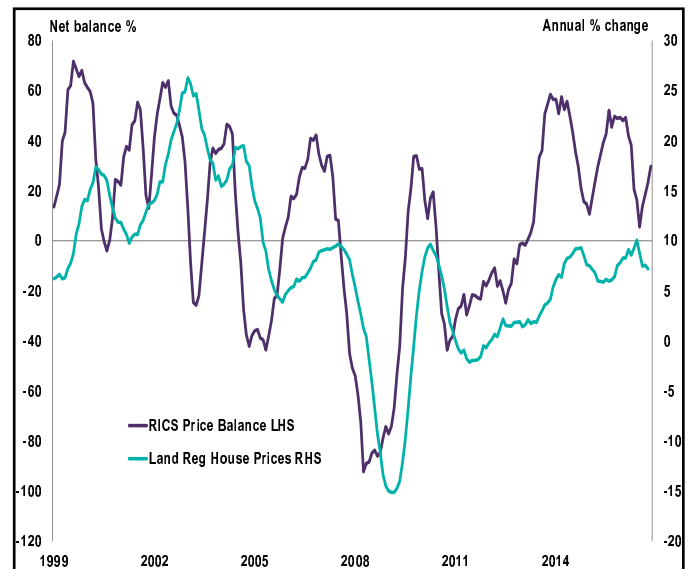
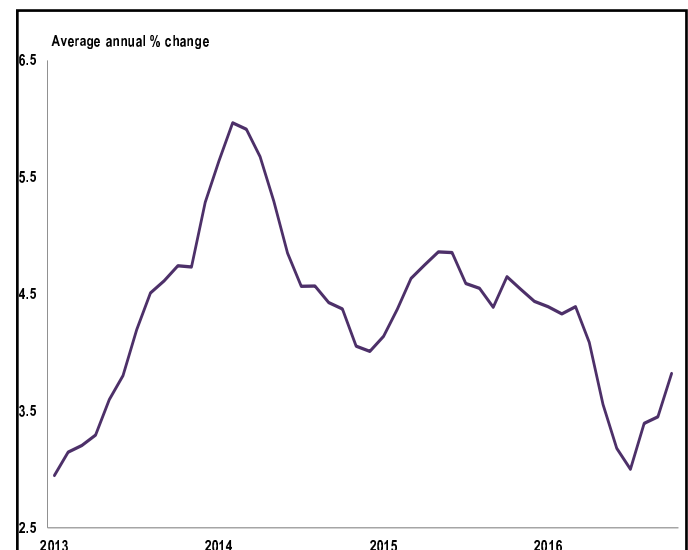


Chart 8: RICS Housing Survey Five Year Price Projections



### Rents to also rise further

While we are concerned by the prospect of further house price gains given existing affordability challenges in some parts of the country, arguably a bigger challenge is being presented by the private rental market with the BTL element (which accounts for around 95% of it) facing increasing obstacles. It remains to be seen how the change in the tax treatment for interest payments play out as they come into effect over the next few years as well as the proposed banning of letting fees. However before the latter was announced, we did use the housing market survey to try and gauge landlords medium term intentions in the light of recently imposed and planned tax adjustment concerning the BTL sector. The results are shown in chart 9 and suggest that there is a suspicion that more landlords' will look to downsize portfolios (than increase them) both in the near term and, more visibly, over the next five years.

How such a development plays out in the lettings market will only be visible in time but even with Government support for Build to Rent, it is difficult to conclude that this emerging source of supply for the sector will expand sufficiently to make good the potential losses from BTL. An up-scaling of 'affordable' development, fuelled in part by the enhanced funding regime, may help ease the pressure with the impact of this most apparent in London where affordability constraints appears to be biting hardest and the lion's share of the additional finance is being directed.

Significantly, RICS data suggests that tenant demand (measured in net balance terms) is continuing to grow across virtually all of the country; the only area where we are picking up negative readings is in London. Meanwhile the new landlord instructions series has been pretty flat at a headline over the past four quarters at a headline level. Against this backdrop, it is hardly surprising that the rent expectations series (latest data point taken before the announcement regarding lettings fees) continues to highlight this imbalance. Charts 10 tracks the national data which is broadly consistent with rents continuing to increase (using the ONS portfolio index rather than a new lets index) by a further two to three percent over the next twelve months. Chart 11 draws on the same relationship but focuses on the London data. In this case, it is pointing towards more modest rental growth for the capital with an increase of between zero and one percent.

One other piece of feedback worth noting is the five year expectation for rents. We noted earlier that for the sales market, respondents projections have begun to edge upwards in recent months. Perhaps not surprisingly, a similar pattern is also evident for rents but more interesting is the inference that rents at a headline level over this time horizon could rise as a faster rate than prices despite similar issues around affordability.

Chart 9: RICS HMS Landlord Investment Intentions

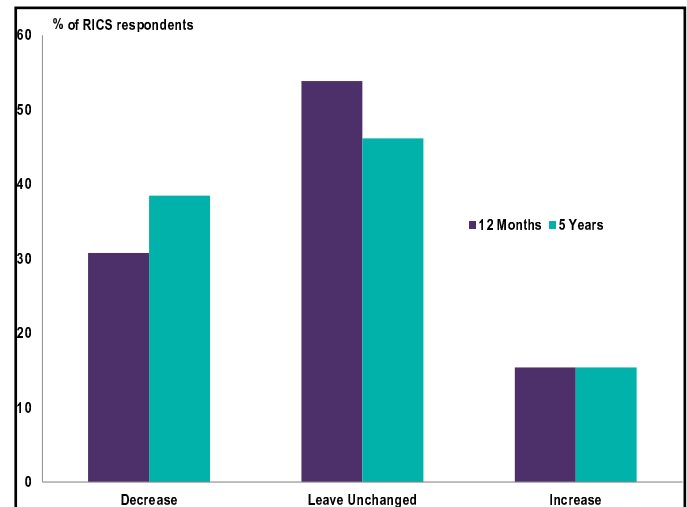


Chart 10: RICS Rent Expectations - National

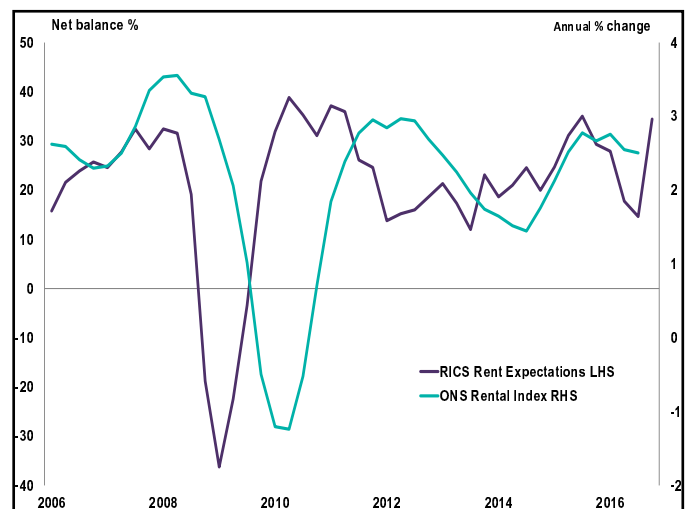
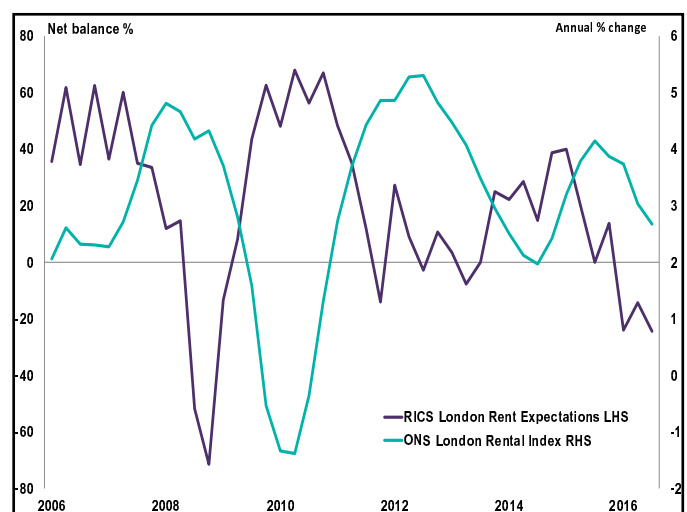


Chart 11: RICS Rent Expectations - London





## Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 118,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our members are involved the same professional standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

United Kingdom RICS HQ  
Parliament Square, London  
SW1P 3AD United Kingdom  
t +44 (0)24 7686 8555  
f +44 (0)20 7334 3811  
contactrics@rics.org  
Media enquiries  
pressoffice@rics.org

Ireland  
38 Merrion Square, Dublin 2,  
Ireland  
t +353 1 644 5500  
f +353 1 661 1797  
ricsireland@rics.org

Europe  
(excluding UK and Ireland)  
Rue Ducale 67,  
1000 Brussels,  
Belgium  
t +32 2 733 10 19  
f +32 2 742 97 48  
ricseurope@rics.org

Middle East  
Office G14, Block 3,  
Knowledge Village,  
Dubai, United Arab Emirates  
t +971 4 446 2808  
f +971 4 427 2498  
ricsmenea@rics.org

Africa  
PO Box 3400,  
Witkoppen 2068,  
South Africa  
t +27 11 467 2857  
f +27 86 514 0655  
ricsafrica@rics.org

Americas  
One Grand Central Place,  
60 East 42nd Street, Suite 2810,  
New York 10165 – 2811, USA  
t +1 212 847 7400  
f +1 212 847 7401  
ricsamericas@rics.org

South America  
Rua Maranhão, 584 – cj 104,  
São Paulo – SP, Brasil  
t +55 11 2925 0068  
ricsbrasil@rics.org

Oceania  
Suite 1, Level 9,  
1 Castlereagh Street,  
Sydney NSW 2000, Australia  
t +61 2 9216 2333  
f +61 2 9232 5591  
info@rics.org

North Asia  
3707 Hopewell Centre,  
183 Queen's Road East  
Wanchai, Hong Kong  
t +852 2537 7117  
f +852 2537 2756  
ricsasia@rics.org

ASEAN  
10 Anson Road,  
#06-22 International Plaza,  
Singapore 079903  
t +65 6635 4242  
f +65 6635 4244  
ricssingapore@rics.org

Japan  
Level 14 Hibiya Central Building,  
1-2-9 Nishi Shimbashi Minato-Ku,  
Tokyo 105-0003, Japan  
t +81 3 5532 8813  
f +81 3 5532 8814  
ricsjapan@rics.org

South Asia  
48 & 49 Centrum Plaza,  
Sector Road, Sector 53,  
Gurgaon – 122002, India  
t +91 124 459 5400  
f +91 124 459 5402  
ricsindia@rics.org