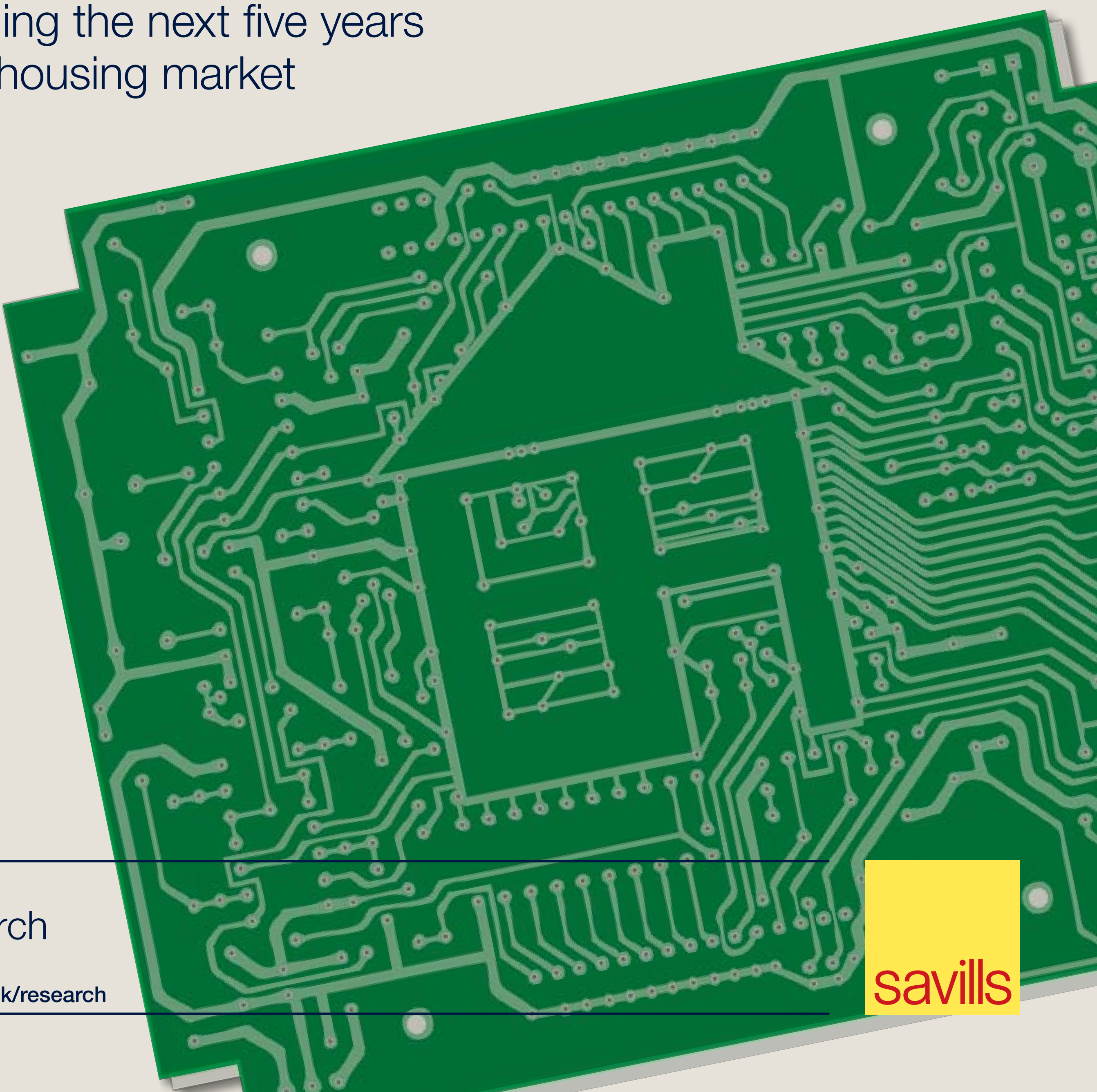
Residential Property Focus

The **Forecasts** Issue

Re-programmed: 2012-2016

Decoding the next five years of the housing market



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Foreword

WHAT NEXT IN THE RE-PROGRAMMED ECONOMY?

Since we made our forecasts last year the world has changed, and we are making them this year viewing a dramatically altered economic outlook

Our forecasts for the housing market are shaped by forecasts from Oxford Economics for economic growth, household incomes, base rates and all the other variables that go into our model of housing affordability.

This host of variables is determined by their outlook for the global economy. This year, in common with virtually every other forecaster, they have been revising their outlook for growth consistently and constantly downwards. Expectations are now, at best, for continued lower growth rather than the gradual recovery predicted in 2010.

So we now find ourselves looking at a fundamentally altered national economic backdrop – and also a potentially confusing array of housing market indicators saying different things. Taken on an annual basis, house price movements in the 12 months to September varied according to which monitor you looked at. Rightmove said +1.5% while Land Registry and Hometrack said -2.6% and -3.5% respectively. Our index for prime central London property was saying +13.6% while our index of prime regional property showed –2.8%. Clearly, market behaviour has been complex.

There are three drivers at work in the market currently: 1. Overseas equity 2. Wealth created domestically and 3. Limited mortgage availability.

Prime central London is acting as a safe haven for global wealth so is growing. Prime South East markets and London-centric markets did benefit from city bonuses and financial sector recovery after March 2009 but are now waning. Elsewhere, there has been essentially no significant recovery since the markets fell in 2008 and transactions have been extremely low.

So the market has polarised in three directions: between the equity haves and have nots, between North and South and between prime and mainstream. No wonder different indices are saying different things. Understanding these differences helps shed light on the market.

Asking price indicators reflect the optimism of vendors rather than the price at which a property will actually transact. This is valuable in revealing the stickiness of supply that dogs the market. It shows how turnover is often the first casualty of a falling market as sellers withdraw (or let) their property when they can't achieve a desired price.

There is a difference between transactions involving a mortgage and those involving equity. Cash transactions are now a more significant proportion of the market than ever before. These transactions are not showing up in every index and are making the whole-market sample measured by Land Registry very different to what has gone before.

Valuation-based indices have a representative sample of all stock, not just the properties that are selling at any one time. They tend to pick up change earlier than others which have to wait for vendor's expectations to adjust and a transaction to take place. These indices outside London have picked up signs of further falls in property value and indicate vendors will have to adjust their expectations if they want to sell.

This forecast issue suggests how much these expectations may need to adjust over the next five years in different markets. ■

Executive summary

The key findings in this issue

■ Most property markets in the UK have not seen the recovery observed in the London-centric markets of southern England and have remained at low levels of growth and/or seen small falls since 2008.

■ We expect very low growth in average nominal house prices over the next five years. It is inflation that will continue to strip value from mainstream property over this time.

■ In the absence of widespread repossessions flooding the domestic markets, we see that turnover will remain the main casualty of this recession, with transaction levels staying at their all-time low level.

■ London and southern markets, and particularly prime markets, are different. They have seen a V-shaped recovery as opposed to the L-shape of other regions. This is because they are capable of being driven by buyers with large amounts of equity and low reliance on borrowing. The discretionary nature of these purchasers makes these markets more volatile however, and buyers withdraw when sentiment fails.

■ Prime London is different again as it belongs to a different class of world cities. The downside risks in this market are factors which diminish the creation of global wealth, such as commodity prices and appreciation in the sterling exchange rate. While global economic turmoil persists and the global rich seek a safe-haven store of wealth and a sterling-denominated currency play, prime central London property will prosper.

Contents

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UK mainstream market

INFLATION IS MAJOR THREAT TO VALUE

Due to weak economic growth and constrained access to mortgage finance, our forecasts predict low capital growth prospects for the mainstream market over the mid term

Words by Lucian Cook

This time last year, we foresaw a turbulent time for mainstream house prices and anticipated that austerity measures in the economy would start to impact on household finances and home buyer confidence.

These effects have indeed turned out to be negative, but not as damaging to values as we thought. The main casualty of the current housing market downturn has been transaction levels. Owners are simply not selling in the current climate and, with interest rates at manageable levels, are not forced to sell.

While these circumstances prevail and repossessed and distressed stock levels remain low, it is difficult to see the mechanisms by which widespread price falls will take place.

This means the shape of the mainstream housing market has changed rather more than house prices over the past 12 months.

In this article we argue that it is inflation, rather than nominal price falls that will erode housing value over the next few years.

More equity, less debt

Transaction levels have been far lower than the pre-crunch norm for some four years now. Proportionately more equity and less debt has been used to buy property. This has led to relatively stable prices, with little upward or downward movement across the country as a whole.

In recent decades, average house prices have outgrown inflation by around 2.5% per annum. Due to the recent downturn though, there has been no real (inflation-adjusted) growth so that in real terms, average mainstream house prices now stand at 2003 levels.

MAINSTREAM MARKETS

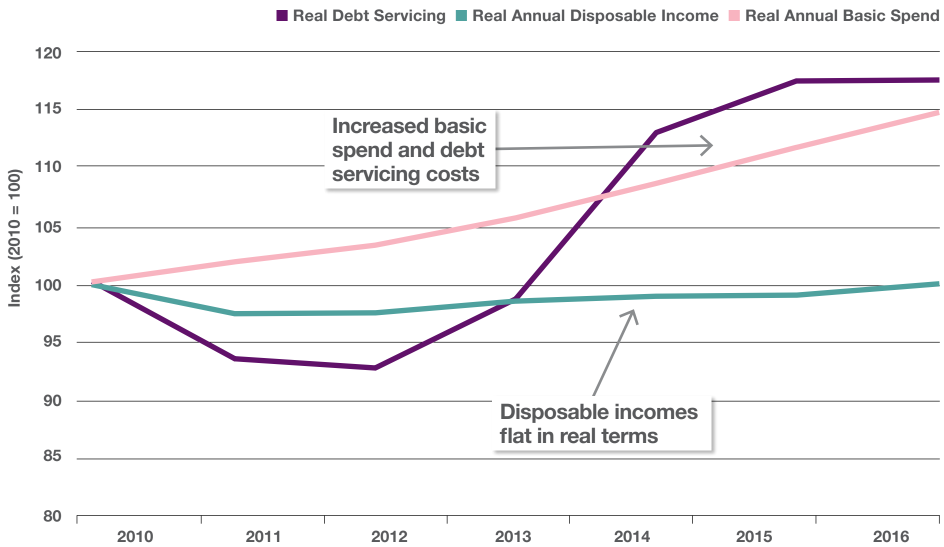
Five-year forecast values 2012-2016

Forecasts	2012	2013	2014	2015	2016	Inflation-adjusted 5-year growth	Nominal 5-year growth
UK	-2.0%	0.5%	1.0%	2.0%	4.5%	-11.0%	6.0%
London	-0.5%	1.0%	5.0%	6.0%	6.5%	2.0%	19.1%

Graph source: Savills Research

GRAPH 1.1

Components of Housing Affordability 2010-2016



Graph source: Oxford Economics, Savills Research

ECONOMIC VIEW

Expectations for global economic growth now incorporate a 'second slip' over 2012 that wasn't there this time last year. The implications for the UK are that 2012 GDP, which was expected at around 2.5%, is now likely to be closer to 1%, provided Eurozone collapse and its wider economic implications are avoided. The resulting levels of unemployment will suppress household income growth and, in turn, suppress both household consumption generally and spending on housing in particular. Positively for the housing market, poor economic growth prospects serve to depress base rates and help prevent mass repossessions flooding the market.

This raises the question of whether austerity measures have created a new era for mainstream house prices, with the trend of inflation-busting house price growth firmly consigned to history.

Affordability levels

With the economic outlook weakening over the past 12 months and forecasts for the recovery being pushed out further, the Bank of England is likely to maintain base rates at their historically low level for longer than expected.

Following the announcement of a further expansion of quantitative easing by £75 billion, our economic forecasters do not foresee any base rate increase before Q2 2013 at the earliest. This should have the effect of preserving affordability levels for longer, but it can no longer be relied upon to enable a return to real house price growth.

Our model of house price affordability is based on whether, after taking care of basic expenditure, households can afford the mortgage payments on the purchase of a new house. Through 2008 house price affordability soared as prices, levels of borrowing, and interest rates all fell, but we have already seen some of the affordability cushion built up during that period eroded by the rebound in house prices during 2009, high levels of inflation and flat real incomes.

Growth constraint

A continuation of these factors combined with base rate rises further down the line, are likely to erode affordability further. This is likely to limit the capacity for price growth at a national level, with the lack of economic growth meaning the trigger for house price growth is also pushed back.

Taking all of the above into account our mainstream forecasts have been cut back since this time last year. At a national level, prices are forecast to remain flat. We are predicting total nominal growth of 6.0% in the average UK house price over the five year period covered by our forecasts.

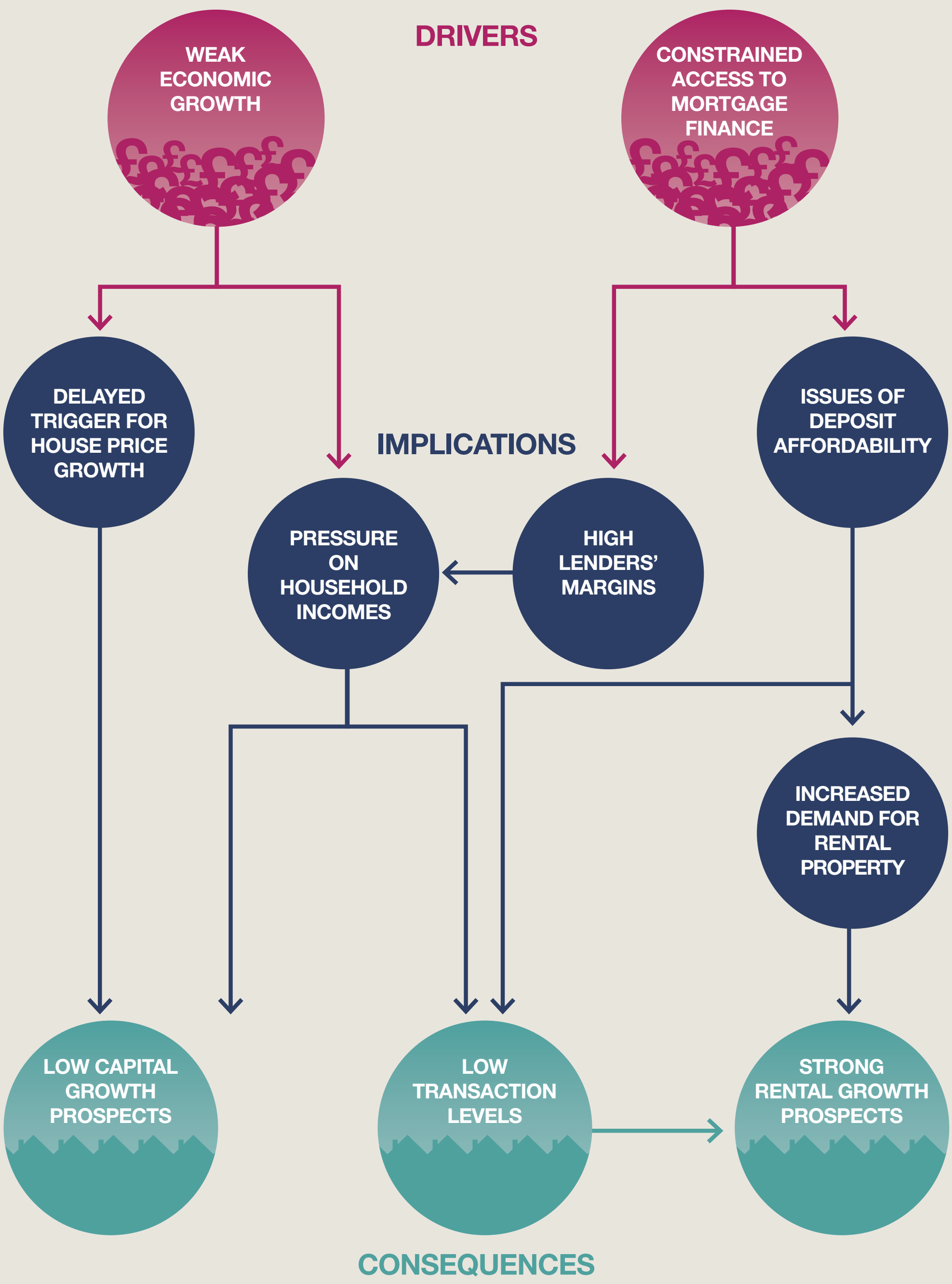
We expect the picture to vary geographically. Relatively strong five year price growth in London (19.1%) and the surrounding markets (South East 15.7% and East 14.1%) is expected on the back of stronger economic performance and a lesser reliance on mortgage finance. By contrast, northern regions are set to lag, seeing little to no growth (see page 6).

While real house price growth is likely to be put on hold for some time, it does not necessarily follow that it is consigned to the history books forever. At the end of 1995, inflation-adjusted house prices were at the same level they were 12 years previously. In the following decade they rose by 140% in real inflation-adjusted terms.

We now expect a period of necessary house price affordability correction that will push out yields and be a draw for investors. ■

FIGURE 1.1

HOUSING MARKET FORCES 2012-2016 Drivers, implications and consequences



House price values

MARKET FORECASTS

PRIME MARKETS

Five-year forecast values, 2012-2016

	Change from peak to date	2012	2013	2014	2015	2016	5 years to 2016
Prime Central London	15.6%	3.0%	0.0%	5.0%	6.5%	6.5%	22.7%
Prime Regional	-16.6%	-3.0%	2.5%	4.0%	5.5%	5.5%	15.1%
Prime South East	-12.5%	-2.5%	3.0%	6.5%	6.5%	6.5%	21.3%
Prime South West	-20.8%	-3.5%	2.0%	4.0%	4.5%	5.5%	12.9%
Prime East	-18.4%	-2.5%	2.5%	4.0%	4.5%	6.0%	15.1%
Prime Midlands/North	-23.5%	-6.0%	2.0%	2.0%	4.5%	5.0%	7.3%
Prime Scotland	-17.8%	-4.0%	1.0%	2.0%	3.0%	5.0%	7.0%

Source: Savills Research

MAINSTREAM MARKETS

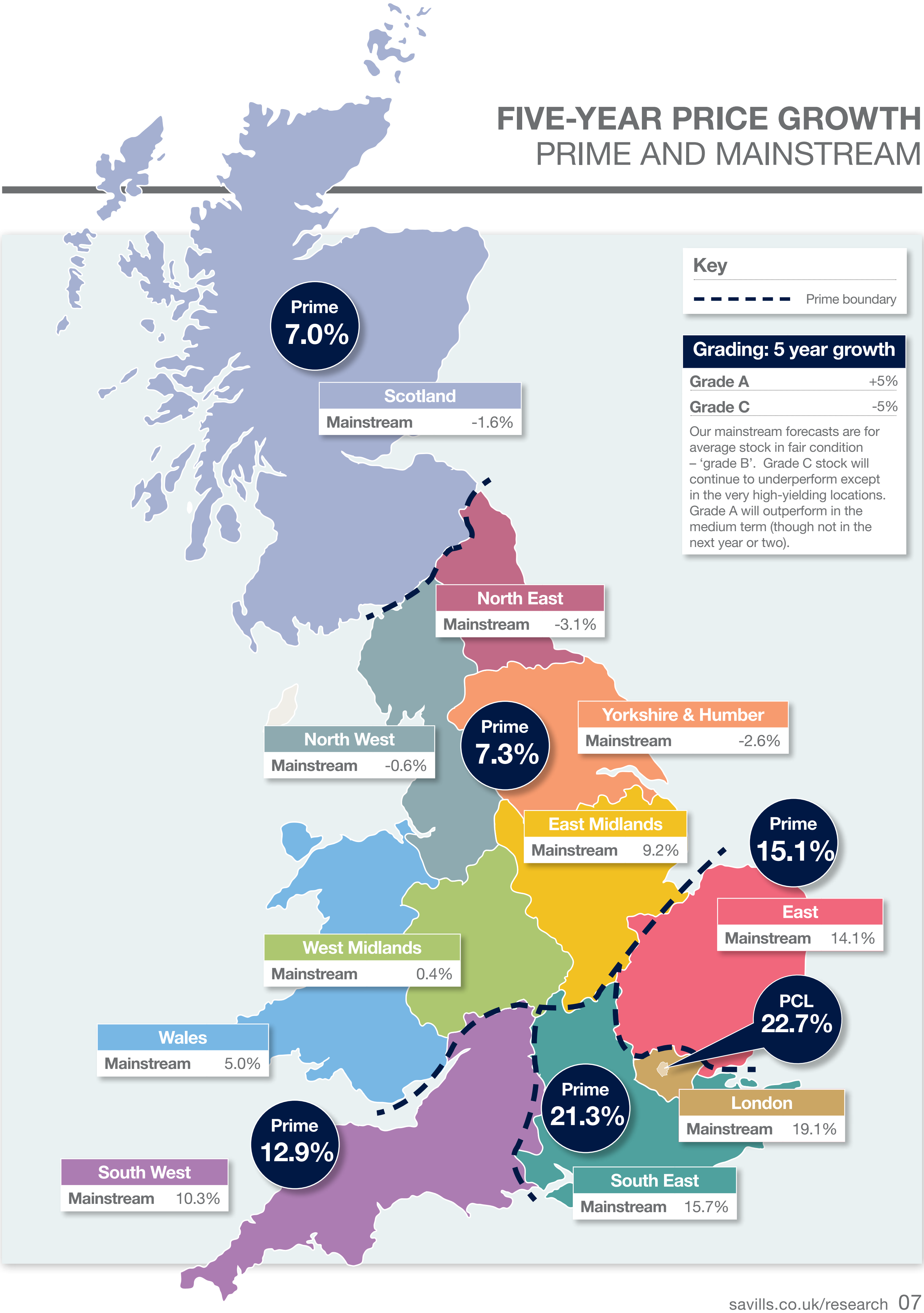
Five-year forecast values, 2012-2016

	Change from peak to date	2012	2013	2014	2015	2016	5 years to 2016
UK	-9.5%	-2.0%	0.5%	1.0%	2.0%	4.5%	6.0%
London	-2.9%	-0.5%	1.0%	5.0%	6.0%	6.5%	19.1%
South East	-7.7%	-1.0%	1.0%	4.0%	5.0%	6.0%	15.7%
South West	-8.0%	-1.5%	0.5%	2.5%	3.5%	5.0%	10.3%
East	-9.1%	-1.0%	1.0%	3.5%	4.5%	5.5%	14.1%
East Midlands	-10.3%	-1.5%	0.5%	2.0%	3.0%	5.0%	9.2%
West Midlands	-10.6%	-2.0%	-1.0%	0.0%	0.0%	3.5%	0.4%
North East	-13.3%	-2.5%	-1.5%	-1.5%	-0.5%	3.0%	-3.1%
North West	-14.0%	-2.0%	-1.0%	-1.0%	0.0%	3.5%	-0.6%
Yorks & Humber	-12.2%	-2.0%	-1.5%	-1.0%	-1.0%	3.0%	-2.6%
Wales	-10.4%	-2.0%	0.5%	0.5%	1.5%	4.5%	5.0%
Scotland	-9.6%	-4.0%	0.0%	0.0%	0.5%	2.0%	-1.6%

Annual house price growth key:
Below 0% | 0% to 2% | 2% to 4% | 4% to 6% | 6% to 8% | 8% and over

Source: Savills Research forecasts based on Nationwide actuals

FIVE-YEAR PRICE GROWTH
PRIME AND MAINSTREAM



Prime markets

WORLD CLASS WINNERS

The prime markets of central London and the rest of the UK are currently heavily reliant on economic factors and the comparative strength of both overseas and domestic equity

Words by Yolande Barnes

The prime markets in London and the rest of the UK have historically always been driven by the availability of equity rather than borrowing. This has made them particularly resistant to the recent downturn in mainstream markets but there is a question over whether this can continue.

Strong buyer sentiment and the availability of equity to prime buyers has meant that prime country house prices rose significantly after March 2009. In London, the impact of equity purchasers, particularly from overseas, has been even more pronounced. We estimate that, in the 18 months to June this year, a net £6 billion flowed into the second-hand and new-build markets of prime London from overseas sources. This contributed to a 12.7% increase in prime central London values during the first three quarters of 2011.

Prime London has been largely immune to the malaise that has hit mainstream property markets over the last year or so. Prime regional markets have been less protected though and changes in local economies have suppressed sentiment outside London so that prime regional values have fallen in line with mainstream markets, by -2.4% over the nine months to September 2011.

Despite the widening price gap between town and country, there seems to be an increasing reluctance among Londoners to move out of the capital and so we have seen a 24% drop in this type of relocation activity. If the equity doesn't migrate from London, prime country markets will remain suppressed.

Personality divide

Meanwhile, the prime London market itself is also experiencing a personality divide. On the one hand, the more 'domestic' prime markets of south west London and locations such as Islington are more reliant upon earnings and employment in the Capital's financial and business services sector.

On the other hand, there is an enormous amount of overseas wealth coming to the capital. High commodity prices and growth in emerging economies are creating international billionaires and multi-millionaires at an unprecedented rate. Many of these ultra high net worth individuals are attracted to the prime London markets. Some come because they are based here but others see a London property as part of a portfolio of must-have real estate.

They are attracted by the UK's political, financial and legal stability and see the City as a 'safe haven' store of wealth. They are also attracted at present by low rates of exchange and some may see a sterling denominated asset as a longer term currency play.

This state of affairs is not uncommon in a market which has seen regular influxes of global wealth in past decades but it does mean that PCL markets have been more volatile

TABLE 3.1

The global outlook

Forecast for	Forecast as at	
	Autumn 2010	Autumn 2011
Eurozone Economic Growth 2012	1.7%	0.6%
Middle East Economic Growth 2012	5.3%	4.4%
Eastern Europe Economic Growth 2012	5.3%	3.5%

Table source: Oxford Economics

TABLE 3.2

Outlook for London has weakened

Measure for Greater London	Forecast for	Forecast at	
		Autumn 2010	Autumn 2011
Financial Services Economic Growth	2011	2.9%	-4.2%
	2012	4.4%	3.0%
Financial Services Employment Growth	2011	0.4%	-1.0%
	2012	0.9%	0.9%
Business Services Economic Growth	2011	4.7%	0.7%
	2012	5.4%	4.1%
Business Services Employment Growth	2011	0.7%	-1.2%
	2012	2.6%	1.7%

Table source: Oxford Economics

PRIME MARKETS
Five-year forecast values

Forecasts	Change from peak to date	2012	2013	2014	2015	2016
Prime Central London	15.6%	3.0%	0.0%	5.0%	6.5%	6.5%
Prime South East	-12.5%	-2.5%	3.0%	6.5%	6.5%	6.5%

Data source: Savills Research

as this activity has ebbed and flowed. What is different today is the relative lack, and little immediate prospect, of large amounts of wealth being created in the City of London and finding its way into the residential real estate markets as the result of a strong domestic economy. In the absence of the influx of overseas equity, prime London would probably be undergoing a similar fate to prime property in the rest of the country.

Further growth in the central London market is dependent on it continuing to defy – or even benefit from – the pressures on the global economy. On the one hand, greater uncertainty encourages the search for a safe haven for wealth while on the other, there comes a point where a slowdown, prevents new wealth being generated and shrinks the pool of potential buyers.

While the Eurozone may be teetering on the brink of a double-dip recession, the outlook in other parts of the world is more favourable. Economic forecasts for the Middle East, Asia and Eastern Europe have been 'trimmed' but they are more positive than for the US and Eurozone so we anticipate that buyers from these regions will drive demand in the medium term (see Table 3.1).

The health of the Eurozone affects the more family-oriented London prime markets such as south west London, where many households are employed in the financial and business services sector (see Table 3.2 for London outlook). So far, these markets remain unsupported by large-scale city bonuses. The latest estimates from the Centre for Economic and Business Research suggests the 2011/12 bonus pool will shrink to about 62% of what is was in 2007 and be paid out over several years.

Global city fundamentals

We have already highlighted the volatile nature of prime central London and a lull in this market is to be expected at some point. On balance, we believe the influx of global wealth in uncertain times still has some time to run and may even be boosted by the international attention that London will receive in the run-up to the 2012 Olympics. We have therefore forecast continued, but lower, prime central London growth next year with a short-lived downward blip in the final quarter before growth resumes later in 2013, driven by strong global city fundamentals and an improving domestic economy.

The prospect of a lull in London will do little to improve sentiment in the prime markets beyond London, but the gap between London and country prices is wide and makes prime property outside the M25 look comparatively good value.

To date, the markets which are completely divorced from London (the Midlands, the North and Scotland) have been the slowest to recover. That is set to continue. ■

"We believe the influx of global wealth in uncertain times still has some time to run"

Yolande Barnes, Savills Research

LONDON'S PRIME WILL GROW AGAIN

PCL property set to perform on a par with UK gilts

Over the next five years, we expect the capital value growth of prime central London residential assets to outperform many commodities markets and perform in line with West End offices and UK gilts, with additional rental growth on top.

In an investment world searching for yield and security there are few options for investors. As illustrated in the table below, capital growth in the non-yielding commodities such as gold could come a long way behind our forecasts for prime central London residential property, which is increasingly heralded as a store of value in uncertain times.

UK property is also a sterling-dominated asset, which makes it look cheaper by international standards and can be particularly attractive to overseas investors looking for an additional currency play.

We even expect UK mainstream residential property to look attractive in the medium to long term. Historically, gold has been the asset of choice during economic uncertainty but Oxford Economics predicts, as do others, that the price of it and other commodities will fall at some point. The income-producing nature of residential real estate as well as the potential for real-world added value and sound capital growth prospects means that the case for housing investment looks increasingly supportable.

TABLE 3.3

Relative performance of different asset classes

Rank	Asset class	5yr growth to 2016
1	Dow Jones Global Index	49.3%
2	West End Offices	26.8%
3	UK 10-yr gilts	24.3%
4	Prime central London	22.7%
5	Oil	10.9%
6	UK residential mainstream	6.1%
7	Non-fuel primary commodities	0.3%
8	Gold	-37.1%

Forecaster: 4,6 Savills Research / 1,3,5,7,8 Oxford Economics / 2 IPD

Private rented sector

RENTAL GROWTH IN A GROWING MARKET

A marked increase in the demand for rental property has caused a shortage in supply, consequently rental values are growing at a far faster rate than capital values across the UK

Words by Yolande Barnes

Even though we have long been advocates of residential property investment in the private rented sector, this has until recently been predicated chiefly on the expectation of increased capital value.

Now, in the face of increased rental demand, a shortage of property to rent is currently pushing up rents at a rate faster than capital values across the UK. According to findaproperty.com asking rents rose by 4.6% in the year to the end of September, while the LSL buy-to-let index suggests rental movements of 3.5% over the same period.

There is a growing demand for rental property as more newly formed households look to rent, more first time buyers choose to delay or are prevented from making a purchase and economic constraints push more people from home ownership into rented accommodation.

This scenario is unlikely to change for as long as mortgage finance remains scarce and first time buyer deposits are unaffordable.

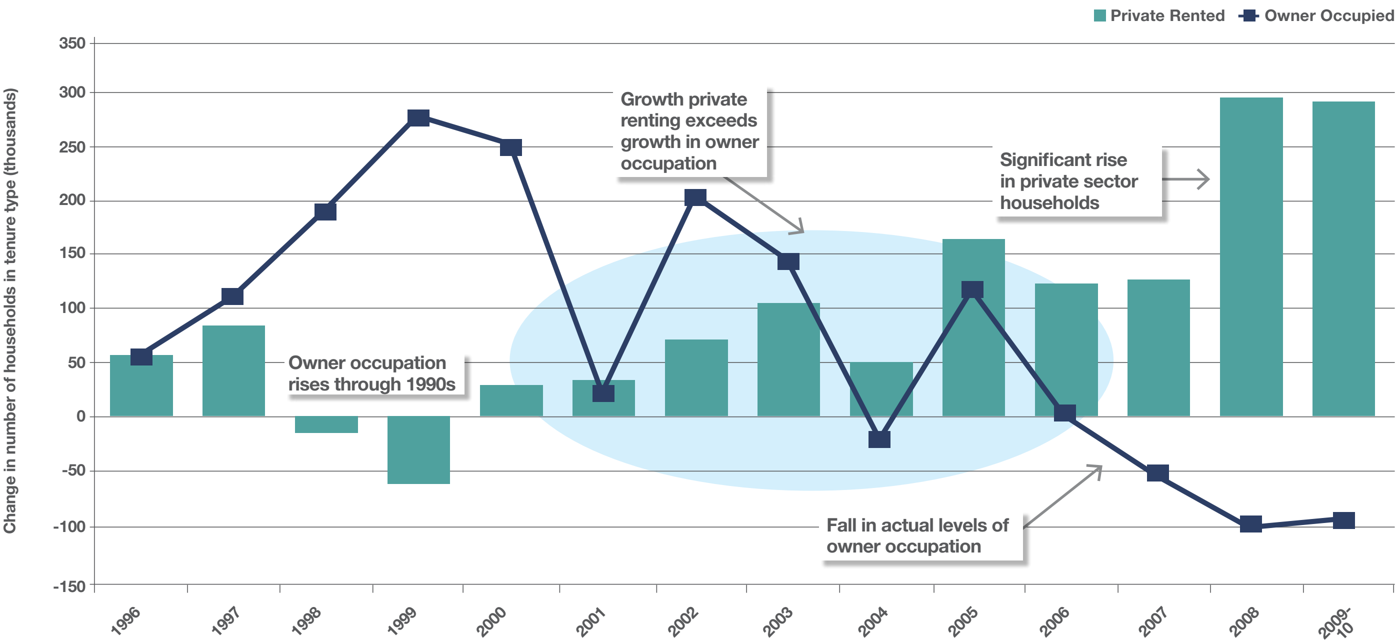
The recent low levels of investment in the residential sector means available property to rent is scarce. Demand for mortgage finance among buy-to-let investors is rising, but the level of new lending in this sector remains heavily suppressed. In the second quarter of 2011 gross buy to let mortgage lending was just 28% of its level at the peak of the market.

Large scale portfolio investment, which has the potential to significantly expand the rented sector, has garnered significant interest; but is yet to bear

> "Large scale portfolio investment for the rented sector has garnered significant interest"
> Yolande Barnes, Savills Research

GRAPH 4.1

The rise in renting Change in owner occupied and private rented households in England



Graph source: CLG

RENTAL MARKETS

Five-year forecast values

Forecasts	2011	2012	2013	2014	2015	2016	2012-2016
Prime London	8.0%	4.0%	5.0%	5.0%	5.5%	5.5%	27.6%
UK Mainstream	4.0%	3.0%	3.5%	3.5%	4.5%	4.5%	20.5%

Source: Savills Research

fruit. Much of this comes down to investors' views of income yields rather than the positive look for cashflows.

In London and the South East where capital values remain relatively high the supply-demand imbalances between renters and available property to rent are greatest. Higher yielding properties favoured by investors are simply in lower supply there.

This sticky supply-side is key to our prognosis that rents will rise by over 20% across the country as a whole over the next five years. Were it not for the constraints of affordability, this forecast would be even higher.

This level of rental growth has the effect of maintaining average UK rents at 38% of net disposable household income which is slightly higher than their 10-year average but in line with where they were at the turn of the millennium. By this yardstick, rental 'affordability', a term which we expect will assume increasing significance, will not worsen under this scenario.

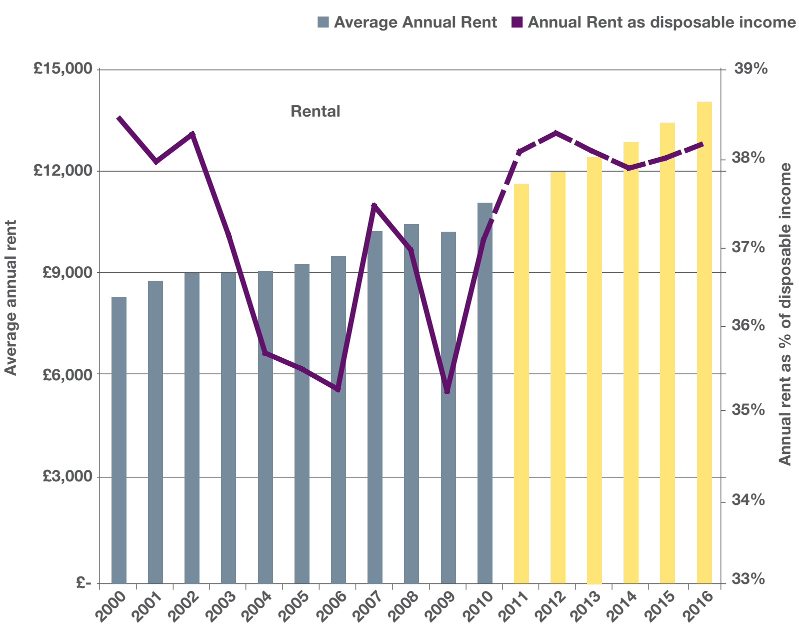
Upward yield shift

Rental growth of this level would see the headline gross yield on residential stock increase from 5.0% to 5.7%. In areas of weak owner occupier demand, where yields start from a higher base, we expect an even greater upward yield shift.

This means one and two-bedroom properties in secondary and tertiary locations should begin to stand up as income yielding investments, when compared to alternative asset classes over the next five years. ■

GRAPH 4.2

The rise of rents Rental affordability



Graph source: Savills Research, IPD

FORECAST OF TENURE PATTERNS

Private renting set to increase to 20% of households by 2015/16

The summer issue of Residential Property Focus outlined in depth how the structure of the housing market has changed, and how the number of owner occupiers has been falling since the early Noughties while the private rented sector has grown.

The increased movement of new households into private renting and movement of former owner occupiers into the rented sector have exacerbated this trend in the post credit crunch environment of rationed mortgages. According to the Survey of English Housing, the number of households in private rented accommodation rose by just under 290,000 between 2008/09 and 2009/10.

We expect this to continue such that private renting will rise from 15.6% of all households in England in 2009/10 to 20% of households by 2015/16.

INVESTMENT CREDENTIALS

Residential investment activity will increase

UK investors in residential property have come to expect that capital growth will provide the bulk of their returns. In the last decade, total returns on standing residential investment portfolios have been 10.1% according to IPD's analysis of the sector. Most of this return (6.2%) has been the result of rising capital values – despite the 2008 downturn. Only 3.7% has been net income from rents.

This does not mean rents have been static over this period, it's just that (more volatile) capital values have grown much more. Indeed, rental growth on commercially managed residential properties has been greater than in other commercial property asset classes in the past three years.

As average UK rents increase in the future at a rate faster than average capital values, income yields will continue to move out. This should increase the attractiveness of the sector to investors, particularly those looking for strong income-producing assets with growth potential and should be the catalyst for increased institutional and other residential investment.

Consequently, we expect activity in the residential investment sector to start its ascendency next year.

TURNING UP THE VOLUME

The shortfall in the supply of new build housing is widening, but is it possible for development volumes to increase to the levels that are necessary?

Words by
Jim Ward

Build rates for new homes are now running at less than half the levels required. This may be good news for homeowners, lenders and investors as it supports existing house prices, but in economic and social terms it is potentially disastrous.

New young working households, expanding families and older households looking for living space are not finding the homes they need.

The Government has acknowledged this much in the draft National Planning Policy Framework and, undoubtedly, we will be reading more on this subject in the Government's Housing Strategy when it is published later this year.

Financial viability

The draft planning framework emphasises how the planning system should respond to signs of unmet demand with the sustainable development of new places.

Furthermore, for meeting housing requirements, it strengthens the need for local planning authorities to identify and maintain a supply of deliverable sites to meet locally identified housing requirements.

The limited financial viability of development has prevented significant volumes of land coming forward for new housing. Since 2007, new planning consents have been granted for 487,000 new homes in England, yet development has started on only 333,000 new dwellings during the same period (see Graph 5.1).

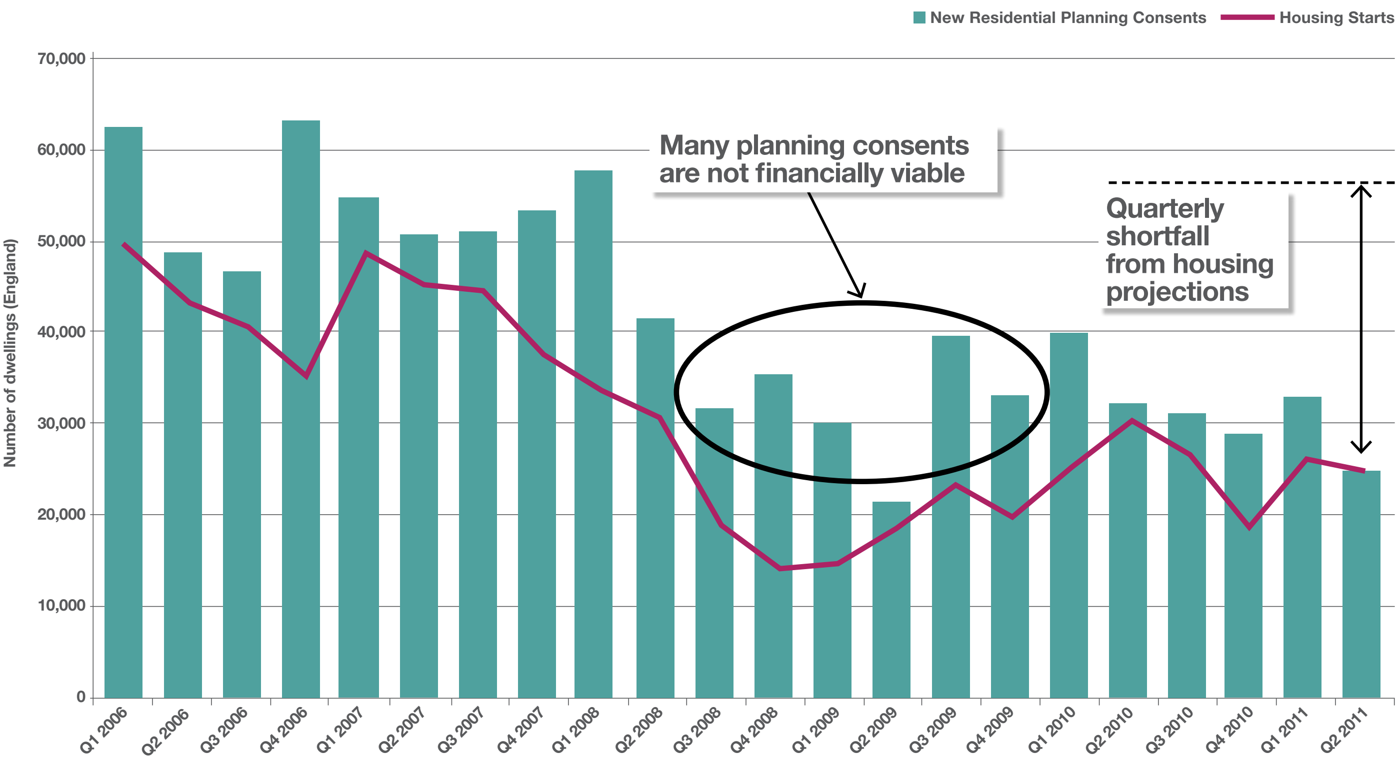
The principal constraint on the financial viability of land is a reduced market capacity brought about by the limited availability of mortgage finance. New homes registrations have fallen by 41% since 2007, in line with the fall in market transactions as outlined on page 14 of this report.

Public sector support

Volumes of new housing would have fallen much further, except for public sector funding of affordable housing. Spending by both the Labour and Coalition governments supported shared equity loans to first time

GRAPH 5.1

Residential permissions and starts in England



Graph source: Glenigans for HBF, CLG

Build rates for new homes are now running at half the levels required.

buyers of new homes via Homebuy Direct and FirstBuy, while Kickstart unlocked the development of 18,500 homes on stalled schemes.

The public purse does not have the capacity to be the sole provider of the funds needed for a substantial increase in development volumes, particularly since Government spending on housing has been cut by more than 70% since the Comprehensive Spending Review. Future funding could come from a number of sources, which include the following.

1. A review of planning obligations

A rising proportion of affordable housing was delivered as part of developers' planning obligations (conditions of the planning consent) during the 2002-06 period, reaching more than half of all affordable housing in 2005-06.

Their contribution has barely changed. This worked during a time of rising house prices and land values by creating a 'viability cushion' for developers. Since the market downturn, and until recently, central government grants have supported viability, but at much reduced development volumes.

In the new age of public sector austerity, Government spending on housing is insufficient to expand development volumes. Today the 'viability cushion' is thin and often non-existent, particularly on larger sites with high costs of development and long cashflow.

Given our forecasts of slower and delayed recovery in house prices and rates of sale, the return of a significant supply from this sort of planning obligation provision is unlikely.

For development volumes to rise significantly, policy should allow for land to come forward from willing landowners for development by willing developers.

It is important this is a guiding principle of the viability testing of charging schedules for Community Infrastructure Levy and other planning obligations, which once fixed is non-negotiable at a site level.

"Government spending on housing is insufficient to expand development volumes."

Jim Ward, Savills Research

FILLING THE GAP WITH PRIVATE RENTED STOCK

Can the rental investor fill the demand for new build housing?

Given the limited extent to which we can rely on a recovery in mortgage transactions, there is a clear role for the private rented sector to fill the gap in demand for new build housing. We expect the private rented sector to expand to 20% of housing stock in England by the end of 2016 (see page 11).

The key variable is the price at which investors are prepared to buy new homes from developers. In the past, individual buy-to-let investors have bought at prices close to the price paid by owner occupiers, or early 'off-plan' at a discount. As these investors, constrained by more risk averse mortgage lending, have faded into the background, professional investors, including property companies and institutions have been the main driver of the investor market. These investors appraise their acquisitions with reference to income return and rental growth prospects and in some markets make their purchases at substantial discounts to owner-occupied values. The gap is greatest where rental demand and rental growth prospects are weakest and conversely at its narrowest in strong markets.

This is the new reality of residential development viability and needs to be understood by developers. On many larger sites, most notably in urban areas where tenant demand is high, market absorption will depend on substantial investor acquisition at discounts to owner occupied values.

2. The use of surplus public sector land

Surplus public sector land offers a significant way of breaking out of the viability deadlock, because of the opportunity to release land at a value that allows wider policy objectives to be met. The Government has recently announced its intention to release sufficient public land to deliver 100,000 new homes by 2015.

The success of this strategy depends on whether the 'Government department landowner' is more interested in the delivery of new places than the realisation of cash receipts. If it is the former, then value can be realised over a longer timeframe and is therefore more likely to be immediately viable. If landowners remain wedded to the latter it is unlikely that land can be brought forward at scale in any but the highest value markets. ■

Transactions

SHORTFALL IN ACTIVITY WIDENS

Activity this year predicted to be just over 50% of level before the crunch

TABLE 6.1

Projected level of transactions (in 000s)

	Transactions	Previous 10 year average	Shortfall	Cumulative Shortfall
2007	1,613	1,684	71	71
2008	901	1,684	783	853
2009	859	1,684	825	1,678
2010	886	1,684	798	2,476
2011	856	1,684	828	3,303
2012	863	1,684	821	4,124
2013	880	1,684	804	4,928
2014	912	1,684	772	5,699
2015	967	1,684	717	6,416
2016	1,047	1,684	637	7,053
Total	9,784	16,837	7,053	7,053

Table source: HMRC

Transactional activity remains the weakest feature of the UK residential market. We anticipate that, by the year end, around 850,000 residential sales will have completed, which is just over 50% of the level recorded annually prior to the credit crunch.

Owners are simply not selling in the current climate and, with interest rates at manageable levels, are not forced to sell leaving repossessed and distressed stock levels low.

This weakness is most pronounced in the mortgage-dependent markets, which tend to be the lower value markets. Conversely, the higher value markets, where equity rich buyers are most prevalent, are the markets in which transactional activity has been strongest.

We estimate that, in the 18 months to June this year, a net £6billion flowed into the second hand and new-build markets of prime London from overseas sources alone; these buyers tend not to sell in order to buy reducing the pool of property available. Also this year, there has been reluctance among Londoners to move out of the capital leading to a 24% drop in this type of relocation activity.

Looking ahead, the strength of recovery in transactions will be determined by the volume of mortgage lending available for house purchases.

Reduced expectations for house price growth may well temper the willingness of banks and building societies to lend and the prospect of tighter restrictions on lending, in light of the ongoing global financial stress, will doubtless affect their capacity to do so.

This points to a slower and later recovery in transaction volumes meaning that in the 10 years to the end of 2016 transaction levels could be seven million fewer than in the preceding 10 years. ■

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