RESIDENTIAL RESEARCH

UK RESIDENTIAL MARKET FORECAST

HOUSING FORECAST OVERVIEW

The Conservative Party's recent surprise election victory has led to a spate of frothy house-price forecasts. The reality is likely to be more sober, argues Liam Bailey

Headlines May 2015

Our immediate post-election forecast review has left our existing five-year forecast largely unchanged, our risk monitor however has undergone a substantial overhaul

Cumulative growth in UK prices will total a little over 18% in the five years to the end of 2019

While political risk for the prime London market has fallen, affordability constraints and rising stock volumes will limit price growth in the near term

UK rents and prime central London rents will rise 2.2% and 3.5% respectively in 2015

Interest rate rises and the risk of a renewed global economic slowdown remain the biggest risks to the UK housing market

LIAM BAILEY
Global Head of Research

"Don't assume the election result means political risks have disappeared for the prime London market."

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We last reviewed our UK house-price forecast in February. At that point, despite a slowing economy, we left our outlook for modest future growth unchanged. Since then forward-looking economic indicators, such as our own House Price Sentiment Index, have begun to tick upwards.

A majority win for the Conservative Party at the General Election on 7 May, means fears of weak government for the next five years have, in the short-term at least, disappeared. In light of this, and allied to improvements in economic and consumer sentiment, we have revisited our forecast for UK house-price growth.

However, with the exception of moving the prediction for our Prime Central London Index from 0% to +1% in 2015 (there appears sufficient momentum in central London to deliver modest positive growth this year), we have held firm on our view for other markets for the moment. We will be reviewing our figures again in June, following the Queen's Speech, and with the benefit of a month's post-election market activity.

The risk from higher interest rates, and therefore potential future affordability pressures, global economic risks and the uncertainty surrounding the outcome of the promised UK referendum on EU membership by 2017, collectively mean we don't foresee an immediate upswing in UK price growth above our existing forecast.

Although our view on prime London prices has turned positive, we are monitoring the volume of new housing supply, especially new-build, which has the potential to weigh on price growth.

In terms of key risks, while we have downgraded the impact of political risk, we remain mindful that the previous Conservative-led administration was arguably the most activist in recent history regarding high-value property taxation. But interest rate and global economic uncertainty in our view remain the key risks for house prices.

Knight Frank Residential Market Forecast May 2015

	2014	2015	2016	2017	2018	2019	2015-2019
Mainstream residential sales markets							
UK	7.2%	3.5%	2.5%	3.0%	4.0%	4.0%	18.2%
London	17.8%	3.5%	4.0%	5.0%	5.5%	5.5%	25.8%
South East	10.6%	5.0%	3.0%	3.5%	5.0%	5.0%	23.4%
South West	8.0%	4.0%	2.5%	3.0%	4.5%	4.0%	19.3%
East Anglia	9.8%	4.5%	3.0%	3.5%	4.5%	5.0%	22.2%
East Midlands	6.0%	3.5%	2.0%	2.5%	4.0%	4.0%	17.0%
West Midlands	6.8%	3.5%	2.0%	2.5%	4.0%	4.0%	17.0%
North East	4.4%	3.0%	2.0%	2.0%	3.0%	3.5%	14.2%
North West	3.8%	3.0%	1.5%	2.0%	3.5%	3.5%	14.2%
Yorkshire & Humber	1.5%	3.0%	2.0%	2.0%	3.5%	3.5%	14.8%
Wales	1.4%	3.0%	2.0%	2.5%	4.0%	4.0%	16.5%
Scotland	4.2%	3.5%	2.5%	3.0%	4.0%	4.0%	18.2%
Prime residential sales markets							
Prime Central London	6.7%	1.0%	4.5%	5.0%	5.0%	6.0%	23.3%
Prime Outer London	10.5%	3.0%	5.5%	5.0%	5.0%	5.0%	25.8%
Residential rental markets							
UK Mainstream	2.0%	2.2%	2.3%	2.3%	2.4%	2.4%	12.1%
Prime Central London	4.0%	3.5%	3.3%	3.3%	3.0%	3.0%	17.1%
Prime Outer London	0.5%	4.0%	3.3%	3.0%	2.8%	2.8%	16.8%

Source: Knight Frank Residential Research

RISK MONITOR

10 9 8 7 6 5 4 3 2 1

HIGHEST RISK — LOWEST RISK

Knight Frank's residential market Risk Monitor provides our latest assessment of key risks to the UK's residential markets. Our risk score, out of a maximum 10, is based on two assessment, firstly our view of the likelihood of the described scenario occurring, and secondly the potential market impact. Both these elements are scored from one (low) to five (high), collectively contributing to our combined Risk Score. Our measure of risk is deliberately narrow – namely the risk that house prices could under perform our central forecast scenario.

RISK	SCENARIO	IMPACT	UK			PRIME LONDON		
			LIKELIHOOD	IMPACT	RISK SCORE	LIKELIHOOD	IMPACT	RISK SCORE
INTEREST RATES	The Bank of England raises base rates more rapidly than expected	Our expectation is that the UK base rate will rise to 0.75% by Q2 2016, and 1% by Q4 2016. A more rapid rise would translate into higher mortgage rates, putting pressure on current borrowers, and reducing the ability of new buyers to purchase at current prices. Rising rates are likely to make alternative investments more attractive, and could prompt investors to look less favourably on low yielding property investments.	1	5	6	1	4	5
GLOBAL ECONOMY	The UK economy is hit by weaker global activity	While the UK economy continues to outperform most developed markets, a key risk to future growth is renewed weakness in the global economy. Deflation and political turmoil in the Eurozone remain potent issues and risks a downturn there. Emerging markets, including China, have seen an economic reversal more recently, which could be reinforced by the withdrawal of US QE.	3	3	6	3	2	5
EU REFERENDUM	The prospective referendum causes economic uncertainty	The possibility of the UK leaving the EU could cause a level of uncertainty in the market from the day a referendum is announced. This will likely gather pace in the run-up to polling day, weighing on activity on all parts of the market. We will monitor the polls to assess the risks associated with the final result as the date of the referendum approaches.	3	2	5	3	2	5
MACRO PRUDENTIAL POLICY TOOLS	The Bank of England imposes restrictive mortgage policies	The Bank of England is increasing the use of macro-prudential measures to help manage risk in the UK housing market. These efforts have mainly been expressed as regulations limiting higher-risk lending. The Financial Policy Committee is seeking additional powers to intervene in the market to control loan to value ratios and debt to income ratios. These measures could weigh on mortgage availability as lenders become more cautious.	1	4	5	1	3	4
GEO-POLITICAL CRISIS	Worsening crisis in Crimea or Syria feeding a wider economic fall-out	EU restrictions on Russian investments have focussed on a small group of individuals, and without a noticeable increase in the scale of the crisis it is difficult to see how this will expand to more significant restrictions. The prime London market would face some risk from this scenario. The growing Middle East crisis, centred on Syria, could easily damage global economic conditions by disrupting world trade, harming residential markets.	3	2	5	3	2	5
DOMESTIC ECONOMY	Economic weakness leads to sharply lower economic growth	The Bank of England has downgraded its forecasts for economic growth this year and next, from 2.9% to 2.5% and 2.6% respectively. Although there are still expectations for steady growth in UK output, policymakers are factoring in higher levels of productivity growth which have yet to fully materialise.	2	3	5	2	3	5
NEW BUILD SUPPLY	Housing supply exceeds demand	Outside London and a few, very specific, regional markets this is a non-issue in our view. In most areas of the UK the real issue is undersupply, which has underpinned price growth. While we remain of the view that at a macro level it is almost impossible to imagine new-build delivery ever outpacing demand for housing in London, in the key development hubs around the edge of central London, this issue is worth watching.	1	3	4	2	3	5
POLITICAL RISK	New property taxes and restrictions on non-resident buyers	While the Mansion Tax has disappeared as an immediate threat to the £2m+ market, those claiming that political risk has ceased to be an issue for the prime markets would do well to remember that the Conservative-led coalition government proved to be the most activist administration on high-value property taxation in recent history. The potential for reform of Council Tax, further tweaks to non-dom legislation and even additional charges to CGT and Stamp Duty should not be dismissed out of hand.	2	1	3	2	3	5
CURRENCY RISK	The pound strengthens against the US dollar	After falling from a 2007 high of \$2.10 to a 2009 low of \$1.36, the pound/US dollar rate has remained relatively constant between \$1.50 and \$1.70. Our forecast is based on the assumption that the rate will remain below \$1.75 to the end of our forecast period. A strengthening in the pound much above this level would begin to weaken the attraction of UK property for investors.	1	1	2	1	3	4

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