UK RESIDENTIAL MARKET FORECAST

Headlines November 2015

Cumulative **growth in UK prices** will total 20.3% in the five years to the end of 2020

In the **prime London and prime country** markets higher transaction costs will continue to weigh on activity and price growth in 2016 as the market absorbs stamp duty

Prime central London prices are forecast to rise by 2% in 2016 and by 20.5% cumulatively by 2020

The risk that UK **interest rates** rise more rapidly than expected or that the **global economy** suffers a notable slowdown in activity remain the biggest risks to the UK housing market

"Regional differences in pricing and price growth are unlikely to unwind significantly in 2016, although the improving economic and employment picture, especially in the regions, will underpin pricing."

UK RESIDENTIAL MARKET FORECAST

Last year we correctly anticipated a slowdown in UK house price growth in 2015. While the market may end the year slightly ahead of our predictions, a continued moderation in price growth underpins our latest forecast.

As always national average performance disguises large regional variations that still characterise the UK market.

Values are growing more strongly in the South of England (particularly London and the South East) compared to slower growth in the North of England, Scotland and Wales.

These regional differences are unlikely to unwind significantly in 2016, although the improving economic and employment picture, especially in the regions, will underpin pricing. This is reflected in our House Price Sentiment Index which we produce with Markit Economics. Households in every region of the country expect the value of their home to increase over the next 12 months.

Interest rates continue to play a key role in the market. While capital values will continue to be supported by ultra-low interest rates, the discussion has now turned to when, not if, the Bank of England will start to raise rates; markets are pricing in a rise in the second half of 2016. However, as we highlight in our Risk Monitor on page 2, the Bank is most likely to act cautiously when increasing the base rate.

The current ultra-low base rate, alongside an increased appetite for lending among banks, has led to record-low mortgage rates, and mortgage lending has risen during 2015. The flip-side of this trend however, is that the best mortgage rates are generally only available to those who have access to sizeable deposits or equity.

While there are now more mortgage deals available to those with only a 5% deposit – a trend which will continue into 2016, the MMR mortgage rules mean that clinching a mortgage deal will continue to be challenging for some, especially for first-time buyers.

Activity in the market has stabilised at around 100,000 transactions a month, although it is interesting to note that the cut in stamp duty for homes worth less than £1.1 million in December last year and the definitive General Election result failed to produce an increase in activity.

This was closely linked to a lack of stock on the market, particularly second-hand stock. A lack of available homes to buy will likely continue to put a floor under pricing in 2016. There is now even more emphasis on the delivery of new homes, and while levels of housebuilding have picked up in recent years, the supply of new-build dwellings is still far below Government targets.

Prime markets

The prime London property market faced a number of headwinds in 2015, led by the increase in stamp duty. Higher transaction costs will continue to weigh on activity and price growth in 2016 as the market absorbs the new rates.

There is a degree of nervousness surrounding global economic events and some reticence following exceptional price growth in some markets in recent years. These factors, combined with the Mayoral election in May, will continue to weigh on demand.

However, the strength of the UK's economic recovery, continued supply constraints and the diminishing likelihood of a near-term rate rise means price growth will remain positive next year.

The turning point for the prime country property market occurred in early 2013, as prices started to edge upwards. By June 2014 annual growth had reached 5.2%.

However, since then the rate of growth has slowed, partly due to uncertainty surrounding the election but also because the top end of the market is adjusting to stamp duty reform.

Prices remain 14% below their 2007 peak. The price differential between most prime markets and the capital is likely to underpin price growth in 2016.

As the economy continues to recover and house prices outside of London show further growth, the trend for more London buyers to move will gain traction, boosting the ripple effect from the capital.

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% in late 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 relatively 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 monetary stimulus or if the Fed raises interest rates in the US.	3	3	6	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.	2	4	6	2	3	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
GEO-POLITICAL CRISIS	Worsening geopolitical crises 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 political tensions it is difficult to see how this will expand to more significant restrictions. The growing Middle East crisis, in which Russia is now involved, could easily damage global economic conditions by disrupting world trade.	3	2	5	3	2	5
DOMESTIC ECONOMY	Economic weakness leads to sharply lower economic growth	The Bank of England has revised its forecast for GDP growth this year from 2.8% to 2.7%, with a forecast of 2.5% for 2016. The outlook for the economy is broadly upbeat, with initial signs that productivity and employment is rising, a crucial factor for a sustainable economic recovery. However the plans to address the UK's large deficit – spending cuts – are likely to weigh on growth.	2	3	5	2	3	5
NEW BUILD SUPPLY	Housing supply exceeds demand	Outside London and some regional hot-spots this is a non-issue in our view. In most areas the real issue is undersupply, a factor which has helped underpin price growth. This problem is likely to be exacerbated in the short-term as uncertainty is introduced on schemes currently in planning by the Government's new rules on 1% rent cuts for social housing. At a macro level it is almost impossible to imagine new-build delivery ever outpacing demand for housing in London, however in some 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 those claiming that political risk has ceased to be an issue for the prime markets would do well to remember that the Conservatives, both since the recent election and as part of the coalition have been one of the most active parties on property taxes. Overseas buyers and rent caps are likely to be live issues discussed in the run up to the London Mayoral election in May.	2	1	3	2	3	5
CURRENCY RISK	The pound strengthens against other currencies	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. The impact of the recent weakening of emerging market currencies could pose an additional risk to the London market.	1	1	2	1	3	4

Knight Frank Residential Market Forecast November 2015

	2015	2016	2017	2018	2019	2020	2016-2020
Mainstream residential sales markets							
UK	4.2%	4.1%	4.1%	3.5%	3.1%	4.0%	20.3%
London	8.5%	5.0%	4.5%	3.0%	3.0%	2.5%	19.3%
North East	2.0%	2.5%	2.5%	2.5%	2.0%	3.0%	13.1%
North West	1.5%	3.0%	2.0%	2.5%	2.5%	3.0%	13.7%
Yorks & Humber	2.0%	3.5%	3.0%	3.0%	2.5%	3.0%	15.9%
East Midlands	3.0%	4.0%	3.5%	3.0%	2.5%	4.0%	18.2%
West Midlands	3.0%	4.0%	3.5%	3.0%	2.5%	4.0%	18.2%
East	3.0%	4.5%	4.0%	4.0%	3.5%	4.5%	22.2%
South East	6.0%	4.0%	4.0%	4.0%	3.0%	4.5%	21.2%
South West	5.5%	4.0%	4.0%	3.5%	3.0%	4.0%	19.9%
Wales	3.0%	3.5%	3.0%	2.5%	2.5%	3.0%	15.4%
Scotland	0.5%	3.0%	2.5%	2.5%	2.5%	3.0%	14.2%
Prime residential sales markets							
Prime Central London	1.0%	2.0%	3.0%	4.0%	5.0%	5.0%	20.5%
Prime Outer London	4.0%	3.5%	4.0%	4.0%	5.0%	5.0%	23.4%
Residential rental markets							
UK	1.7%	1.9%	2.1%	2.3%	2.5%	2.6%	11.9%
Prime Central London	1.0%	2.0%	3.0%	3.5%	3.0%	3.0%	15.4%
Prime Outer London	0.5%	2.0%	2.5%	3.0%	3.5%	3.5%	15.4%

Source: Knight Frank Residential Research

NB: These forecasts apply to average prices in the second hand market. New build values may not move at the same rate

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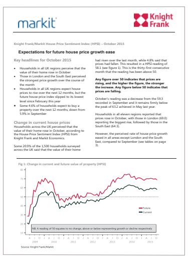
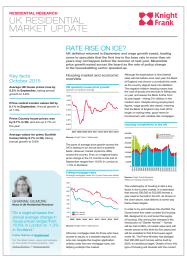


House Price Sentiment Index Oct 2015



Residential Market Update Oct 2015

Prime Central London Sales Index - Oct 2015

Prime Country House Index Q3 2015

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