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Brexit cloud hangs over the real estate market

UK Economy and Property Market Chart Book

Q1 2019



What's the forecast?



Anderson Wilde & Harris, Chartered Surveyors, have a practiced eye on the prevailing conditions in the property markets.

We are members of the RICS and we are experts in all aspects of real estate. But, just as important, we keep a weather eye open to ensure that our clients get the best advice available in changing economic times.



awh

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RICS Survey Release Dates			
Frequency	Survey	Period covering	Release date
Monthly	RICS Residential Market Survey	January	14-Feb-19
Monthly	RICS Portuguese Housing Market Survey	January	25-Feb-19
Semi-Annual	RICS Rural March Survey	H2 2018	28-Feb-19
Monthly	RICS Residential Market Survey	February	14-Mar-19
Monthly	RICS Portuguese Housing Market Survey	February	29-Mar-19
Monthly	RICS Residential Market Survey	March	11-Apr-19
Monthly	RICS Portuguese Housing Market Survey	March	26-Apr-19
Quarterly	RICS Construction Market Survey	Q1 2019	18-Apr-19
Quarterly	RICS UK Commercial Property Market Survey	Q1 2019	25-Apr-19
Quarterly	RICS Global Commercial Property Market Survey	Q1 2019	25-Apr-19

Economic outlook

The UK economy ended last year on a relatively soft note and early indications suggest that the first quarter of 2019 was little better. Predictably enough, it is the uncertainty about the country's future relationship with the EU that is, in no small measure, contributing towards the subdued picture. This is particularly evident in the business world with corporate savings jumping sharply as investment plans are put on hold. Whether matters can be resolved before the March 29th deadline remains to be seen; at this stage, leaving without a deal alongside a possible extension of Article 50 are both also possible. Our judgement is that the former of these two potential outcomes is likely, at least in the near term, to inflict further damage on the economy, although the policy response and the ability to successfully (and rapidly) put in place alternative trade arrangements will be critical to determining how this plays out over time.

Perhaps partly because companies have been reluctant to commit to capex in the current environment, they have been reliant on employing more labour and this has been clearly visible in the employment statistics. In the three months to November (the latest available data), job creation jumped by 141,000, the biggest gain in seven months. As a result, the employment rate climbed to 75.8%, a record high and the rate of unemployment slipped to just 4%, the lowest since 1975. Against this backdrop, a stronger trend in pay growth is emerging. Wages are now increasing (on an annual basis) at their fastest pace in ten years and, with so little slack left in the labour market, the likelihood is that this firmer trend will be sustained in the absence of a material Brexit shock.

For now at least, higher wages are not feeding through into inflation. The headline rate edged down to 2.1% in December, the lowest in almost twenty-four months. Looking ahead, a combination of lower oil (and petrol) prices along with the impact of sterling's depreciation continuing to fade could see inflation fall further this year. However, for this benign climate to persist in the

medium term, it is critical that the productivity picture continues to strengthen helping to offset the impact of the firmer pay trend.

As far as the interest rate outlook is concerned, the MPC appears to want greater clarity around the thorny issue of Brexit before committing to any further policy adjustments. This is also evident in the behaviour of money markets where expectations for a further tightening in policy have eased significantly over the past few months.

Unsurprisingly, RICS data suggests that heightened level of uncertainty is continuing to impede activity in real estate markets. In the Residential Market Survey, for example, comments from respondents overwhelmingly point to the failure to agree a way forward on Brexit having a detrimental effect on market confidence. It is, needless to say, not the only issue highlighted; others include affordability challenges across much of the country, changes in the regulatory and fiscal environment and an ongoing lack of good quality stock. An illustration of the latter point is that new instructions to sell have declined in nineteen of the previous twenty-four months. As a result, the average levels of stock on estate agents' books remains close to record lows at just 42 properties per branch.

Total residential transactions in 2018 were 1.19 million which compares with 1.22 million in the previous year. Our suspicion is that transaction volumes will be modestly lower once again in 2019; the RICS Newly Agreed Sales net balance (which leads the HMRC transaction numbers by about six months) has remained in negative territory over the past five reports consistent with a further drop in activity. As far as prices are concerned, the headline RICS Price Balance slipped to -19% in the latest set of results. This would seemingly suggest that, at a national level, official measures of prices are likely to broadly flatline. The RICS number continues to be weighed down by negative sentiment across London and the South

East whilst the feedback from many other parts of the country is still more positive. Looking ahead, price and sales expectations for the coming three months imply that downward momentum is expected to persist at the national level with the medium-term indicator only modestly more comforting.

The latest RICS Commercial Property Market survey suggests that investor enquiries may have edged lower (in net balance terms) in the final three months of last year after a flat second and third quarter. This is broadly consistent with numbers from Property Data showing total activity dropped to £62bn in 2018 from £65.5bn in 2017. Alongside this dip in transaction volumes, the structural shift associated with changing consumer behaviour has become ever more evident. The RICS survey suggests (again from a sentiment-based perspective) that tenant demand for retail space has fallen for seven consecutive quarters with availability of space continuing to rise sharply (a net balance of 46% of contributors reporting a rise in Q4 2018). In turn, rents are envisaged to decline across the retail sector over both the three- and twelve-month horizons. On the other hand, the industrial segment of the commercial property market has continued to benefit from the preference for online shopping with rental values expected to continue rising firmly in the near term on the back of solid tenant interest.

Turning to the construction industry, the headline RICS workloads indicator is still consistent with an increase in output, albeit the pace of growth has moderated in the latest results. Activity appears to be flatlining across the commercial and industrial segments. In contrast, a net balance of +20% of respondents have reported an increase in private housing activity. This chimes with the improvement in the latest housing supply numbers as net additional dwellings in 2018 came in at 222,190 the highest outturn in a decade.

UK Economy

1. The UK labour market remains firm with the employment rate edging up to 75.8% in November, a record high. In turn, the jobless rate has fallen to just 4%, the lowest since 1975 with the inactivity rate also declining. These figures suggest that there is now relatively little spare capacity in the economy particularly given a likely drop in migration.
2. The latest numbers suggest that wage growth is finally responding to the tighter jobs market, with total pay rising by 3.4% compared with a year earlier. Alongside this, headline inflation has continued to soften with the CPI measure slipping to 2.1% in December (the lowest in 24 months) which has helped to drive a positive trend in real wage growth.
3. The outturn for both wage and price growth could prove to be crucial for household expenditure especially since consumers' appetite for credit has weakened in recent months. Net unsecured lending fell to £0.7 billion in December with much of this weakness stemming from lower credit card borrowing.

Chart 1

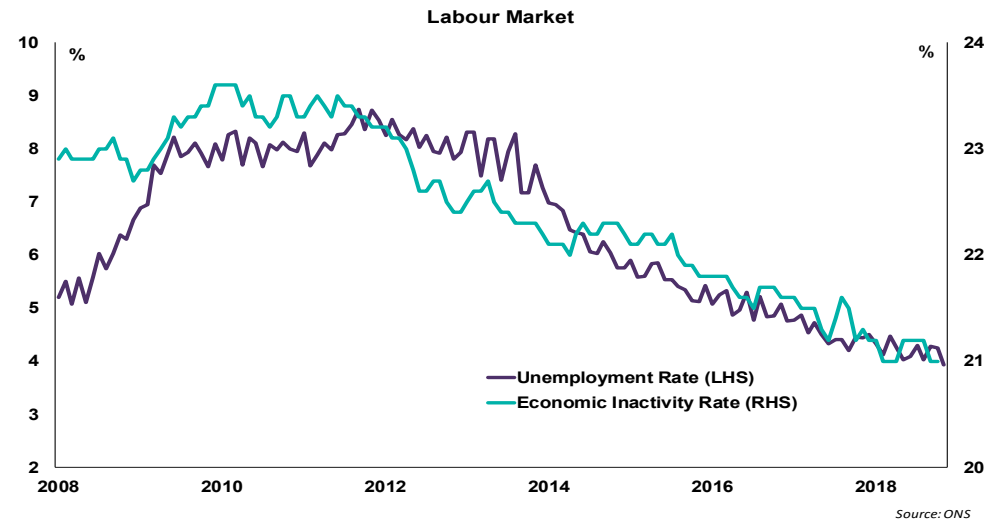


Chart 2

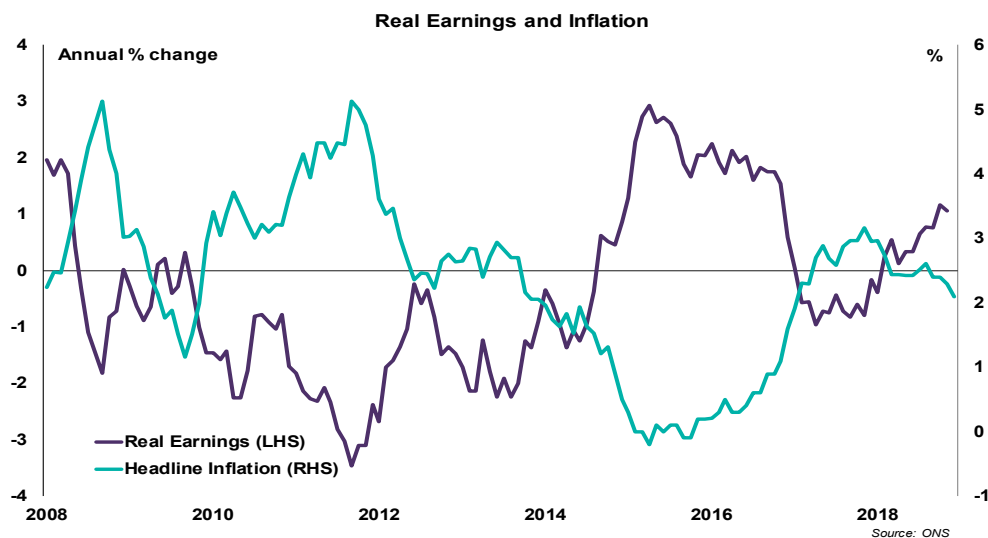
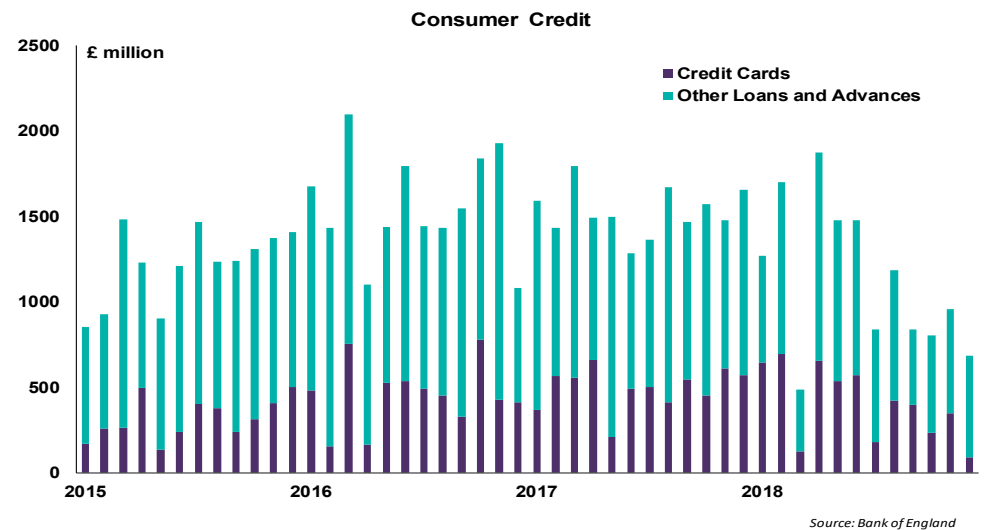


Chart 3



UK Economy

4. The UK's export performance weakened last year as the beneficial impact of sterling's depreciation in 2016 has continued to fade. Interestingly, the share of exports to EU have remained broadly stable since the EU Referendum. However, any potential changes to UK's trading regime following the withdrawal agreement might see this picture change significantly over the coming years.
5. The trade in services has proven to be particularly important for the UK with service industry making up 80% of the economy. The EU remains the UK's largest export partner for services, which leaves the economy in a particularly vulnerable position as far as any future trade deals between the UK and EU are concerned.
6. The IMF projects an improvement in UK real GDP growth in 2019 and beyond but only under the assumption that a Brexit deal is reached this year and the UK is able to transition to the new regime smoothly. Meanwhile, GDP growth across the EU is envisaged to slow this year with momentum expected to moderate in Germany, Italy and France.

Chart 4

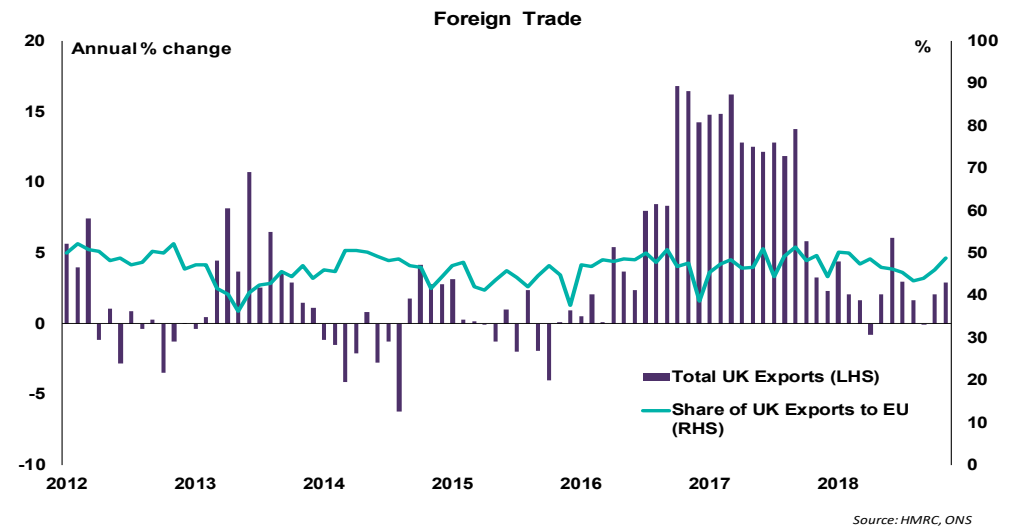


Chart 5

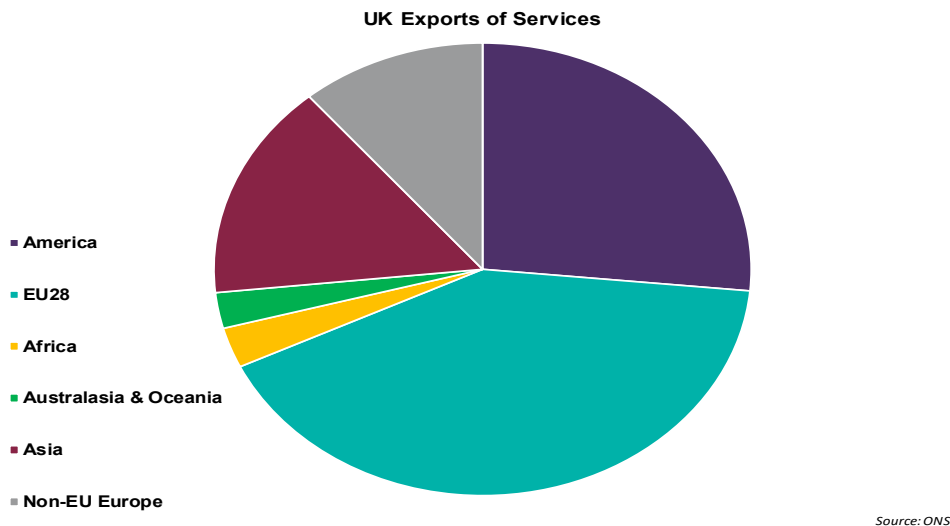
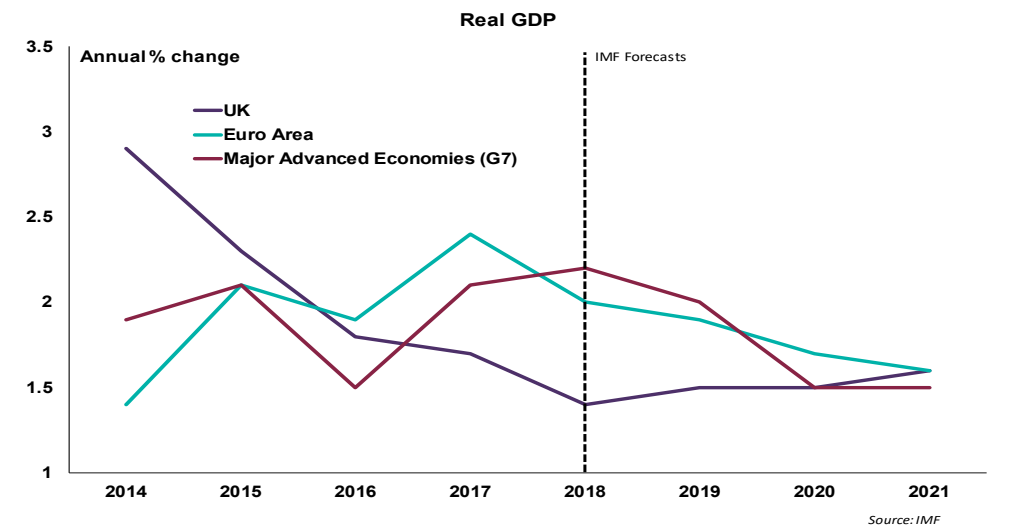


Chart 6



Housing market

7. Indicative of a rather subdued picture across the sales market, the RICS Newly Agreed Sales net balance has remained in negative territory for much of 2017 and 2018. Significantly, the latest figure came in -11% in December suggesting that it is improbable there will be a turnaround in HMRC transaction volumes in the first half of this year.
8. The softer trend in market activity is at least partly a result of a weaker demand backdrop. Indeed, the RICS New Buyer Enquiries net balance edged further into negative territory in the final months of 2018 with Brexit uncertainty, affordability constraints, tax increases and interest rate normalisation all weighing on buyer appetite.
9. Even though average mortgage lending rates are still almost 4% lower than a decade ago, a gradual increase in interest rates sanctioned by the Bank of England could weaken buyer demand further, especially since the recovery in real income growth is only likely to be gradual and affordability across many areas of the UK is still stretched.

Chart 7

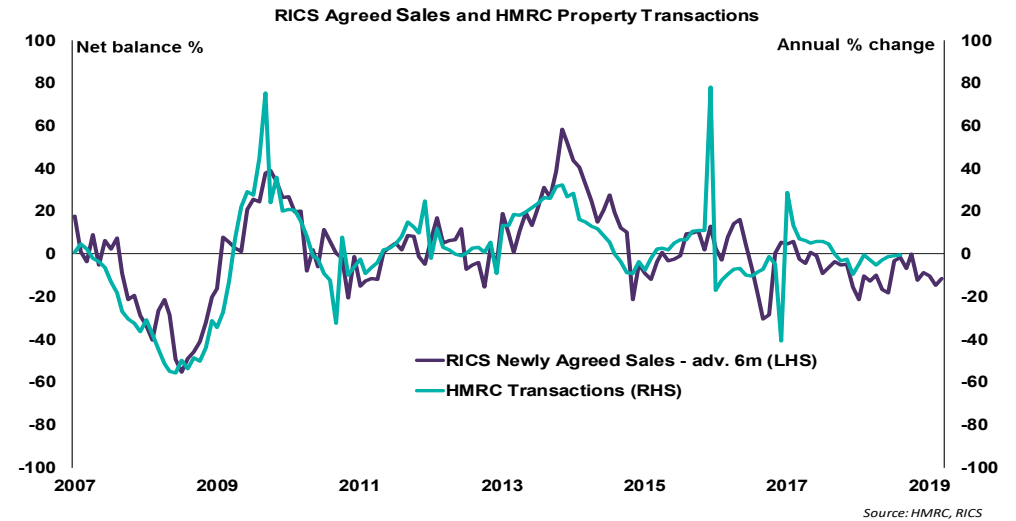


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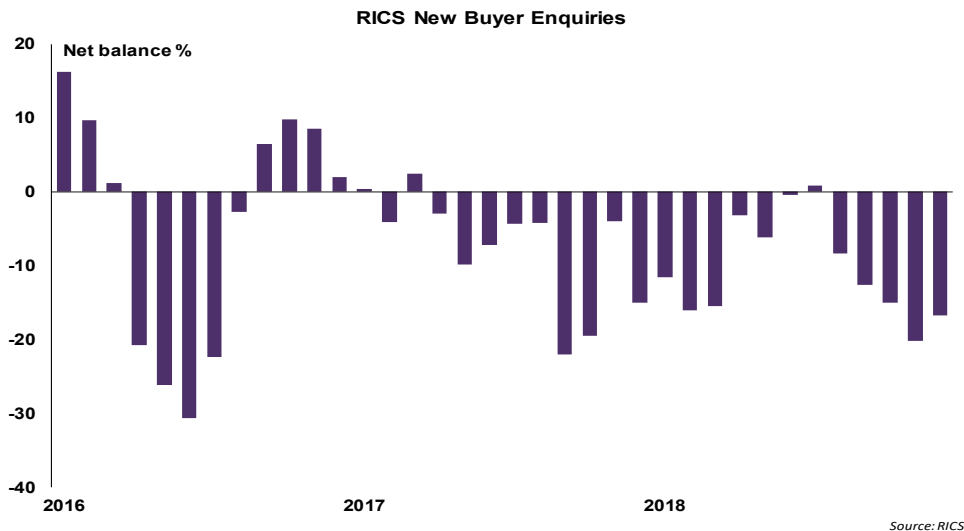
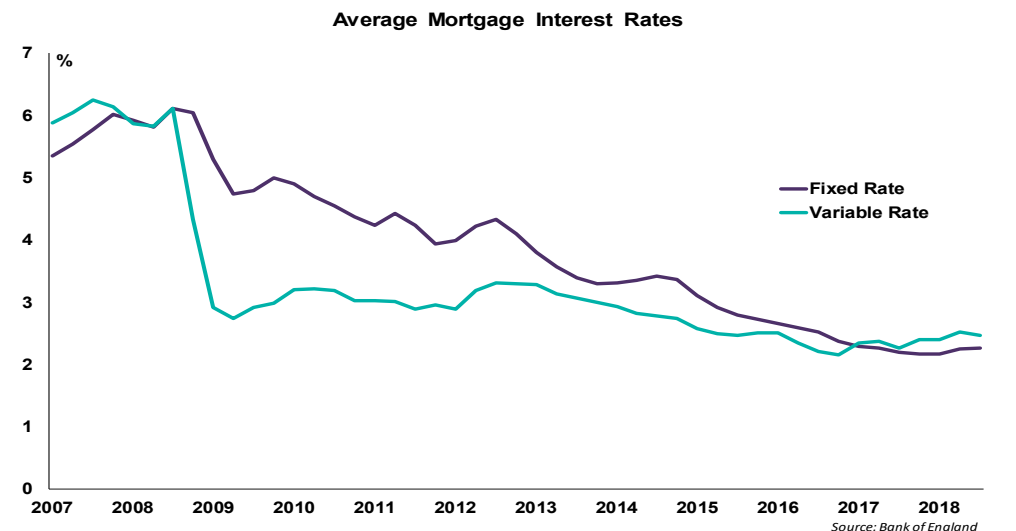


Chart 9



Housing market

10. Supply remains a key issue for the housing market. This is particularly visible in the RICS Average Stock (per estate agent branch) indicator which has remained close to record lows for almost two years.
11. Consistent with a raft of reports featuring a weaker trend in house price growth, the RICS headline price balance fell to -19% in December. This is a good lead indicator of the official measure of house price inflation and suggests that price growth will continue to moderate over the coming months. Still, there is a regional dimension to this trend with the headline gauge weighed down significantly by negative feedback from London and the wider South East. In contrast, price momentum remains solid in other parts of the UK including Northern Ireland, the North West and Scotland
12. With Brexit and political uncertainty being cited as one of the main constraints on the market, contributors envisage prices and sales will soften at the national level over the next three months. That said, sentiment at the twelve-month horizon is relatively more stable.

Chart 10

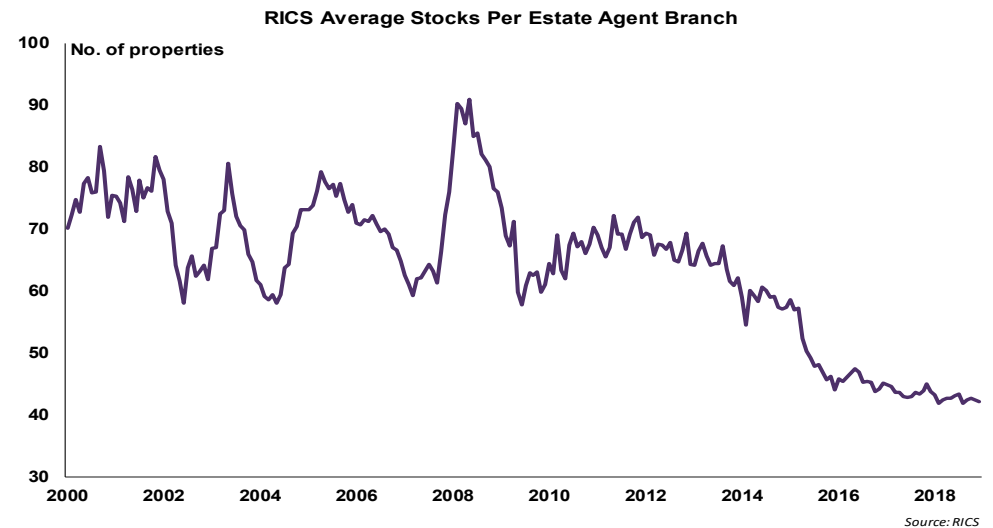


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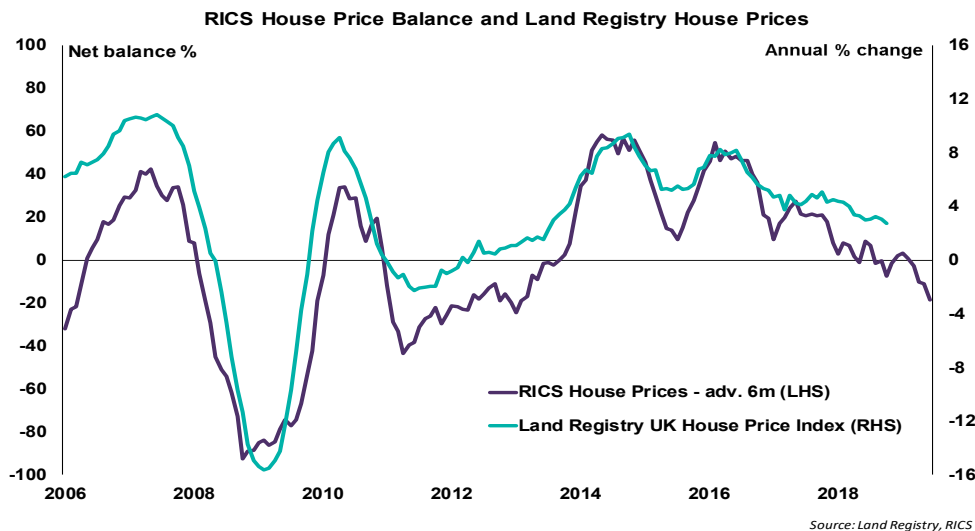
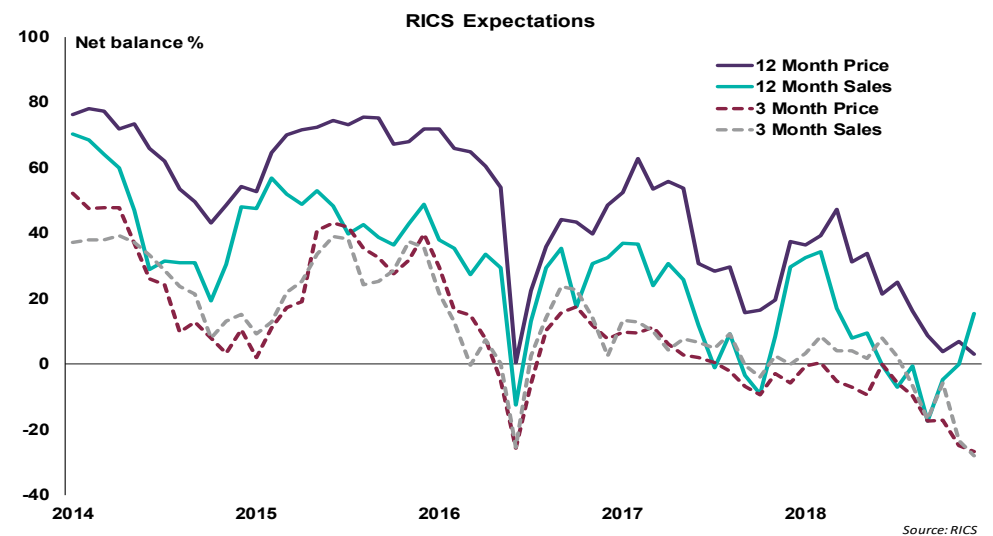


Chart 12



Commercial property sector

13. The UK's commercial property market is still being shaped by diverging trends across the three main market segments. According to CBRE, on an annual basis, while rents across the retail sector have declined by almost 2% in the final quarter of 2018, industrial rental values rose by more than 4%.
14. The RICS Rent Expectations net balance eased to -7% in Q4 2018, from -2% in Q3, pointing to a flat trend at best in UK rental value growth over the coming quarters. That said, this is almost entirely a result of a downbeat outlook for rental values in the retail portion of the market whilst rents are still envisaged to rise at a solid pace in the industrial sector and remain somewhat stable in the office segment.
15. Preferences towards online shopping have resulted in strong demand from tenants looking to occupy industrial space. In the RICS survey, the supply of industrial space has been declining for twenty-five consecutive quarters whilst the supply of vacant retail space has risen sharply over the last two years.

Chart 13

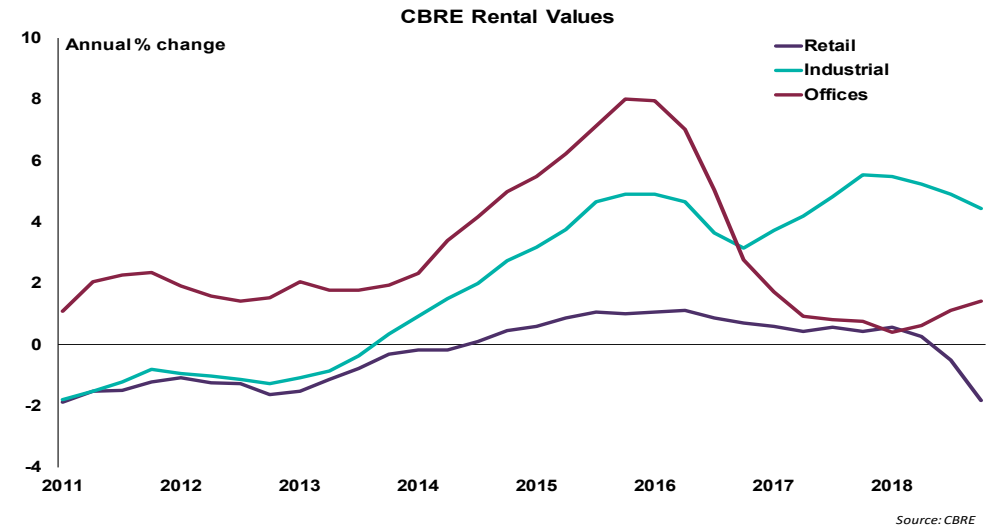


Chart 14

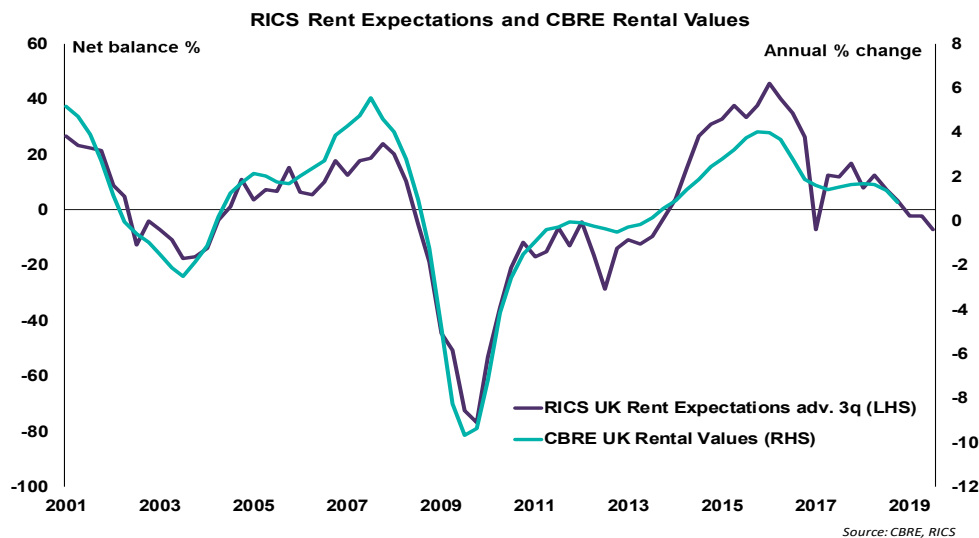
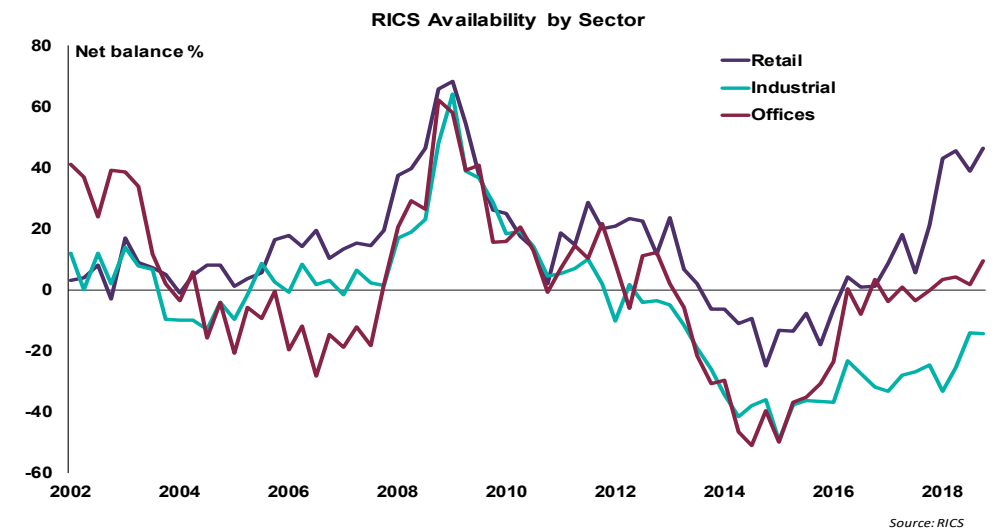


Chart 15



Commercial property sector

- 16. After remaining broadly stable in the previous two quarters, the RICS headline investment enquiries gauge slipped to -9% in the latest results pointing to a marginal decline in capital values in the second half of 2019. Beneath this headline figure however, robust investor appetite for industrials is being offset by declining interest for retail properties.
- 17. Against this backdrop, capital values are projected to decline in both prime and secondary retail markets in the coming year. Significantly, medium term expectations imply that the picture is not expected to improve for the retail sector beyond the next twelve months. In contrast, expectations across the industrial market are comfortably positive.
- 18. Further out, IPF medium term consensus forecasts cast a downbeat outlook for commercial property prices as far as the retail sector is concerned. The most negative projections are for shopping centres, unsurprising given that Property Data estimations suggest that the value of investment transactions has slipped sharply in this segment in 2017 and 2018.

Chart 16

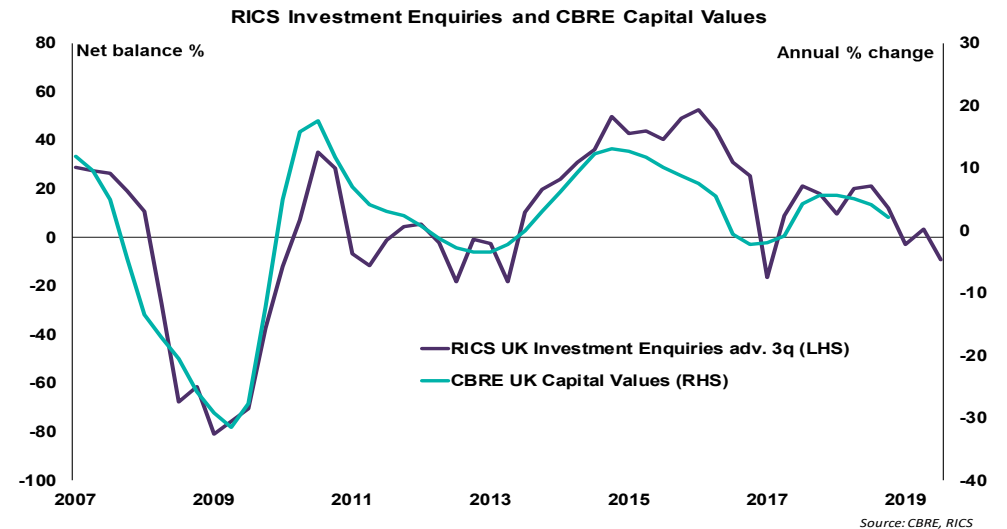


Chart 17

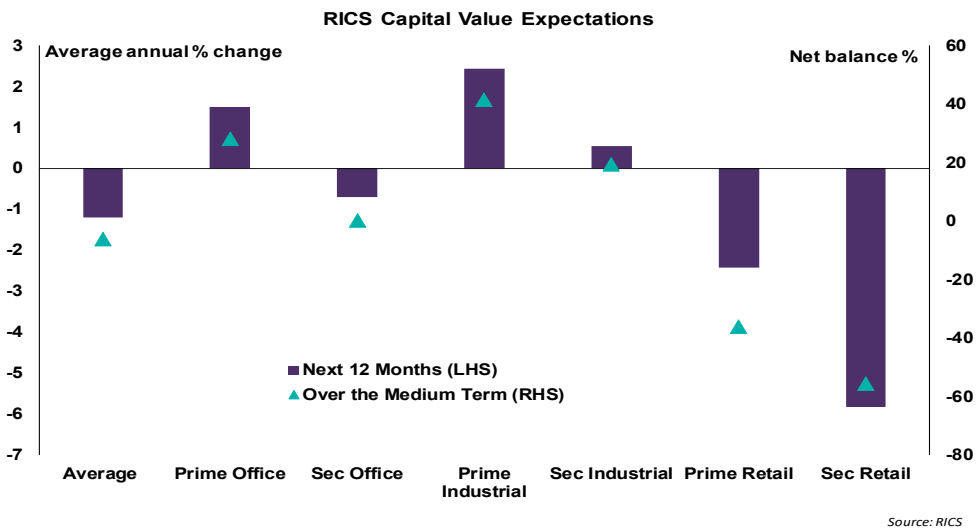
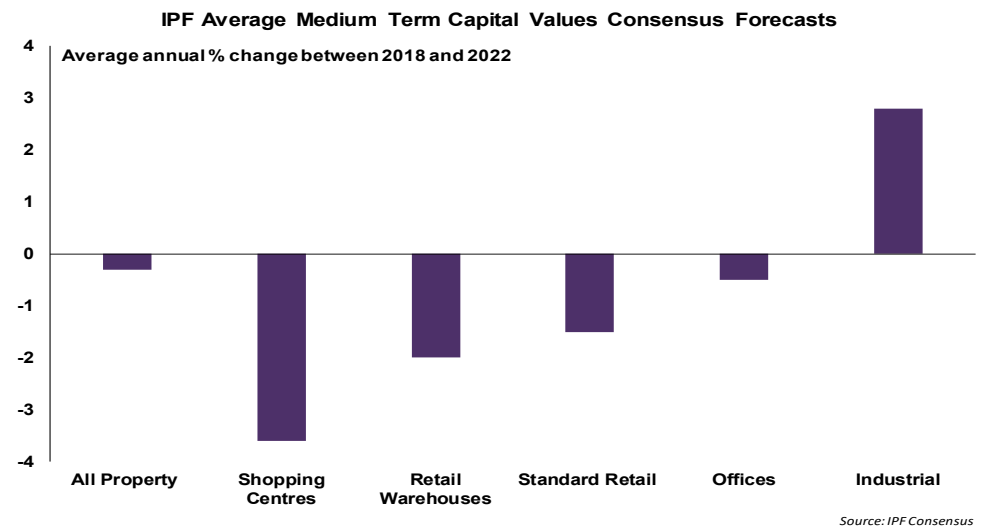


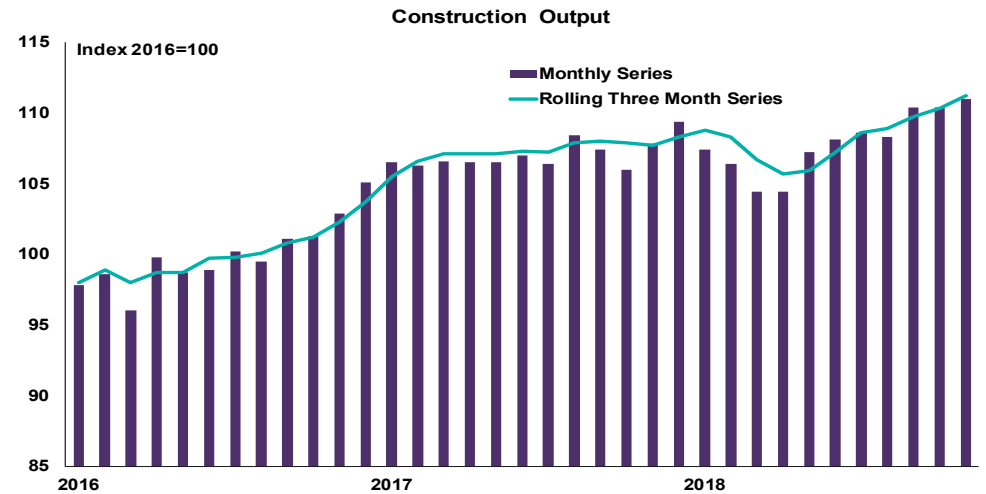
Chart 18



Construction sector

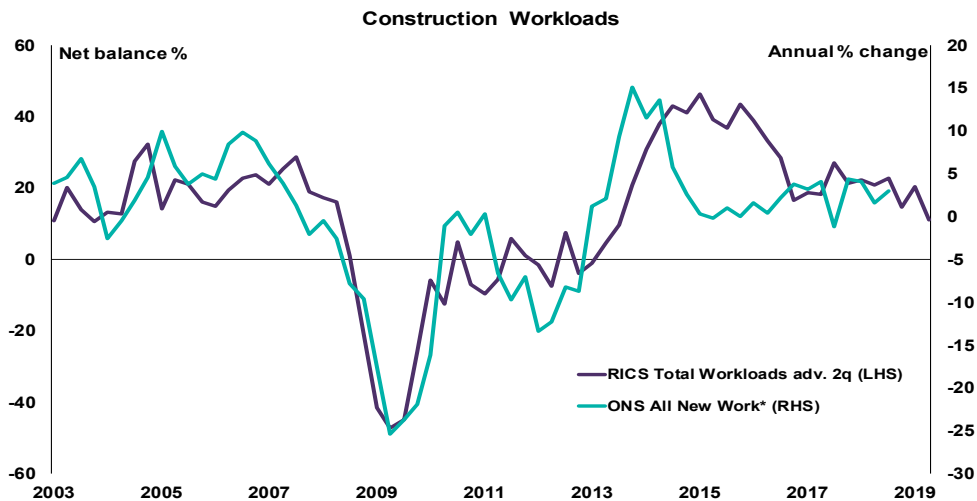
- 19. Momentum across the construction industry has picked-up after activity slowed during the first part of last year due to temporary (largely weather related) factors. It is also worth noting that from the back end of 2016, the underlying trend in the construction industry has been one of growth.
- 20. Going forward, the RICS headline workloads series is consistent with an increase in construction activity. Still, the indicator has eased to +11% in Q4 2018 from +20 in Q3 suggesting that momentum could slow as we move through the year.
- 21. Beneath the headline figures, feedback to the RICS survey continues to highlight that there are a number of constraints weighing on the industry. Financial limitations are reported to be by far the most significant impediments to market activity with a greater share of respondents in Q4 citing a deterioration in credit conditions. Crucially, near term expectations suggest that this issue is unlikely to be resolved anytime soon.

Chart 19



Source: ONS

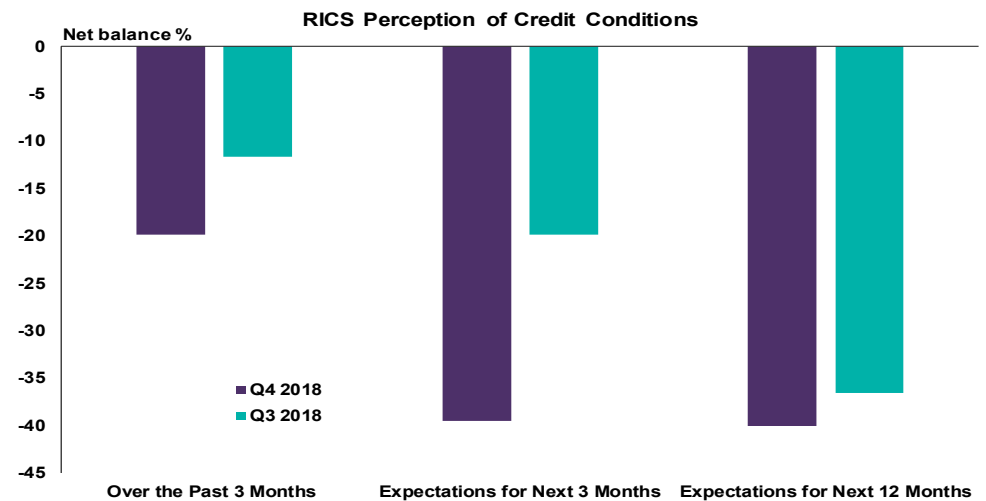
Chart 20



*4 quarter sum

Source: ONS, RICS

Chart 21



Source: RICS

Construction sector

- 22. According to the RICS survey, private housing has been an important driver of activity in the construction market. Workloads in this area (in net balance terms) have continuously outstripped all other segments of the industry over the last two years. The private workloads series has pointed to an increase in housing output consistently since 2013 and indeed, a net balance +20% in the latest survey suggests that output is continuing to rise firmly in this area.
- 23. This is similar to the picture depicted in the latest ONS data. On a three-month on three-month basis, total work grew by £875m. New private housing contributed around half of this, rising by £451m.
- 24. Indeed, total supply of housing has consistently risen over the past five years. Net additional dwelling came in 222,190 in 2018 of which 90% of these were new build completions. Nevertheless, this is still a long way from the government's target of 300,000 new homes per year.

Chart 22

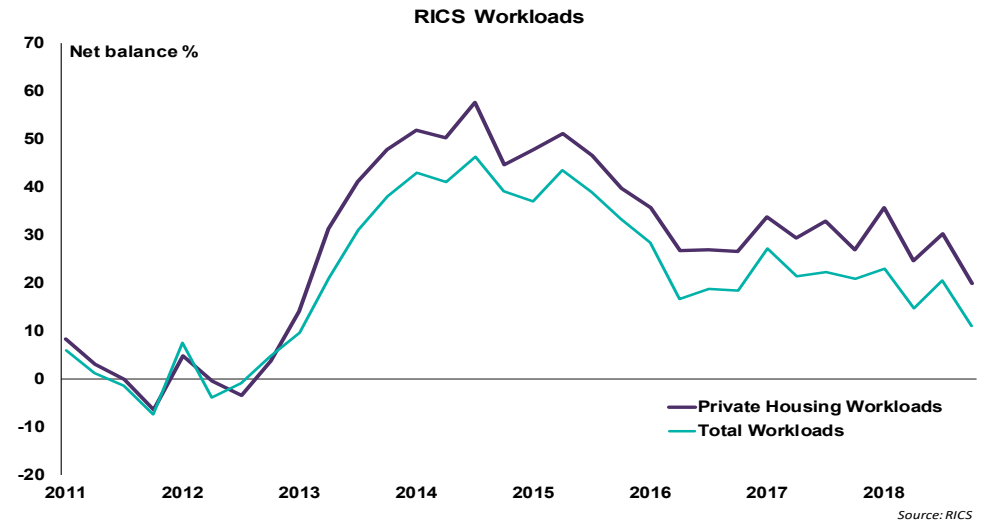


Chart 23

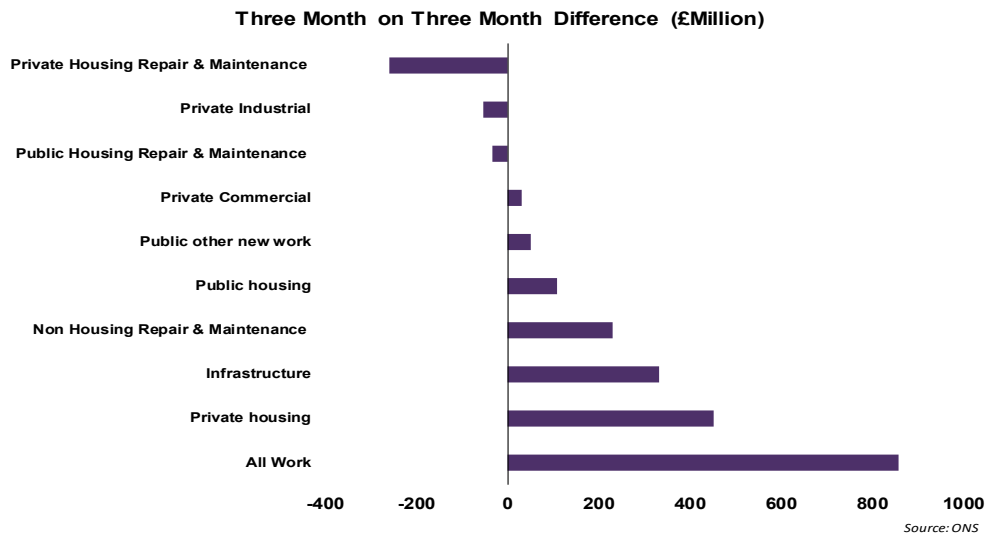
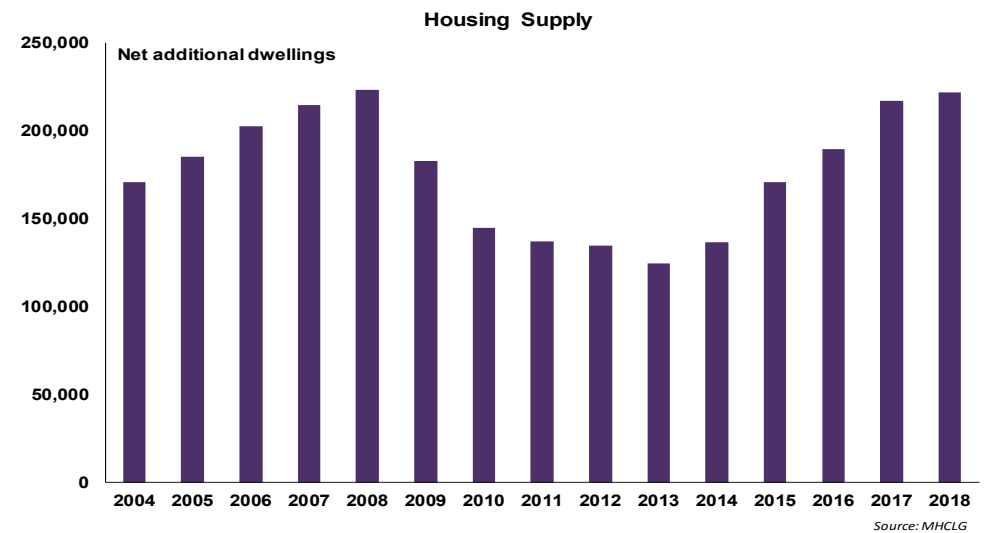


Chart 24



London

- 25. According to the UK Land Registry, house prices across inner London fell consistently through 2018. In the RICS survey, the price gauge continues to point to downward momentum across the capital with the net balance slipping to -66% in December from -48% in November. This points to a further decline in house prices in prime areas over the coming months.
- 26. Turning to commercial property, feedback points to a softer trend in tenant demand to occupy office space across London in the latest RICS survey. Alongside this, the availability of vacant office space has reportedly risen. As a result of these dynamics, the near term RICS Rent Expectations indicator suggests office rental values will slip slightly as we move through the year.
- 27. In the investment market, despite Brexit worries, appetite for Central London commercial property remains firm. This is visible in the solid trend in the value of investment transactions compiled by Property Data and the feedback to the RICS survey, which suggests that investor demand for Central London office space is still holding up.

Chart 22

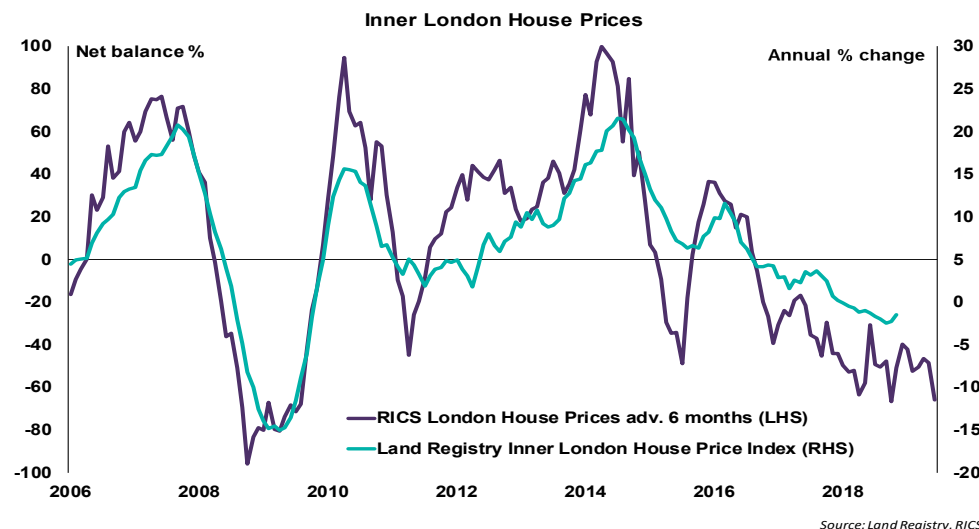


Chart 23

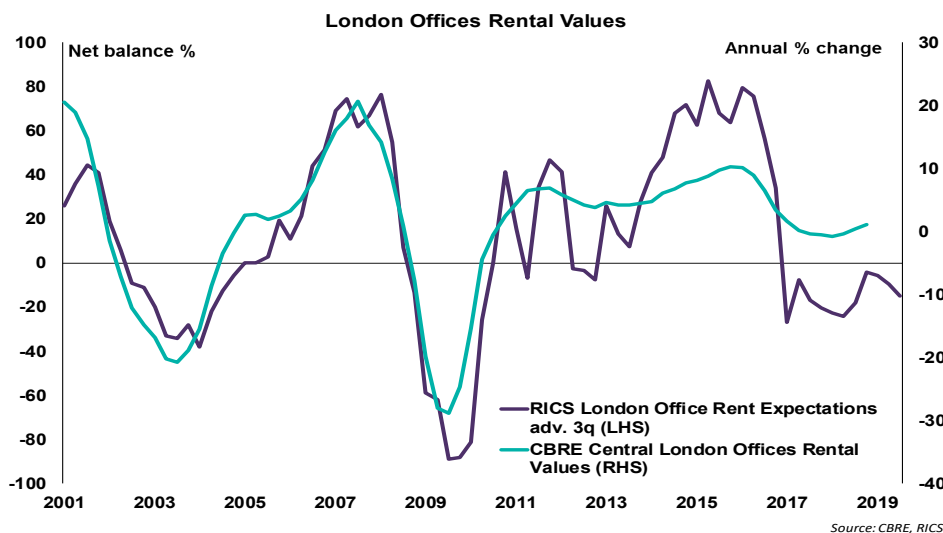
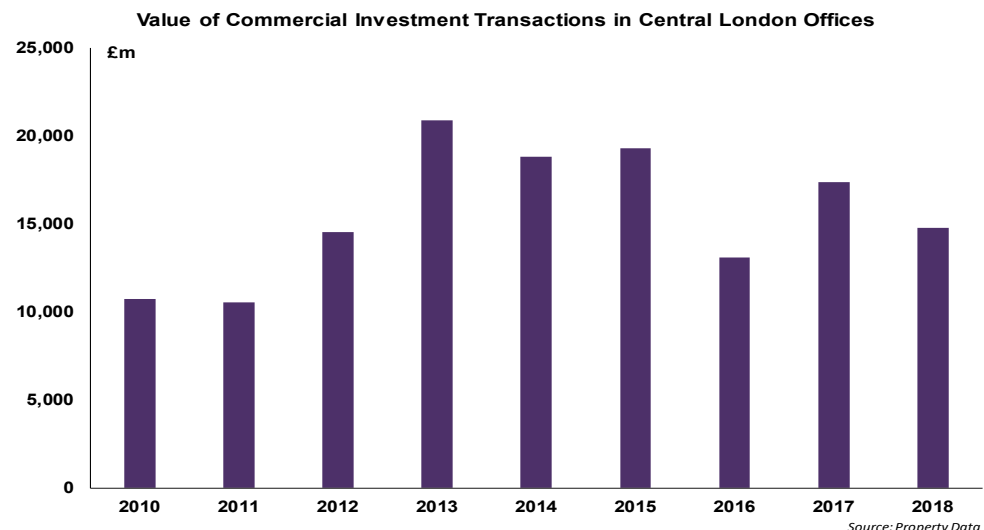


Chart 24



Which way is the wind blowing?



Anderson Wilde & Harris, Chartered Surveyors, are proud to sponsor this RICS Chart Book.

We give advice on any matter relating to property, we do so as established members of the RICS and because we keep in touch with the volatile economic environment in which the markets behave and may behave in the future.

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Market Surveys & Reports

Why the RICS surveys?

"The RICS poll - considered one of the most reliable guides to movements in house prices." **Financial Times**

"The RICS survey - the best short-term lead indicator of house prices and activity in our view." **Goldman Sachs**

"The RICS Survey has been a good leading indicator for the direction of and inflection points in the IPD index, and therefore the UK commercial property market overall." **Morgan Stanley**

"The RICS Commercial Property Survey is an excellent predictor of future IPD total returns." **North Row Capital**

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- *Hong Kong Residential Market Survey (monthly)*
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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.

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