Market Outlook for 2017

Market Briefing

February 2017

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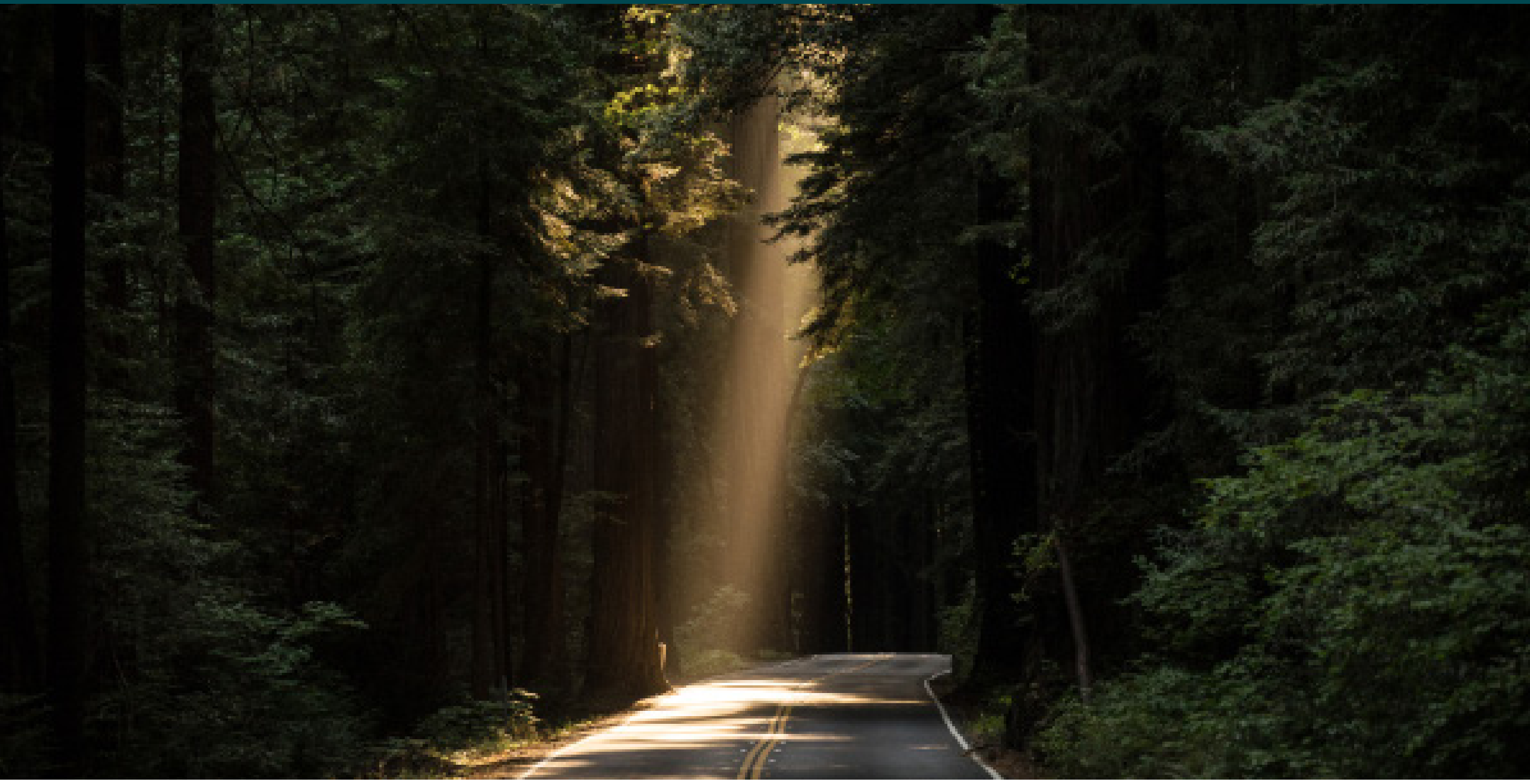


The road less travelled

With the final sales data for 2016 released we can now, somewhat, see the wood for the trees of last year's market. 2016 was the year we arrived at a crossroad having journeyed a long way since the global financial crisis, and bold choices were made.

In 2017, it is looking like we will see these choices continue to influence the market at the same time as other new challenges emerge.

If you subscribe to the views of economists like Fred Harrison, you will note we are half-way through an 18 year property cycle, where one would predict a period of growth to be followed by a mid-cycle consolidation.

From a macroeconomic point of view, the political uncertainty generated in 2016 and subdued economic forecasts have the potential to suppress consumer confidence. On a national level, significant changes to property taxation and the new tenancy regime (being introduced in Scotland this year) are changing the costs and structures in the market. Regionally, Aberdeen's market remains melancholic, other urban markets are pressurised by an undersupply, and the rise of the commuter are all impacting on the behaviour of buyers and market patterns.

With apologies to Robert Frost, having made our decision in the woods last year, we now venture into this year wondering whether choosing the road less travelled will indeed make all the difference.

Andrew Meehan
Senior Researcher

- **Aberdeen's negative performance constrained otherwise positive trends in the sales market in 2016.**
- **LBTT has had an impact in surpressing activity at the upper levels of the market.**
- **New Homes building rates remain below target.**
- **Commuter belt development is taking up the slack from under-delivering cities.**

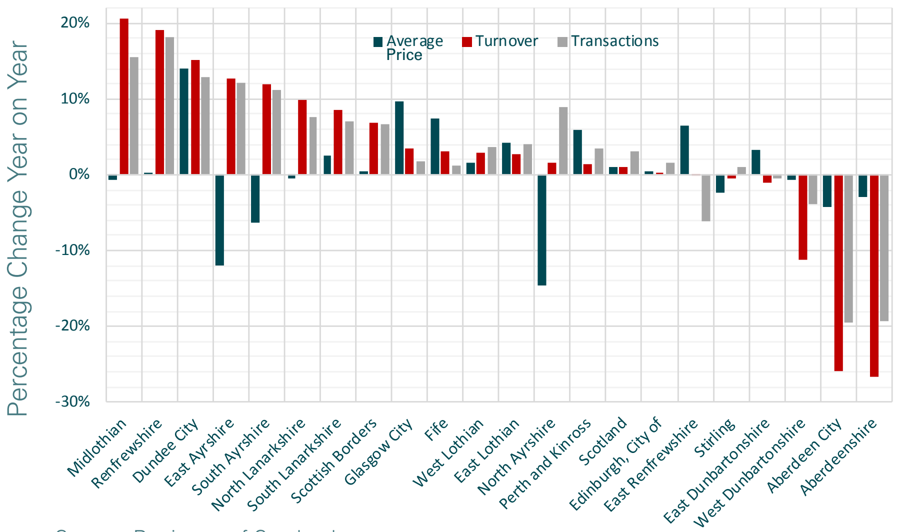
to let

- **2017 is set to be a year of change for landlords as new legislation comes into effect.**
- **The Build-to-Rent sector is expected to break ground in 2017.**
- **We predict a year of consolidation with flat market growth in 2017.**
- **Growth predicted to return to trend in 2018/19.**

Scottish market up, if not for Aberdeen

Continuing challenges in the Aberdeen market constrained growth in Scottish housing market turnover in 2016.

Fig. 1 Yoy Change in Turnover, Avg Price & Transactions



Source: Registers of Scotland

- **Dundee turnover up 15% year on year, Edinburgh turnover flat, and Glasgow turnover up 3.5%.**
- **Aberdeen down around -25%, which dragged national growth back from 5.4% to 1.1% .**

The Scottish market saw a 5.4% increase in market turnover, if you exclude the ongoing troubles in the Aberdeen market, which dropped 25% year on year. Edinburgh and Glasgow, and their commuter belts have seen growth, with the strongest performances in turnover in Midlothian, up over 20%. Slowing activity in the prime markets due to LBTT, and issues in Aberdeen constrained otherwise positive market growth.

LBTT is impacting on the market

- **LBTT has had a significant impact on the behaviour of the market.**
- **A slowdown in the prime market may be constraining transactions further down the ladder.**
- **The slowdown in the prime market drove a £35m shortfall in residential LBTT revenue in 2015/16.**
- **Pressure is mounting on the Government to redraw tax brackets to encourage transactions and drive tax revenues.**

The introduction of LBTT in April 2015 saw a rush as buyers forestalled transactions to beat increased tax bills. This led to a disparity between the forecast and actual revenue, of £35m in its first full year.

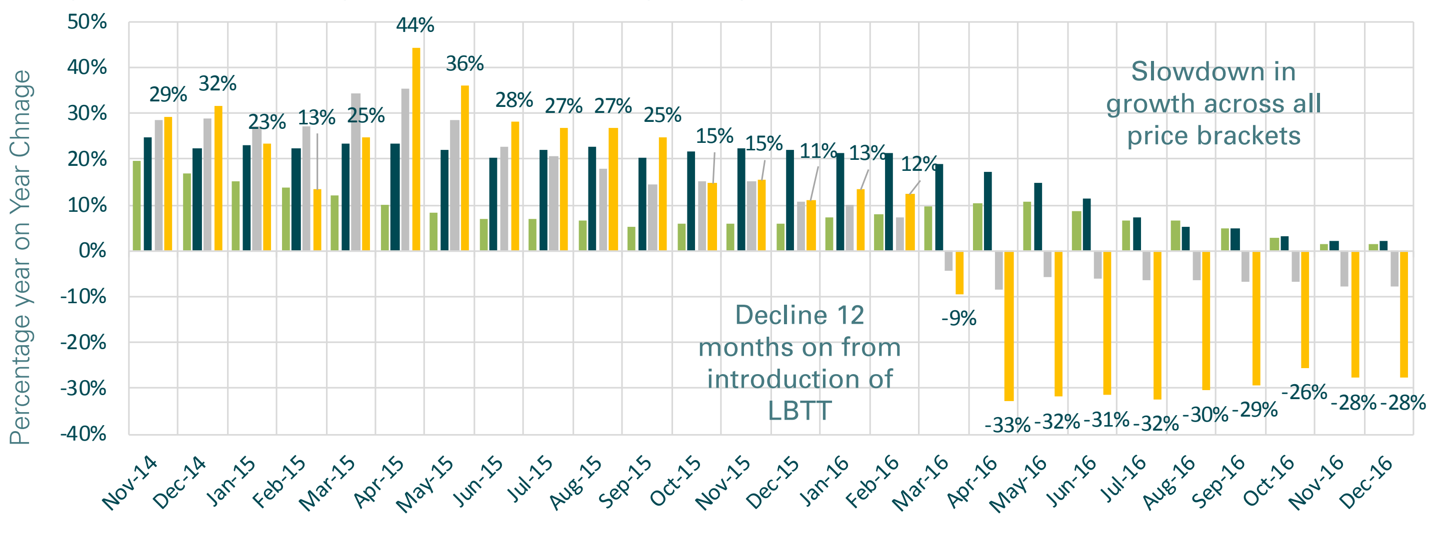
The scale of the decline in transactions can be seen below in Figure 2. This chart compares the average number of sales over the previous 12 months, to the same period in the previous year. A sharp decline in numbers can be seen from April 2016, 12 months on from the introduction of LBTT as the spike in transactions washes through the system.

While the impact is greatest in the high price brackets, there is a clear slowing year-on-year across the rest of the market. This change is partly due to the limited stock coming to the market, preventing families from moving up the ladder.

There are obvious implications for market health and tax revenue from stalling transactions and this has led the Scottish Property Federation to propose moving the 5% threshold up to £500k (from £325k), reducing the burden being placed on family buyers in the urban centre.

There has been a slowdown in transactional activity in the prime market since the introduction of LBTT

Fig. 2 Year on Year Change in the 12 Month Rolling Average Number of Transaction by LBTT Price Band

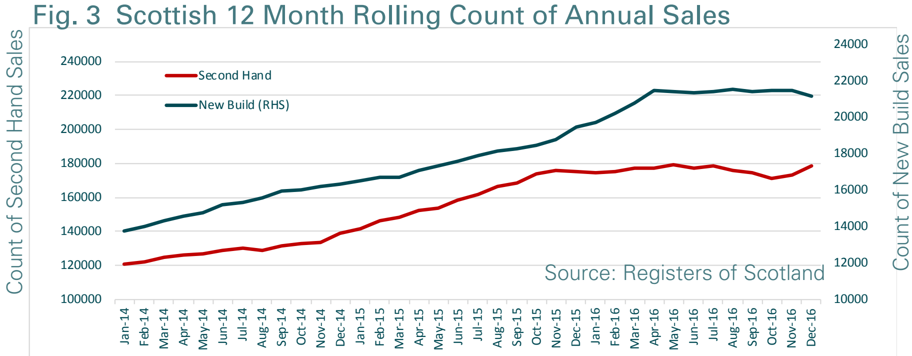


Source: Registers of Scotland

New build improves but delivery shortfall remains

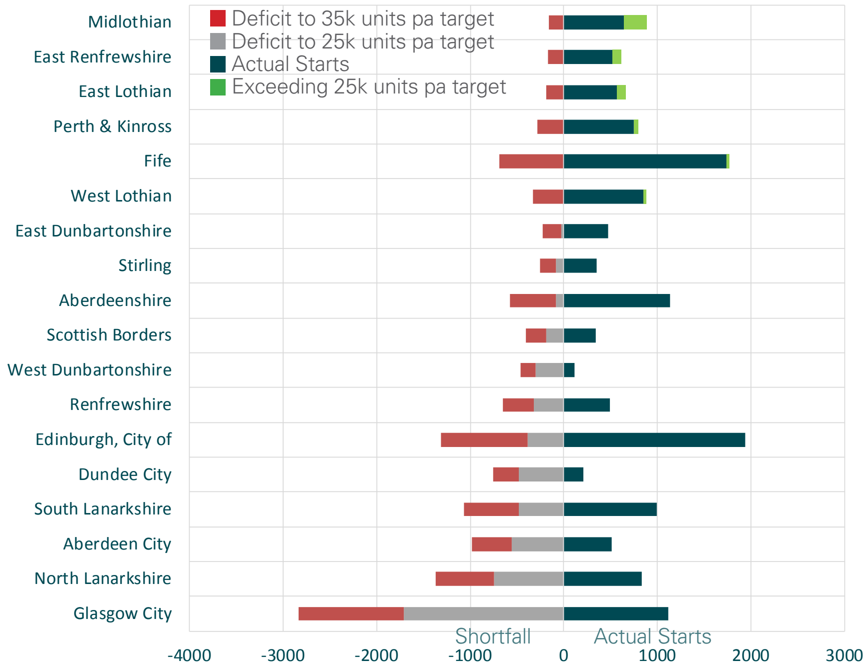
New build sales have recovered more quickly than second hand sales in recent years, but both levelled off over 2016.

Fig. 3 Scottish 12 Month Rolling Count of Annual Sales



Midlothian over delivered relative to its population, while the major cities are under delivering on these targets relative to size (pro-rata by population)

Fig. 4 Housing Starts in 2015/16 vs targets of 25k and 35k per annum



Source: Scottish Government

- **Prime new build sales in Edinburgh are up 30% compared to a 15% drop in second hand sales.**
- **New build delivery remains over 1/3rd below targets across Scotland.**
- **Midlothian has seen the strongest delivery with over 500 new homes a year.**

The new build market in 2016 saw strong transaction levels growth, reaching a new high point since the recession. In the Edinburgh market, this has seen new build sales between £500k and £750k up by 15% compared to a -11% drop in second hand sales in 2016 versus 2015.

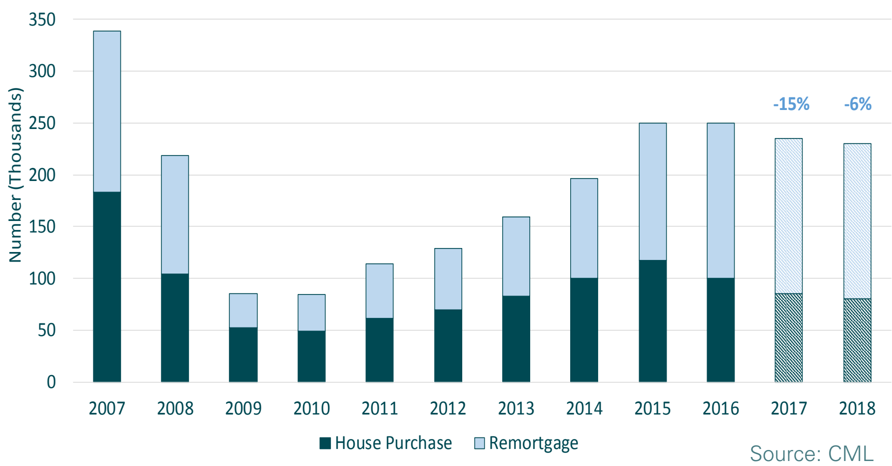
However, house building remains below targets. In Figure 4. national targets have been split by council areas, based on their population, to identify the areas that are falling short of identified requirement.

Midlothian has led the delivery of stock, with an average of almost 500 new households being created per year for the past 5 years, growing the number of households by 1.3% annually. This growth has been delivered by an average new build completion rate of 18 units per 1,000 households over the past three financial years. This level of delivery is well ahead of Edinburgh at 5.4, Glasgow 4.7 and the Scottish average of 6.3.

Rental sector faces changes

Changes in the rental sector have led the Council of Mortgage Lenders to predict a downturn in the Buy-to-Let sector in 2017 and 2018.

Fig. 5 CML Buy-to-Let Mortgage Forecast



Source: CML

- **Build-to-Rent Sector may break through in 2017.**
- **Changes in tax & legislation pose challenges for Scottish landlords.**

Figure 5. shows that the Council of Mortgage Lenders (CML) expects Buy-to-Let lending across the UK to retreat in 2017/18. Additional Dwelling Supplement (ADS) for new purchases, cuts to tax relief on mortgage interest and the end of 10% wear and tear allowance will make the sector more challenging for many landlords. In Scotland, there are additional issues in the removal of no fault grounds for repossession, the end of statutory initial periods and the potential for rent control.

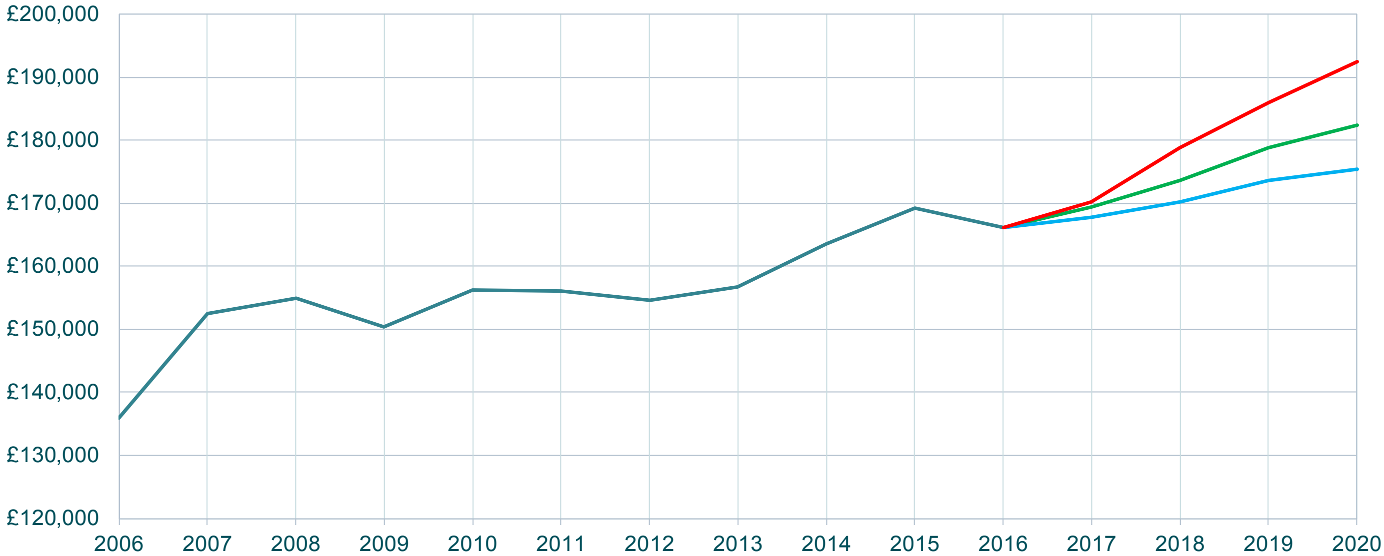
2017 Outlook & Forecast

After four years of positive house price growth, 2016 saw economic and political factors combine to produce negative price growth once again, although overall market activity levels were slightly up on the previous year, and would have been more postive if not for Aberdeen & The Shire. Average house prices actually ***fell 1.4%*** in Scotland over the whole of 2016. In 2017, we expect positive house price growth to return, but to be constrained due to wider macroeconomic pessimism and subdued consumer confidence.

Looking towards 2020 and beyond, we would expect to see growth in the region of 2-3% per annum in our central forecast, with potential for higher or lower scenarios depending on the details of Brexit and the economic conditions at the time. Strong demand and weak supply fundamentals should keep house price growth in positive territory over this period.

2017 will be a year of consolidation with growth likely to return in 2018

Fig. 6 Rettie & Co. Average House Price Forecast 2016-20



Source: Rettie & Co. Research

Development Services

Structured Finance

- 296 Build-to-Rent units delivered over the last 4 years through new rental backed funding initiatives
- £44.8m value of rental assets built on the back of funding streams
- £31.4m value of construction contracts underpinned through agreed re-financing packages

Land & Development

- Advise on land, development sites, residential investment and PRS.
- Advise on every stage of the project, from early appraisal through to site disposals.
- Best results for clients through a proactive approach, creativity and best market intelligence.

New Homes Sales

- 165 new homes sold in the last 12 months.
- £82.1m worth of property sold in the last 12 months.
- Dedicated in-house marketing team.
- Initial advice on mix and specification through to bespoke campaigns designed to meet clients individual needs.

Research & Consultancy

- The largest team in the Scottish private sector.
- Analysis backed by Scottish based and Scottish sourced information.
- Research rooted in real time market information.
- Full range of services provided to many clients including developers, builders, investors, landowners and the public sector.

Asset Management

- A growing portfolio of 1,500+ managed units.
- In excess of £650m in residential assets under management.
- Regulated by both RICS and ARLA.
- Management experience of both PRS & Mid-Rent assets.
- Skilled in analysis of the tenant demographics that drive asset demand.



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