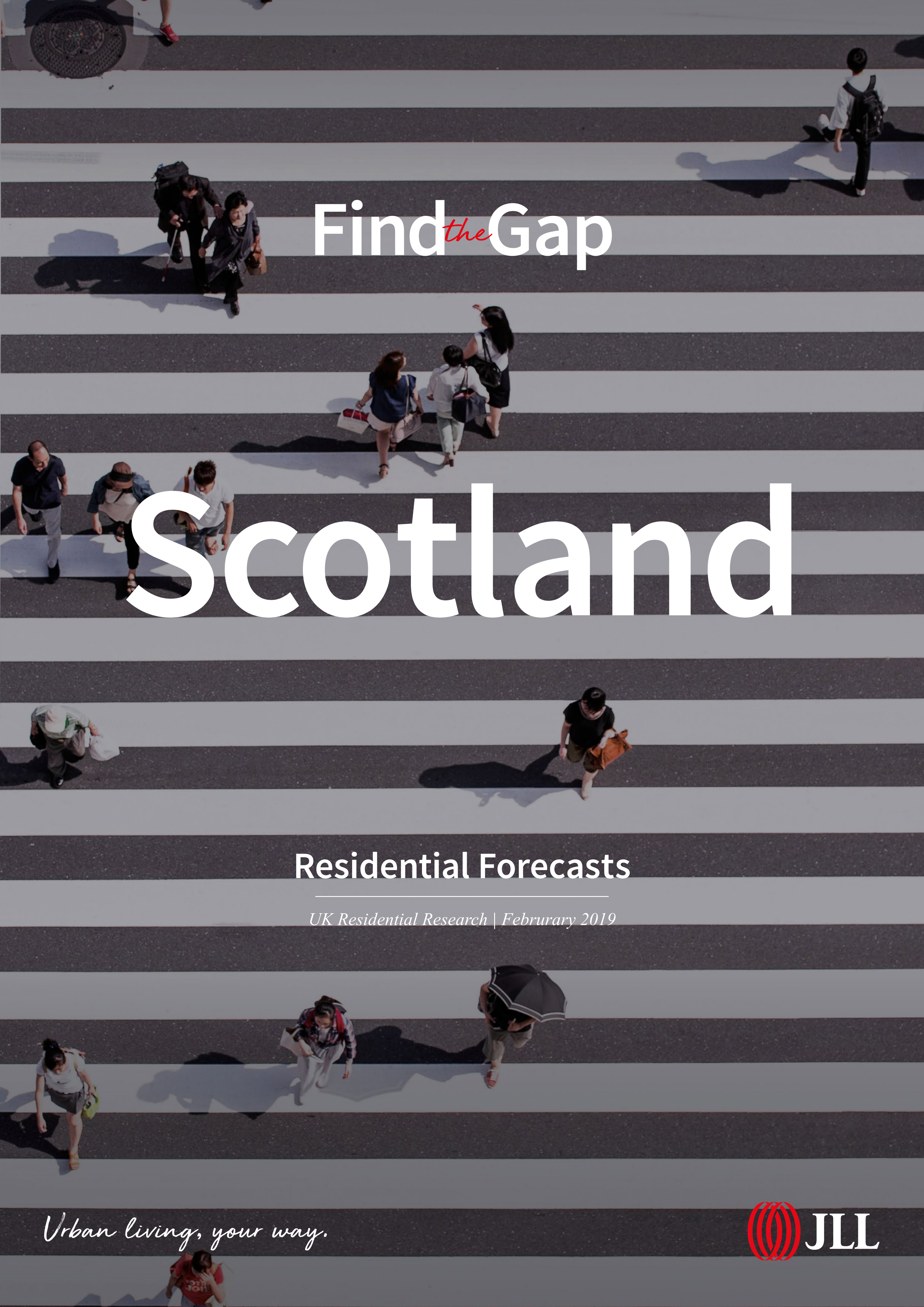


Find the Gap

Scotland

Residential Forecasts

UK Residential Research | Februrary 2019

Urban living, your way.

JLL

Scotland Residential Forecasts

The Scottish economic and political landscape has been dominated by Brexit over the past 2½ years. The next 2½ years are likely to be similar, albeit dealing with a different phase of the process.

Inevitably, the UK will collectively refocus attention on domestic policies as the sphere of influence from Brexit diminishes.

And there are plenty of housing issues that need addressing. These include affordability, taxation, regulation in the private rental sector, affordable homes, housing supply, lack of skilled labour and digital construction.

Our housing market forecasts for the next five years assume that a Brexit deal is hammered out over the coming months and that we have a transition period until the end of 2020.

In recent years Scotland's major cities have established themselves as stand out performers in terms of residential investment and development.

Edinburgh, and to a lesser extent Glasgow, have seen above average house price growth in the face of significant supply shortfalls to meet the increase in demand from people wanting to live in the core city centres.

However, Scotland has faced political uncertainty since 2014 through the Scottish independence referendum and then Brexit. Remain has been the prevailing vote in both referendums with 62% of Scotland voting to stay in the EU – more than any other region in the UK.

The uncertainty has left some sectors of the housing market presenting more inviting opportunities than others. So, it will be important to 'Find the Gap' rather than to blindly back residential in the broadest sense.

Neil Chegwidden
Residential Research

Nick Whitten
Residential Research

Jason Hogg
Scotland Residential

"Brexit has undoubtedly created heads winds but the residential market in Scotland has remained remarkably resilient."

Scotland housing market forecasts

Scotland

Scotland has seen house price growth of 17% over the past five years, below the growth of 31% seen across the UK over what has been a period of political uncertainty.

Brexit has undoubtedly created headwinds and looks set to create further headwinds over the coming years also. The question in Scotland may yet go full circle back to the matter of independence from the UK if Brexit provides an unsatisfactory outcome. And that could very well be a reality given that Scotland's most important economic hubs Edinburgh and Glasgow were the first and fifth highest remain voting cities in the UK respectively.

Through this air of uncertainty, the mainstream housing market continues to perform remarkably normally. Transaction volumes in Scotland are only around 5% down on where they were at Q1 2016, just before the EU vote. But most of that activity is at the lower value end of the market. Buyers and sellers with any discretion in their decision making – investors, downsizers and higher value purchasers in particular – are typically taking a pause to see how Brexit unfolds.

Looking forward, JLL expects that dynamic to continue. We are forecasting house prices in Scotland and the UK will increase modestly by circa 11.5% over the next five years.

Edinburgh

Despite the impact of political uncertainty on Scotland and UK-wide housing market performance, JLL expects Edinburgh City Centre to be one of the top performing residential markets in the UK over the next five years.

A critical shortfall in supply continues to underpin values in the city. This undersupply is expected to continue in 2019 with only two schemes scheduled to complete during the year. These are Artisan Real Estate Investors' 244-unit New Waverley and Campus Development Management's 32-unit King's Quarter. Both of these schemes are private sale developments. However, there is a distinct lack of proposed purpose built private rental stock for a city that has a disproportionately young population with an above average level of private renters.

Data from CACI shows a quarter of Edinburgh's homes are privately rented versus a UK average of 16%. However, the vast majority of rental stock in the city is owned by buy-to-let investors.

There is currently just one completed purpose built and managed asset in the city, the 113-unit Lochrin Quay, which is managed by JLL and is located in the city's Exchange business district. Demonstrating institutional appetite for stabilised rental assets in Edinburgh, Aberdeen Standard Investments acquired Lochrin Quay in Q2 2018 for £27.5m from GSA, with the scheme now fully let.

There are currently two other purpose built rental schemes totalling 780 units in the planning pipeline. These are Moda/Apache's 337-unit Springside and EDI's 434-unit India Quay scheme. Both schemes have planning permission but neither site has commenced development.

The lack of a modern purpose built scheme means more discerning renters who would value the benefits of a rental product with amenities and services are being completed underserved. This is despite the fact that the demand pool for a more luxury rental product is already present in Edinburgh. A third of Edinburgh's population is aged 15 to 34, compared with 25% across the UK. Some 11% of the city's population work in the typically higher earning financial and insurance sectors. Average household incomes are higher than the UK average with 55% of Edinburgh households earning above £40,000 pa compared with 45% of households across the UK.

Overall, as at the end of 2018, the average sales price of a typical new build two bedroom flat in the city centre is £285,000 which represents an increase of 2.5% compared with the end of 2017. A typical new build two bedroom apartment is now commanding circa £1,000 pcm, an increase of 3.1% in 2018.

The supply and demand imbalance within the city centre is benefiting other areas across Edinburgh including Leith and Bonnington. Cala have commenced development with their 350 unit scheme at Waterfront Plaza and represents the largest Edinburgh 'Waterfront' development since the 2008 recession. The area around Bonnington in North Edinburgh is going through a significant change with multiple residential developments involving Barratt Homes, Miller Homes and J Smart & Co. The accommodation being developed in these locations will seek to fill the supply gap and introduce much needed 1, 2 and 3 bed accommodation at a price point between £200,000–£500,000 compared with recent trend of development targeting the higher price-point end of the market.

JLL expects both price and rental growth to average 3.1% pa, well above our UK-wide forecast of 2.2% pa price growth and 2.4% pa rental growth

Glasgow

Glasgow has seen an undersupply of housing for many years, particularly in the city centre. Against this backdrop there has been a notable increase in demand from young professionals to live in the most central locations. In recognition of this development does appear to be shifting towards the purpose built rental sector in Glasgow City Centre. There are 15 schemes in the residential pipeline, totalling 5,000 units, of which 4,000 are expected to be private rental developments. Many of these units are expected to complete around the same time in 2021/2022). This injection of new purpose built and managed rental product represents an exciting few years for Glasgow and a revolution in housing terms.

One of the largest drivers of rental demand in the city centre is Glasgow's 80,000-strong student population. There are four major universities in the city from which retention rates are particularly strong, ranking 5th highest in the UK. Some 46% of the student population remains in Glasgow upon graduation giving rise to a notably highly skilled workforce. Additionally, Glasgow's universities produce more business and finance graduates than any other UK city, with the exception of London.

Overall these factors contribute to Glasgow being a youthful city with 33% This has persuaded L&G into committing to Scotland's largest ever forward funding private rental deal with the acquisition of 380 units at Buchannan Wharf from Drum Property Group for £85m.

However, as yet there is no real purpose built rental construction activity, aside from enabling works at Moda's 450-unit Holland Park site. Meanwhile there are several private sale schemes under construction, including but not limited to – Ambassador Group's 98-unit Park Quadrant Residences, CALA Homes' 101-unit Mansionhouse Road, Kelvin Properties' 33-unit Atrium Gardens and The Atrium G1, Spectrum Properties' 85-unit North Kelvin Apartments, Sanctuary Homes' 413-unit The Victoria, Westpoint Homes' 63-unit Middlefield School and RH Contracts' 24-unit Belmont West.

The sales price of a typical new build two bedroom flat in Glasgow city centre is around £226,000, which is an increase of 1.8% during 2018.. Over the next five years we expect Glasgow city centre sales prices to rise by an average of 2.6% pa – below that of many other UK city centres which are suffering from more acute demand-supply imbalances, but greater than the UK-wide and Scotland forecasts.

Edinburgh

Average sales price (2018 % change) 2 bedroom flat	*Average rent £pcm (2018 % change) 2 bedroom flat*	*Build to Rent net yield (typical yield range)*
£285k (2.5%)	**£1000** (3.1%)	**4.75%** (4.50-4.75%)

	2019	2020	2021	2022	2023
House price growth forecasts	2½%	3%	3%	3½%	3½%
Rental growth forecasts	3%	3½%	3%	3%	3%

Source: JLL

Glasgow

Average sales price (2018 % change) 2 bedroom flat	*Average rent £pcm (2018 % change) 2 bedroom flat*	*Build to Rent net yield (typical yield range)*
£226k (1.8%)	**£840** (3.7%)	**5.00%** (4.75-5.00%)

	2019	2020	2021	2022	2023
House price growth forecasts	2%	2½%	2½%	3%	3%
Rental growth forecasts	2½%	3%	3%	3%	3%

Source: JLL

Brexit risks & assumptions

Battling through Brexit

With so much uncertainty, so many potential stumbling blocks and a myriad of possible outcomes, the economic and political outlook is not clear.

Here we set out the most likely outturns, discuss the hoops that need to be jumped through and settle on the Brexit assumptions we will make in our economic and housing market forecasts.

A deal most likely

While there are several potential scenarios and routes, as well as the possibility of a 'no deal', we believe that the most likely outcome is that the UK does agree a deal with the EU.

The main reasons for this are that it is in the interests of both the EU and the UK, and that the 'cliff-edge' or 'no deal' route is highly undesirable for all concerned, but particularly for the UK. Polls continue to suggest this is the most likely of the range of outcomes on the table.

What kind of deal?

The two most likely possibilities represent opposite ends of the deal scale.

The first is a soft Brexit whereby the UK accepts the four freedoms of the EU, continues to trade with the EU similar to today, but has no say in the regulations that it needs to abide by. The current Chequers plan would fall under the 'Brexit in Name Only' (BINO) heading, albeit a plan that the EU has rejected.

The other most likely scenario is that the UK and EU agree to trade under WTO (World Trade Organisation) rules after the transition process. Ultimately this is similar to a 'no deal' outcome, but in this scenario, there is a transition period during which many potential issues are ironed out, thereby avoiding a 'cliff-edge' situation.

Obstacles

There are many obstacles to overcome before any kind of decision can be made and agreed – deal or no deal.

Without contemplating exactly how each might arise, the hoops to jump through are Conservative Party approval, Parliamentary consent and EU agreement.

Depending on the outcome of each, other hoops and obstacles might arise. These could include a Conservative leadership contest, a General Election and a second referendum.

Timetable disruption

With all of these issues at play, and the lack of progress to date, it is quite likely that the current timetable will be disrupted.

This could be a postponing of the March 2019 exit, an altering of the length of the transition period or the EU delaying the approval of the proposed plan.

If any of these outcomes were to be realised, the prolonged uncertainty would drag on the UK's economic performance.

JLL assumptions

For the purpose of generating a base case housing market forecast, we assume that the UK will agree some kind of deal with the EU. The implications are that UK economic performance will recover reasonably well over the course of the next five years.

We also assume that UK economic weakness lasts for much of 2019, but is in recovery mode during 2020. This would arise as greater certainty returns, but does not necessarily mean there are no delays to the existing timetable.

Forecast risks

The main risk to our assumptions is that UK economic weakness is prolonged by a year or two. This would result in lower UK GDP growth in 2020 and perhaps also in 2021. Sterling would also remain weaker for longer.

The second most likely risk is that the Brexit deal negotiated and approved is not as favourable for the UK as we assume. This would still result in an economic recovery, but a weaker upturn after 2019 compared with our base case assumptions.

The third risk is that the UK exits the EU with no deal. And whilst we deem this to have a probability of less than 10% at present, it would result in a far weaker UK economy over the next five years.

JLL base case forecast assumptions

JLL assumes
Brexit deal negotiated

>90%
probability*

Brexit deal options

- *BINO* – Brexit in Name Only
- *WTO* – World Trade Organisation
- *FTA* – Free Trade Agreement

UK deal obstacles

- Conservatives approval of proposal
- Parliament approval of proposal
- Possible Conservative leadership contest
- Possible General Election
- Possible second referendum

Possible delays

- Leaving EU in March 2019 deferred
- Transition period extended
- EU approval delayed

EU approves deal

* Probability of no deal estimated at <10%, JLL estimate

Scotland economic forecasts

Positive prospects

The performance of the Scottish economy will be highly dependent on the outcome of Brexit. Although the Brexit pathway is still very uncertain, our economic forecasts assume that a Brexit deal is agreed and approved by Parliament, and that there is a transition period until the end of 2020.

For Scotland as a whole, we expect GVA growth to average 1.8% pa over the next five years. This is slightly higher than the preceding five years and is marginally below the 2.0% pa predicted for the UK. Personal disposable income growth in Scotland averaging 1.4% pa and consumer expenditure growth also averaging 1.4% pa over the 2019-2023 period reflect a robust and expansionary economy.

City outperformance

Both Edinburgh and Glasgow are expected to outperform Scotland in economic terms over the next five years. GVA growth in Glasgow is forecast to outperform that of Edinburgh, especially during the first three years of the forecast period. Glasgow is predicted to see GVA growth averaging 2.3% pa while Edinburgh is forecast to see 2.1% pa. Both are expected to experience stronger economic growth than Scotland and the UK.

Employment growth in Edinburgh and Glasgow is also expected to be strong, and higher than both the Scottish and UK averages over the next five years. Employment growth averaging 0.8% pa in both cities compares with 0.3% pa in Scotland and 0.5% pa in the UK.

Edinburgh and Glasgow are also forecast to experience notable increases in their populations. Edinburgh is predicted to see an exceptionally high addition of 18,000 residents, a 4.3% increase, in just five years. Glasgow's pace of expansion is predicted to be a more modest, but still significant, 9,000 person rise, a 1.6% increase.

Earnings and interest rates

UK earnings growth is forecast to return to a more normal rate of 4.0% pa following several years of subdued growth. The improved employment and wages outlook will be important for housing market confidence and affordability.

The heightened wage growth is predicted to be even more influential for the housing market over the next five years because CPI inflation is forecast to be around 1.6% pa during the next three years before rising to 1.9% pa by 2023. This will give households greater disposable income and spending power.

With the economy on the road to recovery over the next few years, the bank rate will increase steadily and incrementally.

The bank rate should rise to 1.00% by the end of 2019 once the Brexit outlook has become clearer.

By the end of our forecast period in 2023 the bank rate is still only expected to be at 2.75% as rate rises are contained in order to encourage and boost economic growth and stability.

Exchange rate

The strength of sterling will be keenly watched over the next five years as a bellwether to how the UK is viewed post-Brexit.

The pound is expected to strengthen to circa US$1.41 by end-2019 before rising to US$1.50 by end-2023. Against the Euro, the pound is forecast to strengthen and then remain at €1.20 through to end-2023.

Source: Oxford Economics

Edinburgh
2019–2023 forecasts

GVA growth **2.1% pa**

Employment growth **0.8% pa**

Population growth **0.8% pa**

Glasgow
2019–2023 forecasts

GVA growth **2.3% pa**

Employment growth **0.8% pa**

Population growth **0.3% pa**

UK GDP growth (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.5%	2.0%	2.2%	2.1%	2.0%

UK CPI inflation (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.6%	1.6%	1.6%	1.8%	1.9%

UK unemployment rate (%)

2019	*2020*	*2021*	*2022*	*2023*
4.0%	4.0%	4.0%	4.0%	4.0%

UK earnings growth (% pa)

2019	*2020*	*2021*	*2022*	*2023*
3.2%	4.0%	4.1%	4.1%	3.9%

Bank rate (% pa)

2019	*2020*	*2021*	*2022*	*2023*
1.00%	1.50%	1.75%	2.25%	2.75%

Exchange rate (£/US$)

2019	*2020*	*2021*	*2022*	*2023*
1.41	1.46	1.50	1.50	1.50

Source: JLL, Oxford Economics. Note GDP and GVA forecasts are annual averages, all other forecasts are end-Q4 each year.

UK housing market forecasts

Forecast rationale

The assumptions used to generate our base case UK housing market forecasts are that the UK agrees a deal with the EU on Brexit and that the UK economy recovers to circa 2% pa GDP growth during 2020-2023.

Within this broad Brexit and economic environment there are several other factors that will influence the UK housing market.

Consumer confidence is key

Consumer confidence is a critical driver of the housing market. The uncertainty surrounding Brexit has dented consumer confidence while also casting a shadow over the job and personal financial prospects of millions of people. Such uncertainty is not conducive to big ticket purchases and has therefore impacted the UK housing market.

Other factors such as negligible real wage growth and, more recently, higher interest and mortgage rates are also not supportive of a thriving housing market. A lack of affordability, especially for first-time buyers, is also hampering transactions and house price growth, despite support from Help to Buy and the Bank of Mum and Dad.

Investor influence fading

Government initiatives to dampen the role that investors play in the housing market look to be working. Although only a part of the story, the number of loans to BTL landlords has fallen by 46% between the Referendum and July 2018.

The principal disincentive is the less favourable income tax regime, with higher stamp duty an added financial deterrent. We expect investor appetite to remain muted while house price growth prospects remain both uncertain and relatively weak.

This shift is important because it means that owner-occupiers, and therefore fundamental affordability, are even more important than before.

The consequence of all these influences has been a slowdown in UK house price growth and housing transactions since the EU Referendum. Annual UK house price growth has eased from 8.2% to 3.1% by July 2018, while UK transactions have declined by 7.4% from 1.29m to 1.20m.

Supply boost easing

A further consequence of the uncertainty and the relatively weak economic and consumer confidence backdrop, is that new housing supply, which was in the midst of a five-year surge, has slipped back over the past year.

New housing starts in the UK were running at 196,000 pa in Q1 2017 but have dropped back to 179,000 by Q1 2018.

Base case housing forecasts

As a consequence of these combined factors, our base case forecasts are for UK house price growth to weaken further during 2019, fading towards 1% pa from 3% pa now. We expect transactions to slow too, down to around 1.12m pa from 1.20m today. Housing starts will also slow.

Assuming the Brexit process continues along the current proposed timetable, the economy and consumer confidence will improve during the second half of 2019 and into 2020. This greater certainty will lead to a marginally improved UK housing market. We expect house price growth to rise to 1½% pa with London and south-eastern markets first to react. Housing starts will initially remain subdued.

From 2021 we expect greater certainty to lead to an economic recovery and improved business and consumer confidence. This will lead to a brighter UK housing market with house price growth and the number of transactions increasing – especially in London and south-eastern markets. Housebuilders should also feel more confident, increasing housing starts gradually.

Forecast risks

The main risk to our base case assumptions is that UK economic weakness is prolonged by a year or two. This would result in lower house price growth and transaction forecasts in the early years of our outlook, pushing the housing market recovery into 2022 or 2023.

The second most likely risk is that the Brexit deal negotiated and approved is not as favourable for the UK as we assume. In this scenario our house price growth and transaction forecasts will be slightly weaker over the forecast period.

The other risk is that the UK exits the EU with 'no deal'. This would result in a far weaker UK economy and housing market over the next five years.

UK house price growth forecasts

% change in house prices pa

Source: JLL

2019	½%
2020	1%
2021	3%
2022	3½%
2023	3%

UK housing transaction forecasts

Number of transactions pa

Source: JLL

2019	1.15m
2020	1.18m
2021	1.23m
2022	1.28m
2023	1.32m

UK housing start forecasts

Number of units pa

Source: JLL

2019	175k
2020	180k
2021	185k
2022	195k
2023	205k

Find the Gap

Reasons to be cheerful

It's easy to be cynical these days in the UK and no doubt many housing market participants have been spending a disproportionate amount of time this year modelling downside risk for the years ahead.

In a world of uncertainty, more so than normal, it would be easy to wallow with indecision and pull back on development programmes. So, credit where due, the housebuilding community has stepped up production. Net new additions in England increased by 15% in the year 2016-17. In London the increase was 30%.

However, the outlook for development is not as positive. Development starts in Greater London during Q3 2018, for example, slowed to their lowest level since 2012.This is bad news for just about everyone. But, rather than join the gloom it is worth taking a contrarian position for a moment. Not just because being optimistic is an agent's prerogative but because, when the mist clears, the market backdrop should present more positives than negatives.

Make no mistake, JLL sees every reason to expect a hard couple of years for the industry. The confluence of factors we noted in last year's forecast statement – with upward pressure on costs to both builders and buyers, and very little escape through rising prices or incomes – will plague the 'business as usual' approach to delivery. But land values will adjust, real incomes will nudge upwards and the majority of the industry will solemnly trudge forward. Yet, there are also reasons to see a more optimistic picture, too.

Infrastructure

The UK is creeping towards a new era of infrastructure. HS2, HS3, Crossrail 1, Crossrail 2; these are all important catalysts for new housing sites and induced demand. Where tied to a structured housing delivery outcome, or linked to delayed/ lower land payments, things will get done.

Despite their scale however, none of these will be as important to housing delivery as CaMkOx, or the Varsity Arc, that connects the UK's two great institutions of higher learning. Over one million homes are planned for this region, connected by both rail and dual carriageways. In truth, the arguments for connecting Oxford and Cambridge are weak, but the local and regional linkages with London will drive a wave of sustained community building for several decades.

Digital disruption

This is a bit of a catchall for the wave of 4th industrial revolution technologies that will gain both momentum and adoption over the next five years. Digital construction will mainstream. BIM will transform the relationship between supply chains, contractors and developers.

Smart technologies will enable better, more nuanced relationships with buying customers and renting residents. These are all statements of the obvious and if you are still a sceptic, just think back to what any of this meant to you only five years ago.

But we believe the big changes will come towards the end of the forecast period, when off-site manufacturers achieve scale, when multi-family operators have built genuine brand-driven followings, and when consumers have normalised the benefits of these technologies.
To get there, adoption and investment starts now.

The 52%

Lest it hasn't been said enough times, the end of the Article 50 period and beginning of the UK's brave new, independent world, will be welcomed by a majority of the population.

This is not just relief that the cross-channel tit for tat is over, but across major swathes of the UK and away from the London bubble, it will be welcomed as a good thing. Do not underestimate that shift in sentiment. You don't need to like it to want to make the best of it and the implications remain at this stage, largely an unknown.

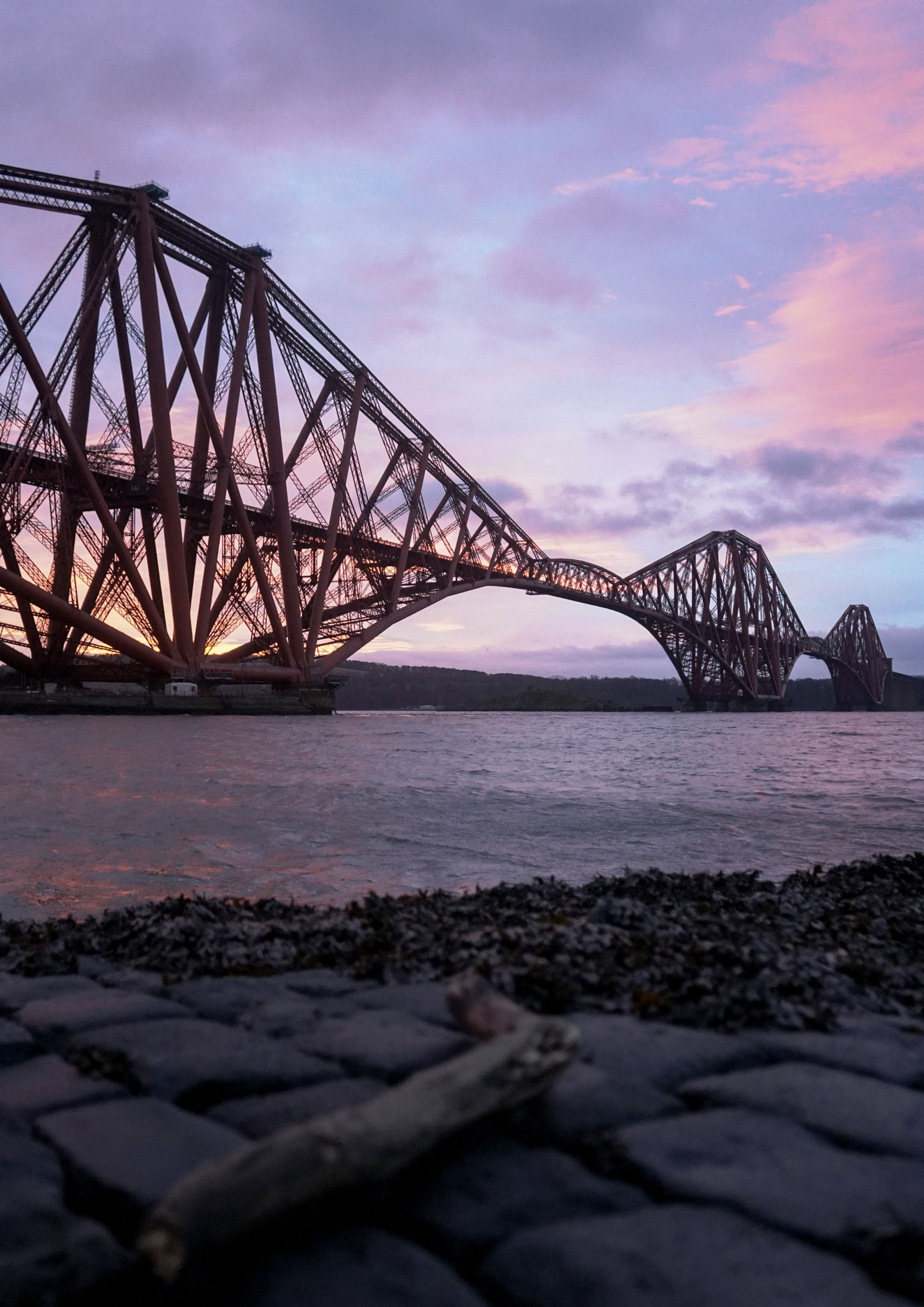
However, it is worth stating again – a majority of the population (or at least a large minority these days) is looking forward to independent Britain and this may well trickle into stronger consumer sentiment. Stranger things have happened.

> "It is less about stepping off onto the platform and more about stepping on board."

Find the Gap

These are all big, structural changes for the housing industry. So, Find the Gap is a way of reframing the risks of a Mind the Gap perspective. The challenges are broad-based and well-known.

At the same time, there are several very large pillars to support new opportunities for the housing sector. They may require a shift out of traditional comfort zones to embrace new markets or new technologies, but they are undoubtedly there for the taking.



Our forecasts 2019 – 2023

House price growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Edinburgh	2½	3	3	3½	3½	16.5
Glasgow	2	2½	2½	3	3	13.7

Rental growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Edinburgh	3	3½	3	3	3	16.5
Glasgow	2½	3	3	3	3	15.4

House price growth (% pa)	2019	2020	2021	2022	2023	2019-23*
Greater London	½	2	4	4	3½	14.8
South East	0	1	3	3½	3½	11.4
East of England	½	1	3½	4	3½	13.1
South West	1	½	2½	3½	3	10.9
East Midlands	0	½	2½	3½	3	9.8
West Midlands	1	½	1½	3	3	9.3
Yorkshire & The Humber	1	½	2	3½	3	10.4
North West	1	1	2½	3½	3½	12.0
North East	0	0	1	2½	3	6.6
Wales	1	0	1½	2½	3	8.2
Scotland	2	1	2½	3	2½	11.5
UK	½	1	3	3½	3	11.4

Activity and development	2019	2020	2021	2022	2023
UK transactions (m)	1.15	1.18	1.23	1.28	1.32
Scotland housing starts, private (000s)	13.50	14.50	15.00	15.50	16.00
Scotland housing completions, private (000s)	13.50	13.50	13.50	14.50	15.00

Source: JLL * *cumulative growth; ** average pa*

Residential services

Investment | Affordable Housing | Estate Agency & Lettings | Funding & Corporate Finance | Land Sales & Acquisitions | Research

Valuations | Mixed Use Development | Planning | New Homes Sales | International Agency | Development Consultancy

---

Urban living, your way. Insight | Agency | Advisory | Investment & Development

Adam Challis
Residential Research
adam.challis@eu.jll.com
+44 (0)7841 199 056

Neil Chegwidden
Residential Research
neil.chegwidden@eu.jll.com
+44 (0)20 7087 5507

Nick Whitten
Residential Research
nick.whitten@eu.jll.com
+44 (0) 20 7087 5665

Jason Hogg
Scotland Residential
jason.hogg@eu.jll.com
+44 (0) 131 301 6710

Nina Stobie
Scotland Residential
nina.stobie@eu.jll.com
+44 (0) 141 567 6622

Makela Milne
Scotland Residential
makela.milne@eu.jll.com
+44 (0) 131 243 2233

jll.co.uk/residential JLL @JLLUKResi JLL Residential JLL Residential