THE POST-BREXIT ROADMAP

MID-YEAR MARKET UPDATE

The natural inclination for business and consumers to hold back is leading to a modest softening of activity. How quickly 'normal' – yet to be defined – resumes will depend on a range of factors.

UK Research, July 2016

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Coping with change

The pace of adjustment post-Referendum has left an indelible mark on the British psyche. Social media, far more relevant than mass media in this minute by minute news cycle, is full of the philosophy of coping with change. The bad news is that when it comes to real estate, often the impacts of change are delayed, like a slow motion crash. The good news is that we don't believe events will unfold anything like that.

As things change, they also stay the same. We still have a housing crisis, although the 15th July House of Lords report now puts the requirement from 240,000 up to 300,000 units per annum. So, it's potentially even worse than we thought, at a time when market factors will invariably make it more challenging to meet.

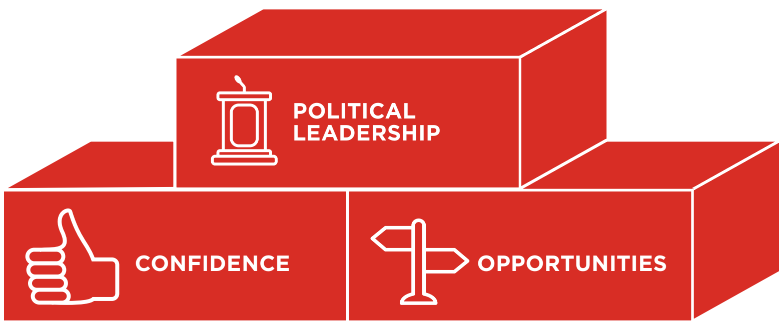
RESIDENTIAL RESEARCH

ADAM CHALLIS

"Our political leadership must be cognisant that some of the biggest opportunities for change in the next couple of years will start at home."

With the main political fallout and market responses behind us, the first wave of volatility and uncertainty is coming to an end. It is time to look more closely at rebuilding lost momentum through the Referendum process and return to the job at hand; to grow rates of housing supply and to create a more stable and resilient industry to protect supply over the long-term.

There are three building blocks that will define the next steps taking place over the second half of 2016.



DEFINING THE NEXT CHAPTER

THREE BUILDING BLOCKS

Political leadership

With Theresa May, we have a new Prime Minister that has been close to the top job as Home Secretary for 6 years and understands the leadership qualities needed to return confidence to the UK economy and real estate markets. The danger for housing markets is that the focus of attention on international relationships will have a drag on momentum. Renewed energy to drive effective housing policy on multiple fronts is required to support new supply and stimulate market activity. Targeted solutions from policymakers are also needed to address the specific challenges of this post-Brexit market.

Confidence

As they say, confidence breeds confidence. It is expected that housebuilders will continue, broadly undeterred by the impact of Brexit, with a modest softening of consumer buying sentiment partially offset by downward pressure on mortgage rates. Developers, notably of higher density schemes, may find the combination of market softening and the threat of uncertain build costs to be too much of a risk in the short-term. In some cases they will seek alternative exit strategies to de-risk exposure on sites that have yet to launch. Momentum in housing delivery will oscillate around news in this space, combined with policy directives designed to offer support and that all important confidence to the market.

Opportunities

Genuine activity improvements will build off the back of earlier opportunistic deals, where good value assets stand out despite the Brexit noise. Leaders to watch in this space will be the Build to Rent investors who have already made statements about the expected resilience of the sector and its modest countercyclical attributes. In addition, Housing Associations will take up a bigger role in delivering higher proportions of market product. Expect the larger HAs to pick up some of the slack in urban land markets, while also progressing on schemes that others may perceive to be of too high risk over the next couple of years. Purchasers that are already chasing aggressive discounts have generally been rebuffed so far. However, they will find the middle ground, perhaps with a package of incentives, supported by the knowledge that mortgage rates must now be as good as they're ever going to get.

The Direction of Policy

The tone and tenor of our new political leadership is taking shape, including a new Housing Minister in Gavin Barwell, MP for Croydon Central. At this stage it is unclear whether the expanded portfolio, which includes Planning as well as a new focus on London, will offer extra teeth for dealing with the Capital's particular housing challenges, or whether it will prove dilutive. The Minister's dual role may prove to be a masterstroke from the PM, or a fatal flaw that will expose time and again the challenges of mixing national housing policy and local implementation.

Of material importance in the short-term will be the details that underpin the Housing & Planning Act, notably the introduction of Starter Homes and its impact on delivery. This will be determined over the next couple of months and will have implications for supply of both market and affordable homes.

The bigger legislative challenge for housing in London has little to do with the Housing Minister directly, however. Any discussion about supporting housing construction in the Capital will need to start with the new Chancellor. A redressing of Stamp Duty for high value property or more materially for investors in new build deserves a fair hearing. These policies have undermined the flow of investment that in turn supports development financing. A simple ring-fence for new build investment would have allowed the policy to protect second-home holiday areas and first-time buyers of secondary stock, while channelling the investment that enables more new supply.

The Direction of Markets

We know that the direction of markets will tend sideways in the short-term as consumers take stock. The extent of any stronger movement will depend on the three pillars above. Market evidence remains anecdotal, but the range of opportunistic activity already taking place demonstrates an underlying market strength. For example, all of the below has taken place post-Referendum:

- LaSalle IM completed on the £107 million Greengate scheme in Manchester
- Two separate development funding packages for £320 million and £500 million for tower schemes in London
- Yorkshire strategic land transaction that attracted 9 bidders
- Several prime house sales, with 2 JLL properties valued at over £10 million and upper floor new build sales valued at over £3 million
- Over 20 units sold on launch day in schemes in Manchester and East London

Buyers are keen to identify good value in this market, which can include very high value properties as noted above. Where this is being achieved transactions are proceeding. Agents often talk of the flight to quality in less-certain markets, but in truth it is value that today's buyers seek.

The examples also demonstrate willingness from the development and housebuilder industry to launch, fund and construct new schemes – again, all post-Referendum. Of course there will be marginal sites, or schemes with viability challenges that do not proceed on schedule. Notably, smaller builders and higher density schemes in high value locations are exposed to funding, construction and/ or market risks. But again, the examples above demonstrate that this market bears little resemblance to the last downturn in 2008.

Opportunistic activity will translate into a more stable market, provided Political Leadership and Confidence are playing a supporting role.

To better understand the potential impact on build costs over the next couple of years, Simon Latson, Director of Residential Building Consultancy at JLL, provides a few early thoughts post-Brexit.

BUILDING CONSULTANCY

SIMON LATSON

In the wake of the Referendum, what are the immediate impacts on build costs?

It is hard to be sure as build costs face pressure from both sides in the short-term. Although we anticipate issues with currency fluctuations, risk profiles and in due course trade deals and employment mobility pressures, the immediate factors to consider include the feeling that contractor prices were high and with an expected reduction in activity, they should be keener. Only time and the emergence of certainty following Brexit negotiations will tell.

Do you think there are any particular pressure points within the industry that could be more affected by this uncertainty?

Changing cost profiles, if they come through, would not impact everyone equally. National housebuilders and developers are more insulated from these pressures as they enjoy greater control over their own supply chain and tend to source more UK based materials, for example bricks, than commercial projects. Those with the hardest challenge could be medium size developers. Margin pressure could ratchet up as either supply of work falls away or they are forced to absorb costs to keep up in a more competitive environment.

Is Brexit likely to have an impact on supply in the short to medium term?

The supply and availability of construction materials is not going to change drastically in the short to medium term. The primary effect of Brexit will be on the cost of overseas materials, which will be determined by the strength, or weakness, of the £GBP and their availability and ease of procurement, which will not change until we leave the EU, if at all.

So, limited translation to supply volumes?

Developers and housebuilders have already become more cautious and general construction activity has shown signs of moderation leading up to Brexit. This is likely to disrupt projects as developers and investors re-evaluate their plans. The increased uncertainty, and associated risks, will lead to a greater focus on project viability so before anyone presses ahead with a new development they will want to ensure that it can be delivered under the new worst case scenarios. In some cases developers and housebuilders may simply withdraw from making new commitments on commercially tighter projects in the short term as they wait for uncertainty to dissipate. Supply will be affected, but the question of how much depends on how quickly political uncertainty abates so that confidence can return to buyers and subsequently to the industry.

FINAL WORD

Our new Prime Minister is fond of saying ‘Brexit means Brexit’. In truth, this is a meaningless statement.

From the ‘Norway option’ that preserves most of the current relationship, to a hard Brexit that reverts to new trade agreements through the World Trade Organisation, Brexit really means quite a range of possible outcomes. It is the narrowing of this scope, as soon as possible, that will be the proxy for greater clarity over trading relationships and ultimately, will shape the economic impacts from the Referendum result.

Our ‘building blocks’ are of course interlinked. Political leadership has already begun to provide confidence that has settled markets, yielding many of those opportunistic deals that will form the evidence base of the UK’s new economic trajectory. In housing, the post-Referendum market has made the even deeper systemic problem of housing supply more challenging. The market weakness and recovery may take many months or several years, but the bigger underlying issues for UK housing will still need to be addressed.

Many of the current programmes now gaining traction should continue to be supported. Build to Rent has taken most of this cycle to become established as a robust complement to traditional housing delivery. It now has sufficient runway for takeoff, with nearly 60,000 of these homes in Private Rented Communities now completed or planned. Equally, reforms to impose a more commercial approach to delivery amongst Register Providers is paying dividends; they now deliver more than 1 in 10 private homes in London. RPs will deliver an even greater share of private homes in the next cycle and if governance structures catch up, will also preserve a higher delivery rate of sub-market housing at lower average cost to the public purse.

New innovations in the housing market take time to achieve lasting results. Longer than political cycles; longer sometimes than market cycles. Genuine political leadership will mean that we do not get another set of knee-jerk, demand side stimulus ideas that paper over the cracks of an industry that is simply not scaled to deliver 200,000 + homes per annum. As is the case for both of the above examples, the best ideas need to be cultivated over time, often against quite vocal opposition.

While focussing on issues abroad, our political leadership must be cognisant that some of the biggest opportunities for change in the next couple of years will start at home.

Adam Challis
Head of Residential Research

KEY CONTACTS

With over 350 professionals operating from a comprehensive network of UK regional offices, the Residential team at JLL is the most comprehensive full service advisor in the market.

This is our New Residential Thinking. Join the discussion on twitter @NeilChegwidden / @Adam_Challis / @JLLUKResi

RESIDENTIAL RESEARCH

ADAM CHALLIS

adam.challis@eu.jll.com
T +44 (0)20 7399 5324

HEAD OF UK RESEARCH

JON NEALE

jon.neale@eu.jll.com
T +44 (0)20 7087 5508

HEAD OF RESIDENTIAL

ANDREW FROST

andrew.frost@eu.jll.com
T +44 (0)20 7087 5566

jll.co.uk/residential