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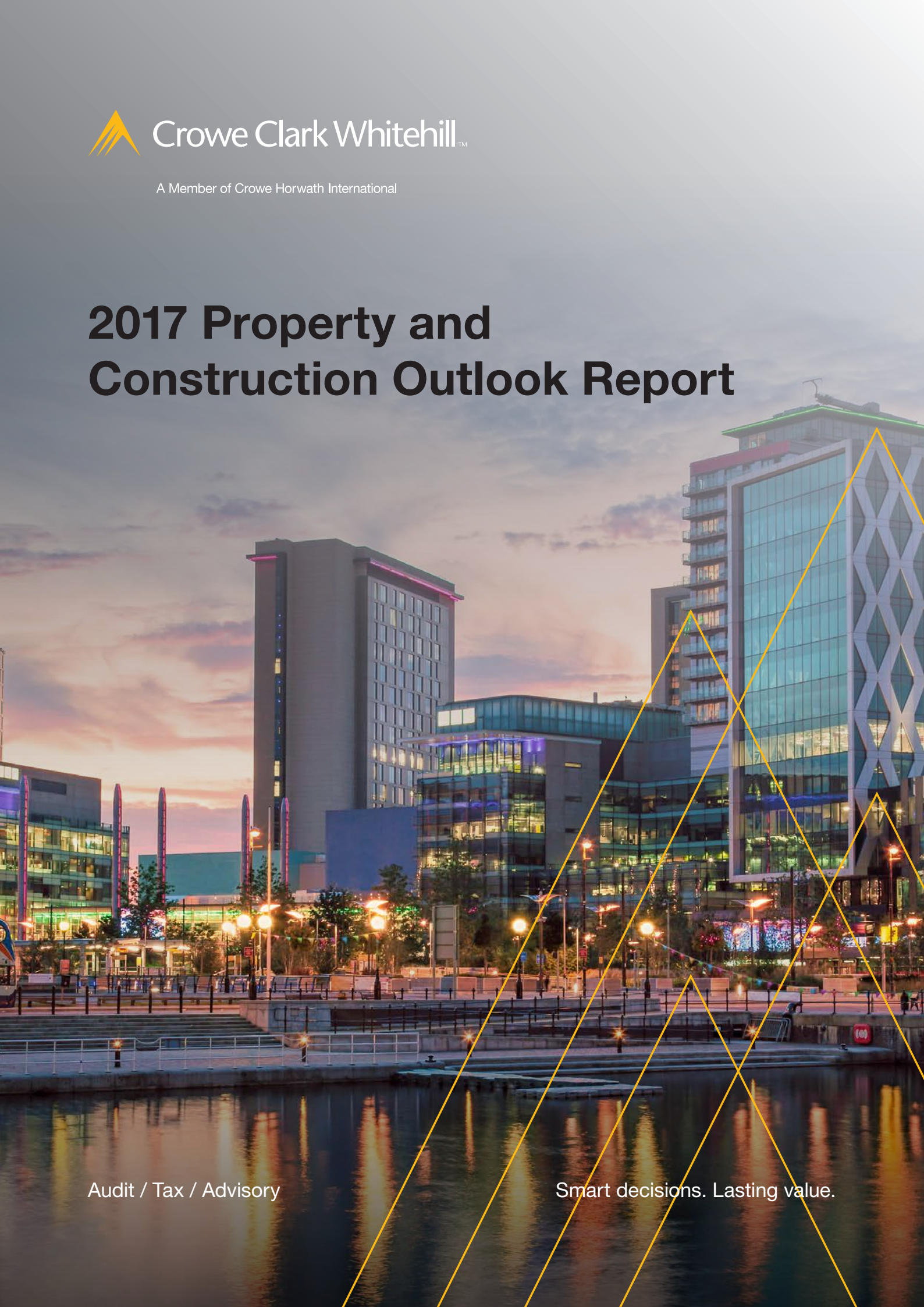
2017 Property and Construction Outlook Report



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Introduction

The results of this year's report show that in an uncertain political and economic climate, more support is needed at policy level to boost the UK's property and construction industry.

A number of key issues have developed over the past 12 months which are having a real impact on the growth of the industry. Uncertainty around the consequences of Brexit for instance, has caused many businesses to be wary of a negative effect on their operations. They are now holding off on investing while they wait for the UK government to reassure them before the UK formally leaves the EU.

The respondents to the report additionally identified the current UK tax system as a key area of concern. Stamp Duty Land Tax (SDLT) has consistently been perceived by the industry as the biggest tax barrier to business growth, while Capital Gains Tax and the current 45% rate on income tax are also seen as discouraging to growth.

This year's Property and Construction report has collected the opinions of those working in the industry, identifying the key challenges and opportunities they face. The results provide a unique snapshot into the sector's conditions and identifies ways in which the government can provide the support it needs.

Stacy Eden
Head of Property and Construction

01 Summary of findings

Brexit and the UK Economy ‘the clock is ticking’

The referendum vote on 23 June 2016 had an immediate effect on the financial markets and the sterling fell to a 30 year low. Since then the financial markets have calmed and volatility is lower. The short-term impact of Brexit had reduced confidence in the housing market in certain areas, although there are of course other reasons.

On 29 March 2017 Theresa May triggered Article 50 which kick started the Brexit process. The exit negotiations awaited by the property market were proceeding slower than expected. However, The Prime Minister’s speech in Florence in late September outlined the government’s plans to keep Britain in the EU in all but name until 2021, five years after the vote to leave.

Contrary to earlier assertions of non-payment, in this more conciliatory approach it was announced Britain would also pay 20 billion Euros into the EU Budget in what could be only an initial down payment on what is likely to be a substantially larger bill to exit.

Just under half of our respondents considered that the vote for Brexit was not favourable to the UK property and construction market, closely followed by a similar percentage who were unsure. Very few respondents (9%) thought Brexit was favourable to the industry. Respondents who consider Brexit unfavourable should be encouraged by the current plan that Britain would formally leave the UK in March 2019 but would remain subject to all EU rules, decisions of the European Court of Justice, the free movement of EU workers and the requirements to contribute to the Brussels Budget until 2021. However, there are likely to be further market fluctuations and uncertain times during the transition process. Much of the uncertainty that the property industry feels, revolves around what deal the UK government eventually agrees.

The plans for Brexit were thrown into confusion after the June 2017 General Election that deprived Theresa May of a Conservative majority in Parliament. Since forming a minority government with the support of the Democratic Unionist Party there has been speculation of potentially diluted policies. However some commentators and analysts forecast another General Election within two years.

Since Brexit, there is a need for ‘passporting’ arrangements for financial services and the possible impact this will have on London’s position as Europe’s financial centre. Various businesses and commentators highlight the risks of large numbers of financial services jobs that might need to be moved to other financial centres in the EU. Leaders of other European cities are actively promoting benefits of their cities as the obvious successor to London. Several banks have already established additional headquarters in other European cities such as Frankfurt and Dublin.

Top 3 concerns to businesses in the next 12 months

27% UK Economy

22% Brexit negotiations and outcome

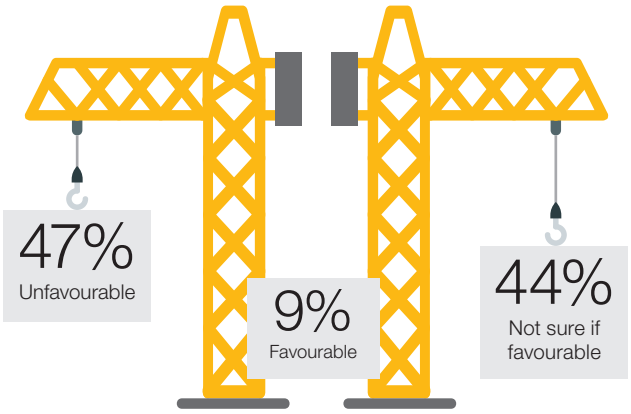
14% General Election / political uncertainty poses the most concern

Effect of the General Election to the UK Property and Construction Market

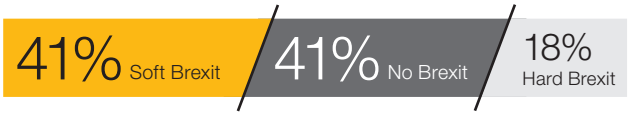
77% Unfavourable

23% Favourable

Was the result of the 2016 EU referendum favourable to the UK property and construction industry?



The type of Brexit respondents preferred



UK tax system and government priorities

Our respondents suggest that support for the UK property and construction market needs to be high on the government's priorities over the coming year. Alok Sharma, the Government Housing and Planning Minister stated that industry leaders had identified five key priorities:

- Implement the housing white paper
- Help local authorities get their local plans in order
- Address the future of Help to Buy
- Construction industry concerns for adequate labour during Brexit negotiations
- Ease restrictions on the Green Belt

Indirect government investment through local authorities is expected to play a greater role over the next few years. The government launched a £2.3 billion housing infrastructure fund in July 2017 designed to support the infrastructure underpinning delivery of new homes. So far more than 150 local authorities have applied. Following the Grenfell Tower fire, public attention has focused on social housing but the demand by local authorities for social housing funding could suffer if the European Investment Bank cuts its future funding. 75% of our respondents said the current policy around the Green Belt protections were not conducive to solving the housing crisis.

The Help to Buy scheme since its launch in 2013 has resulted in over 120,000 people purchasing a new build home and assisted developers to build more homes. The government has committed £8.6 billion for the scheme up to 2021, thus ensuring continued support to home buyers and the stimulation of the housing supply.

A potential barrier to the free movement of labour could increase the construction industry average wage, and the industry's scope of operations could be reduced by the lack of skilled labour. The recent Brexit transition announcement will hopefully improve this outcome.

The increases in UK stamp duty land tax (SDLT) have resulted, as was widely predicted, in a considerable slowdown in the market. While the 2016 to 2017 SDLT statistics revealed that stamp duty receipts have risen,

this should not cloud the reality of what is going on in the market. SDLT remains a negative levy. Aside from the fact that a reduction in SDLT – particularly for high value residential properties – would lead to higher revenues raised through an uptake in transactional activity, SDLT in its current form also reduces liquidity in the market. This is evidenced through the lower volume of transactions, and ultimately hits housing stock, resulting in unaffordable housing prices. This impacts 'generation rent' who have less choice and higher costs.

The cost of materials used in the construction process has also risen due to the depreciation of the sterling. Conversely foreign investors benefit from the more favourable exchange rate.

The economic growth, experienced after the Brexit vote, began to slow at the start of 2017 due to a flattening in consumer spending. A key factor for this moderation is due to the fluctuation of the Consumer Price Index (CPI) over the recent months. August 2017 figures showed a rise to 2.9%, an increase from 2.7% in July. The Bank of England August 2017 Inflation report forecast CPI to rise to just below 3%. The National Institute for Economic and Social Research, whose models are used by the Treasury, forecast that inflation could rise to 3.5% later in 2017. The value of the sterling continues to fluctuate in reaction to political events, but in mid-September 2017 hit its highest value against the dollar since the Brexit vote.

The Bank of England Monetary Policy committee voted on 2 August 2017 to maintain its base rate at 0.25% by a majority of six to two. These low interest rates are encouraging buyers to invest in real estate because of the low return in other markets. In November 2017 the Bank of England increased its base rate after a decade.

Is the tax system favourable for property developers and investors?

17% Favourable

72% Unfavourable

11% Not sure

Believed to be the biggest tax barrier to business growth

54% stamp duty land tax

Respondents forecast that over the next six months valuations across commercial and residential property would increase by

0-5%

Is the current policy around Green Belt protections conducive to solving the housing crisis?

25% Yes

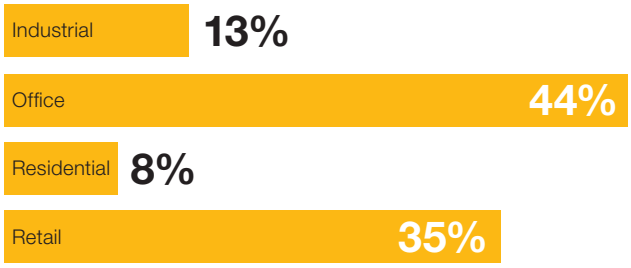
75% No

The impact of technology

44% of participants identified the office market would be most affected followed by retail (35%). As to office occupancy, less space would be needed due to the rise in agile and flexible working with more staff working from home or working remotely. Technological advancements enabling offshoring and outsourcing would also see a reduction in support staff, thereby needing less square footage.

The retail market has been hit by consumer spending constraints and also by technological advancements, enabling consumers to buy all sorts of goods online. Retailers are having to rethink their business models and become 'omnichannel'. The rise of online shopping has however had a positive impact on the industrial warehousing sector, boosting the demand for the construction of warehouses to meet the supply chain demand from consumers. In the last year alone, traditional stores have become increasingly redundant, with store closures being seen across the board, rising vacancy rates and an increase in retailer administrations and failures.

Which types of property are most likely to be impacted by technological trends?



National versus London

Results show that the residential London market will be affected by the low growth the industry is experiencing. The South East is regarded by our respondents as having the highest potential for investment in the next 12 months, this could in part be due to the development of Crossrail.

Outside of London, the West Midlands and the North West were regarded by 19% and 13% of respondents respectively as the best places for investment. Birmingham has become home to the largest professional and financial services sector outside of London. Due to its central location and comprehensive rail, road and transportation network Birmingham offers benefits for those looking to invest.

One reason the West Midlands is increasingly attractive to investors is in part due to the 'Midlands Engine' initiative which makes the East and West Midlands an engine for growth for the UK economy. This initiative is backed by businesses, local authorities and 10 local enterprise partnerships.

Beyond the British border

The majority of our survey respondents (77%) operated UK only businesses with 81% having no intention of overseas expansion in the next 12 months. 33% of respondents cited political uncertainty and anxiety about economic stability as primary reasons for not investing in mainland Europe.

Access to finance and tax burdens were also cited as barriers to investing in property in mainland Europe. However, Germany leads the field for 46% of our respondents as having the best potential for property investment due to its economy.

In the rest of this report we provide further analysis of our findings and how they impact the UK property and construction industry.

UK businesses with no intention of overseas expansion in the next 12 months

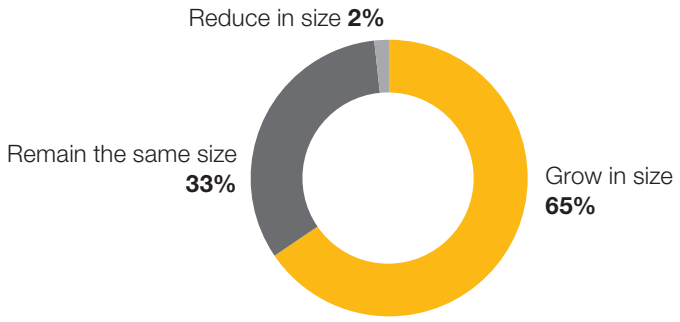
81%

02 | The findings

Business operations and growth

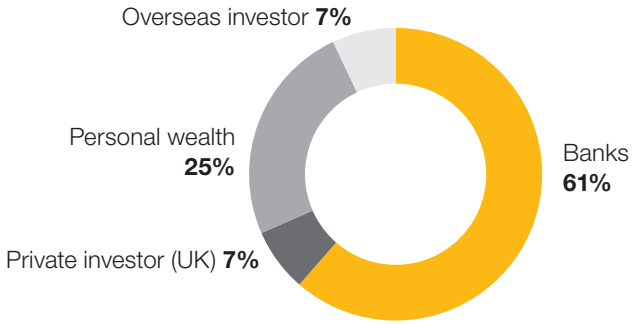
In the next 12 months, 65% of participants were confident about their business growth. Despite political and economic instability in the market, businesses' strategic growth plans would not be derailed. 56% of participants have little or no difficulty in obtaining funding. Confidence in financing has not reduced over the last 12 months, with banks and personal wealth providing the largest sources of investment.

In the next 12 months do you expect your business to:



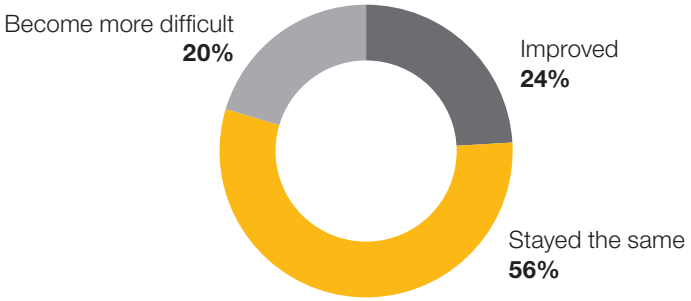
65%
Grow in size

In the past 12 months, where has the majority of your financing come from?



61%
Banks

How has access to funding changed over the past 12 months?



56%
Stayed the same

Valuations

Parts of the property market has been experiencing low growth. 32% of respondents said that the greatest impact would be on the residential London market with 22% suggesting that the regional retail industry would be affected. A number of factors could be attributed to low growth in the residential London market including affordability and a weaker demand for buy to let properties because of the higher stamp duty charges. The growth of regional retail industry has declined in part with the rise of online retail and automation. Online as a channel however is continuing to take the majority of overall sales; retailers are finding that stores are becoming less productive.

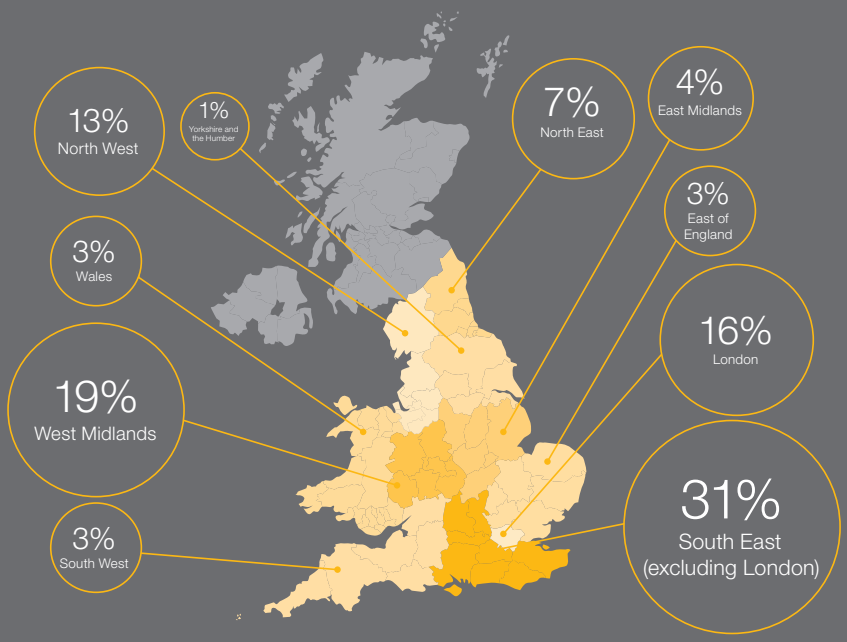
Nationwide commercial and residential property prices as predicted by our respondents were expected to increase by less than 5% or stay the same. Residential prices in the South East were predicted by the highest majority to increase.

The reasons attributed for this price increase across domestic properties is due to the South East being the prime commuter belt market. It is being driven by the demand by young professionals who may not be able to afford the rising rents in London, but require properties with easy access to local amenities such as shops, sport facilities and any easy rail commute into London.

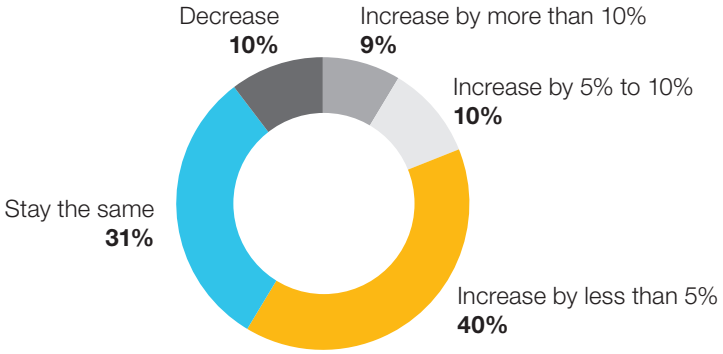
Crossrail, one of Europe's largest infrastructure projects, is having a major impact on prices in London and the surrounding areas which it will service. Once operational, Crossrail is expected to reduce journey times into central London by 15 minutes on average and up to a maximum of 40 minutes. This opens up new parts of London to residential buyers. Since the development of Crossrail commenced, the property prices around its host stations have increased by over 30% and these are likely to continue to increase.

With the property market experiencing low growth, which types of property are most impacted by this trend?

What region offers the best outlook on investment over the next 12 months?

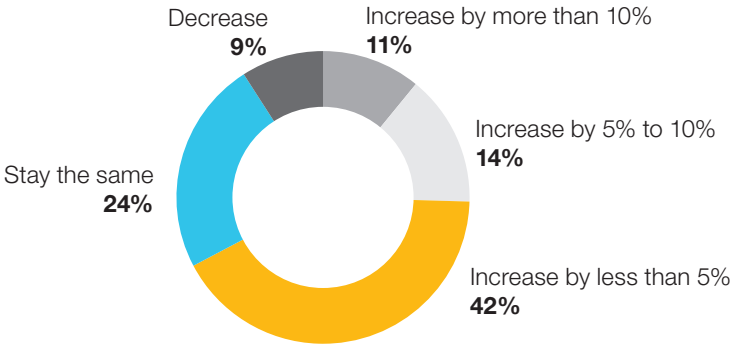


Commercial:
In the next 6 months, do you expect property prices nationwide to:



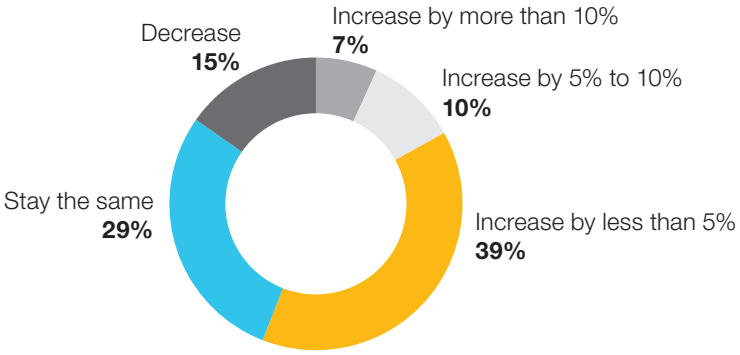
40%
Increase by less than 5%

Commercial:
In the next 6 months, do you expect property prices in the South East to?



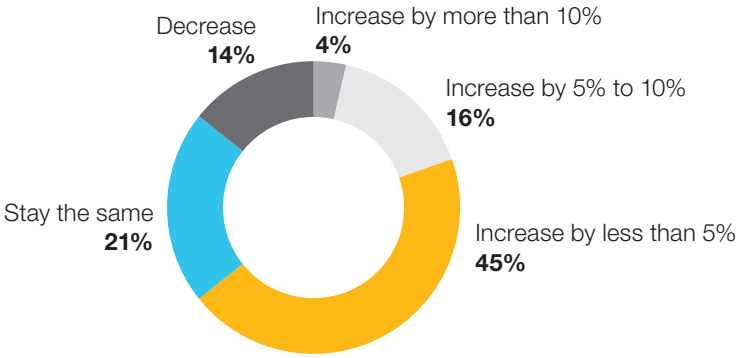
42%
Increase by less than 5%

Residential:
In the next 6 months, do you expect property prices nationwide to:



39%
Increase by less than 5%

Residential:
In the next 6 months, do you expect property prices in the South East to:



45%
Increase by less than 5%

Government activity and priorities

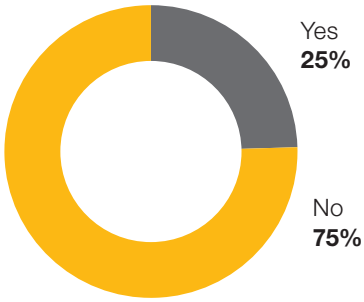
Over 72% of respondents agreed that the UK tax system is unfavourable to the property and construction industry with 54% attributing SDLT as the main fiscal barrier to business growth, followed by 17% citing 45% income tax and 14% citing capital gains tax.

Another concern raised by respondents was business rates. The latest revaluation in April 2017 has shown a growing variance in property prices between London and the rest of the UK. The period between 2013 and 2015 saw rental levels increase dramatically in particular in London and the South East and these are now at record levels. Other regions in the UK however have seen a continued decrease in rents.

The discrepancy between London and rest of England's rates bills shows that the London non-residential property market has been historically outperforming the rest of the market.

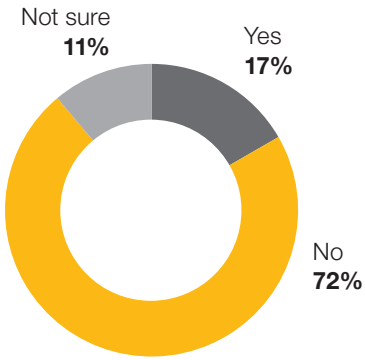
75% of respondents highlighted that the Green Belt protections were not conducive to solving the housing crisis. Building on Green Belt land is the only chance the councils have for hitting the 300,000 new homes a year target that is needed to solve the housing crisis.

Is current policy around Green Belt protections conducive to solving the housing crisis?



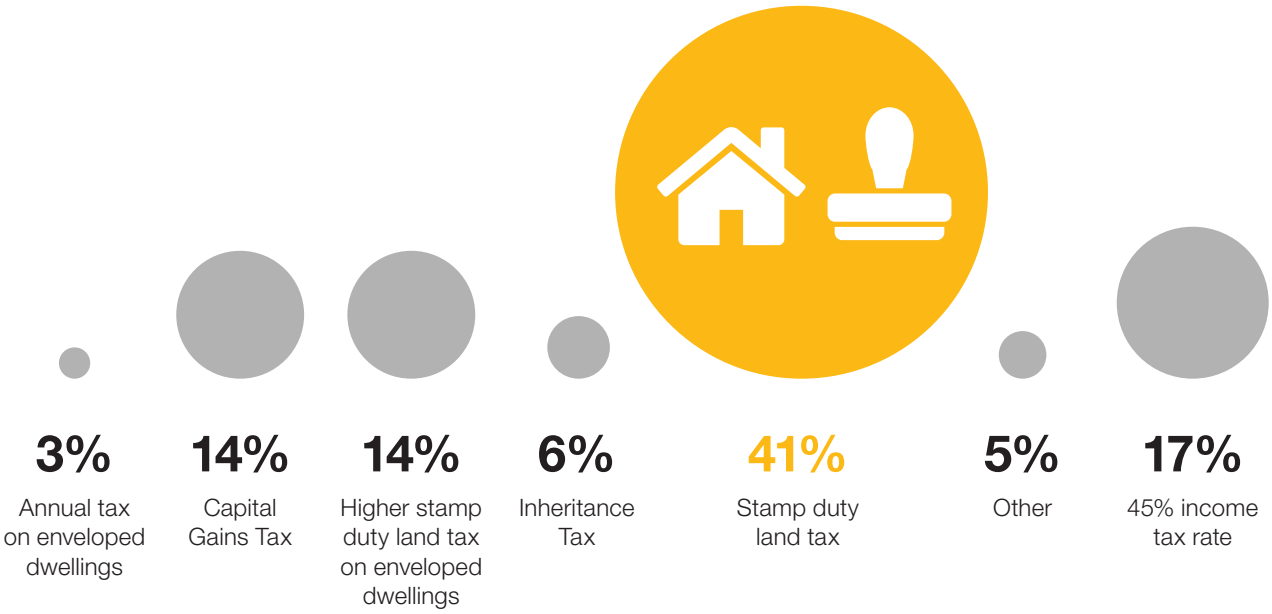
75%
No

Is the tax system favourable for property developers and investors?



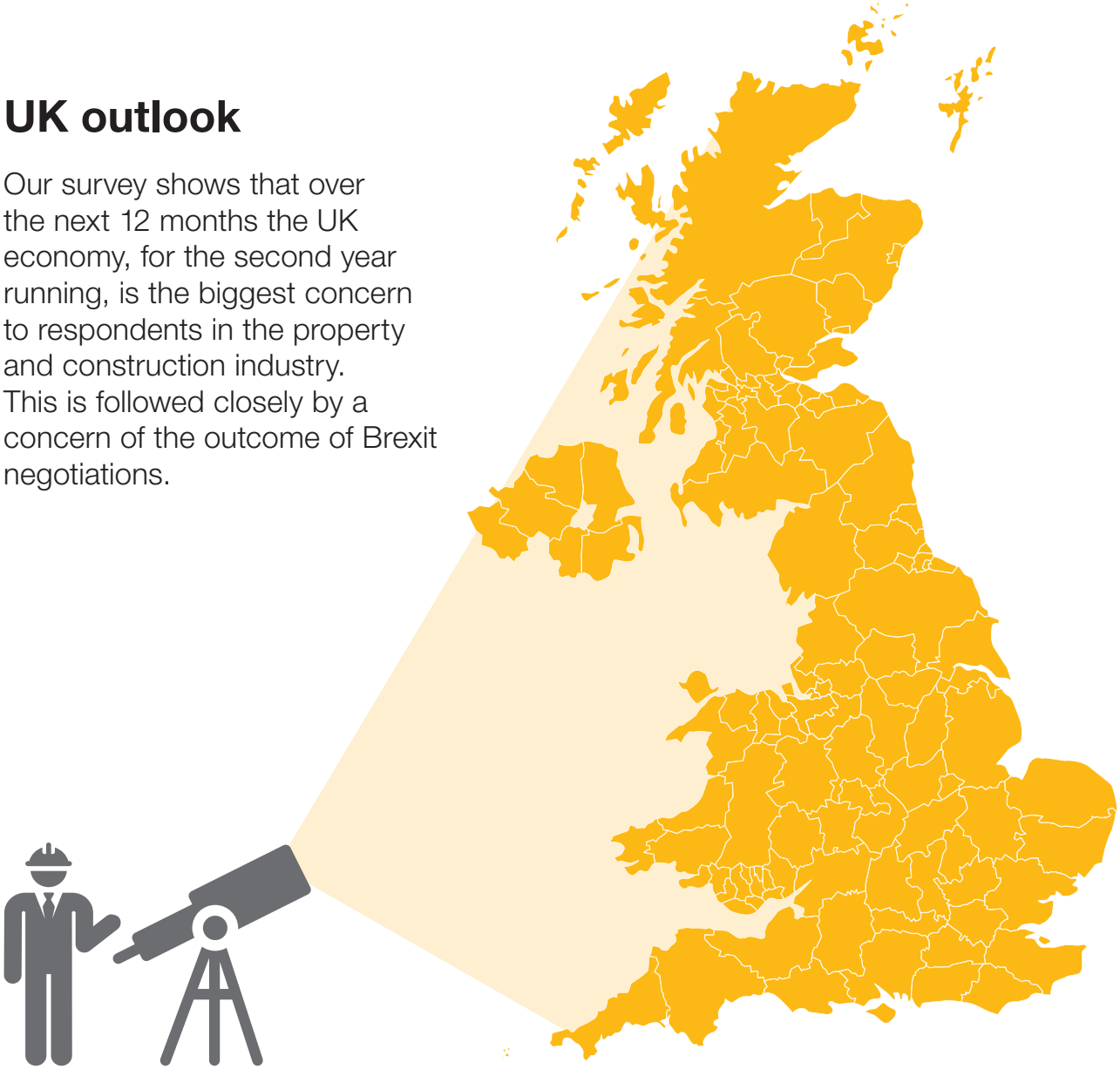
72%
No

What do you perceive as the biggest barrier to business growth?

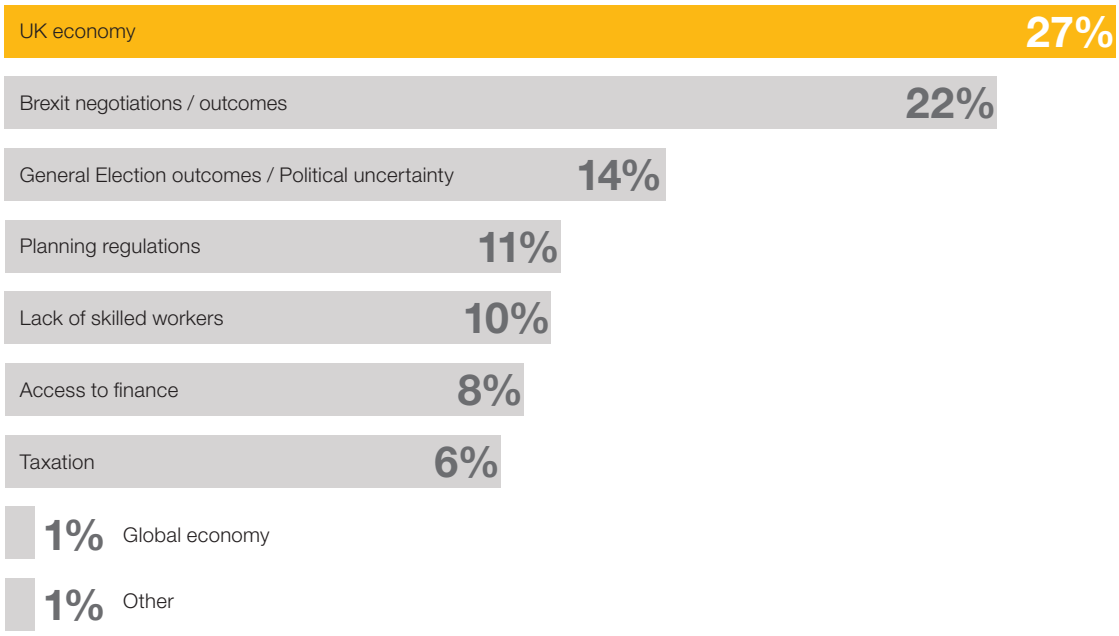


UK outlook

Our survey shows that over the next 12 months the UK economy, for the second year running, is the biggest concern to respondents in the property and construction industry. This is followed closely by a concern of the outcome of Brexit negotiations.



In the next 12 months, which factor poses the most concern to your business?



International activity and the EU referendum

Over 74% of respondents had operations only focused in the UK; 81% did not have plans to invest or expand overseas.

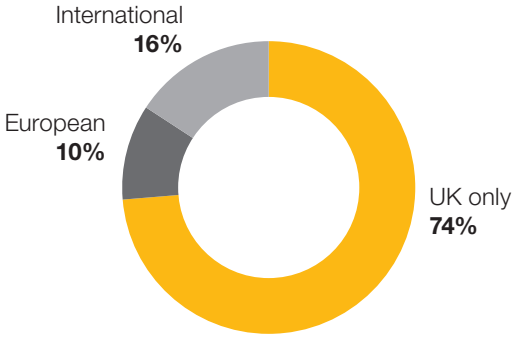
At the time of our survey 47% still feel that the EU referendum was not favourable to the UK property and construction industry and 44% were unsure.

77% said that the 2017 General Election was not favourable. When the respondents were asked what type of Brexit they preferred it was an equal split of 41% each between soft Brexit and no Brexit at all.

The majority of respondents named Germany as the best potential for property investment. The German property market is well regarded as an investment area in Europe due to the size of the market and economic stability in the country. In 2016, Berlin was seen as the number one city for both investment and development prospects. The lower cost of living has driven Berlin's progress.

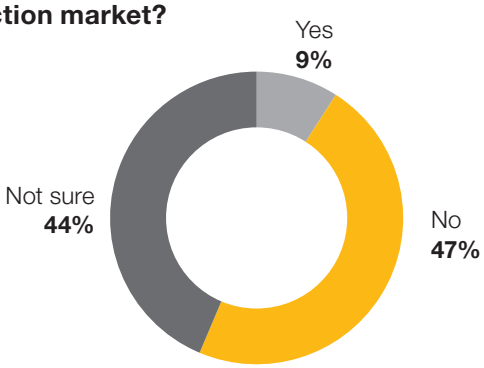
The respondents cited access to finance and tax burdens as some of the biggest barriers when it came to them investing in property in Europe. Others named political uncertainty and lack of economic stability.

Is your property portfolio or business activity:



74%
UK only

Is the result of the 2016 EU referendum favourable to the UK property and construction market?

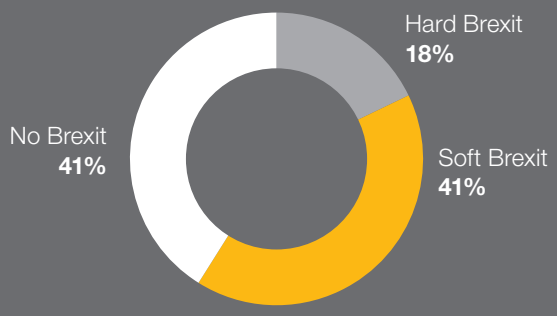


47%
No

Is the result of the General Election favourable to the UK property and construction market?

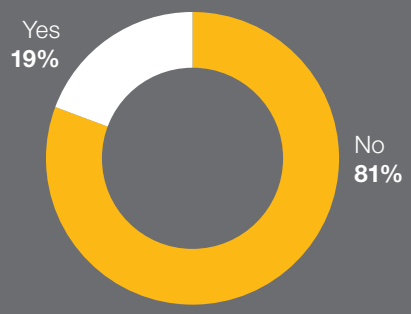
77%
No

What type of Brexit do you prefer?



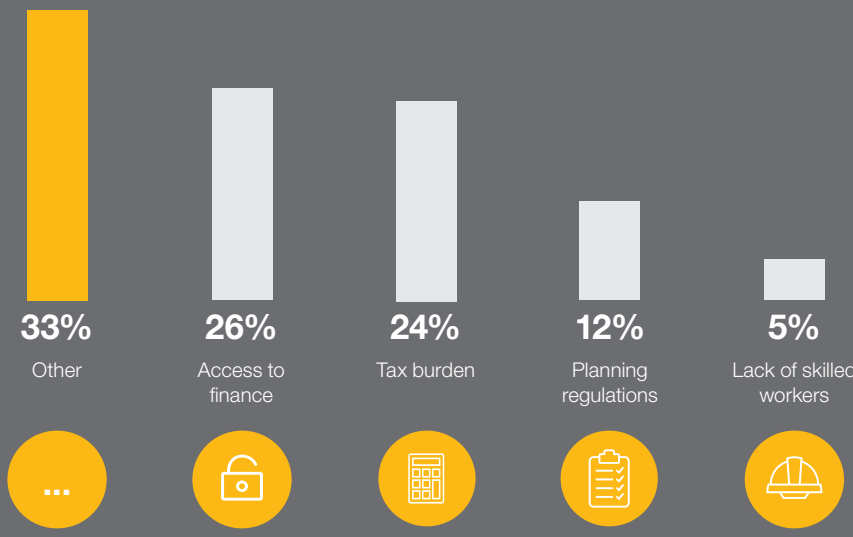
41%
No Brexit / Soft Brexit

In the next 12 months, do you have plans to invest or expand overseas?

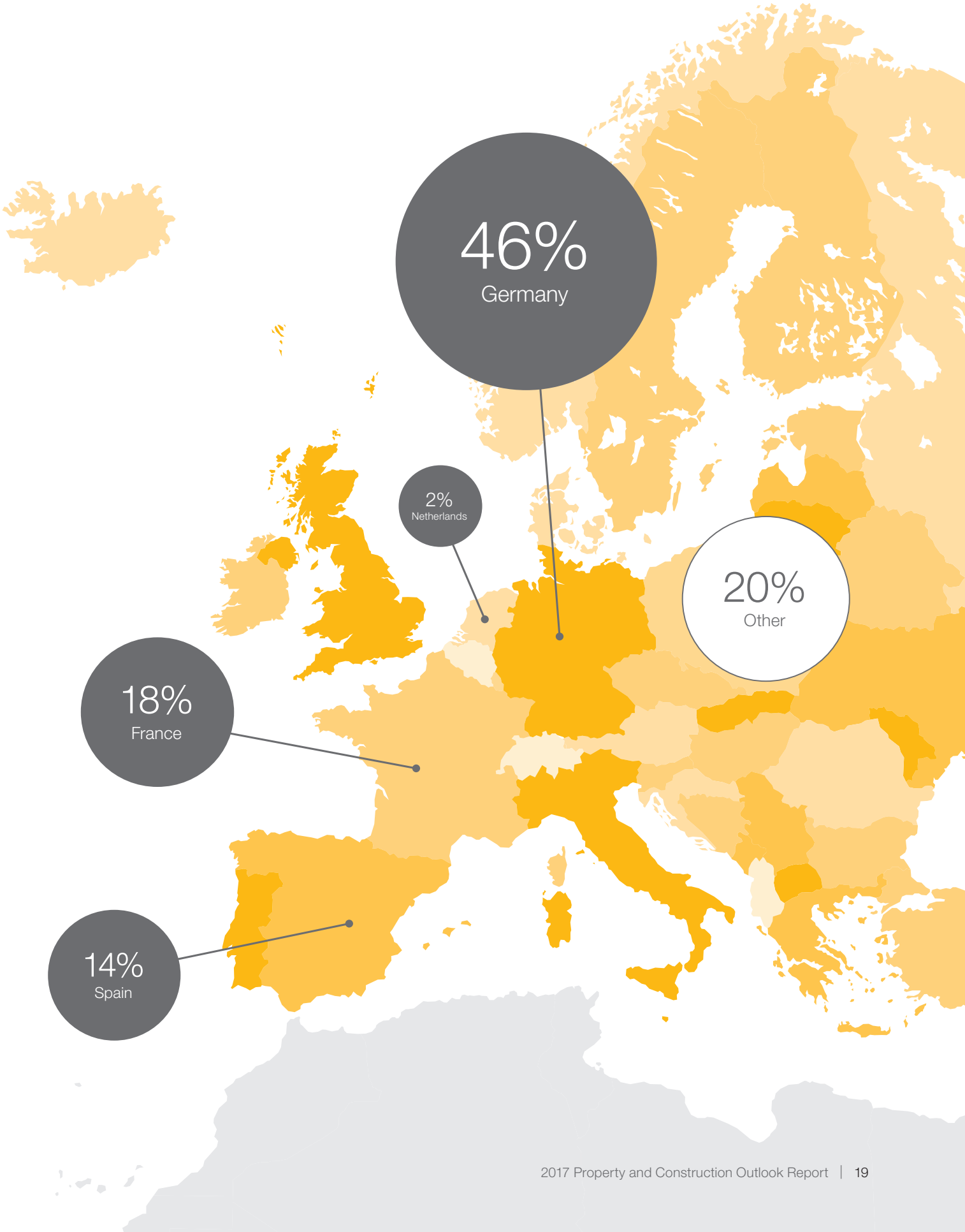


81%
No

What are the biggest barriers for investing in property in Europe?



Which countries in Europe have the best potential for property investment?



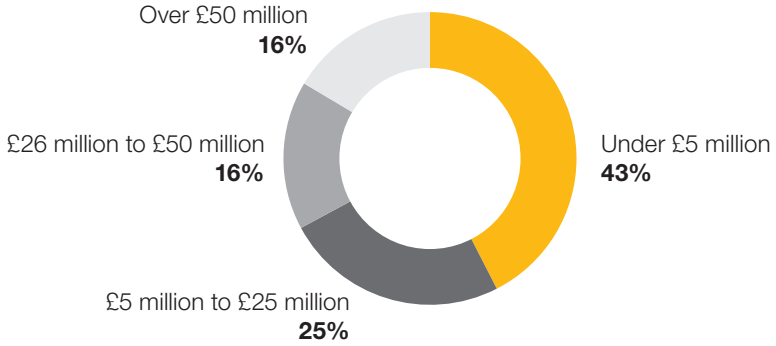
A snapshot of the participants

The majority of participants (41%) work in commercial property development. 32% work in residential development, while the remaining respondents are working in intermediary organisations such as brokers or other organisations such a banks and lawyers.

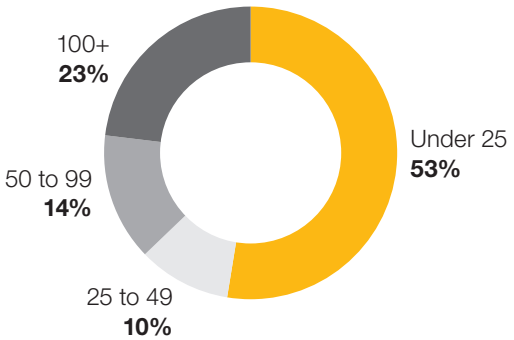
Of our respondents, the value of their property assets was varied, ranging from under £5 million and some respondents having assets valued over £50 million.

Which description best fits your company activity?

What is the value of your property assets?



How many people do you currently employ?



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