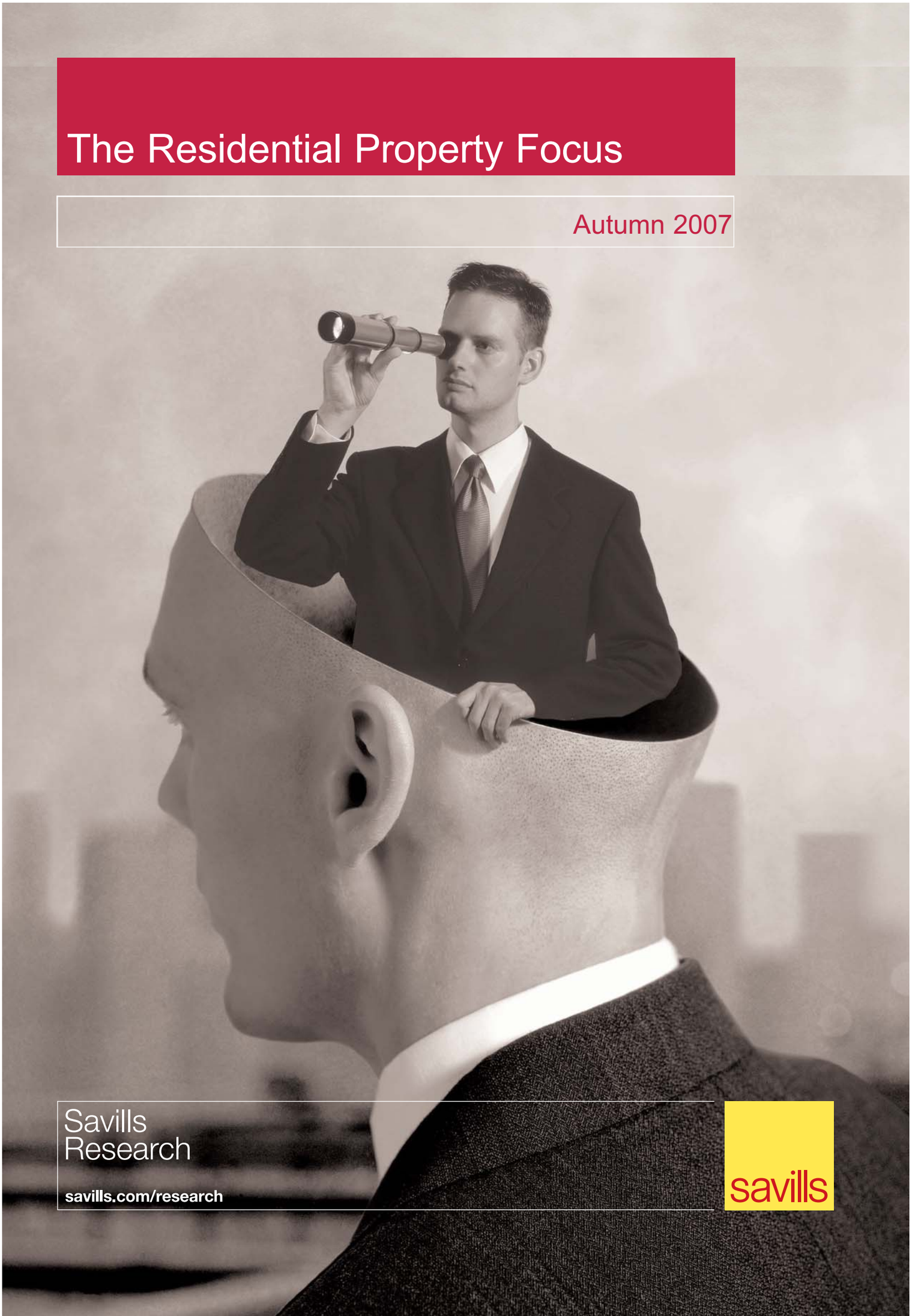
The Residential Property Focus

Autumn 2007



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This Publication

This document was published on 26th October 2007. It contains a review of all the key housing market indicators and news to the end of the third quarter 2007. The data used in the charts and tables is the latest available at the time of publication. Sources are set out for all the charts. We have used a standard set of notes and abbreviations throughout the document. The most commonly used are:

– Q307 refers to the third quarter of 2007
– H107 refers to the first half of 2007
– LHS and RHS refer to which data series in a chart is on the left hand scale (LHS) and right hand scale (RHS)

Important note

Contact and further information

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The Residential Property Focus

We expect a period of low house price growth and turnover to continue in 2008 and forecast national house price inflation of 3.0% next year

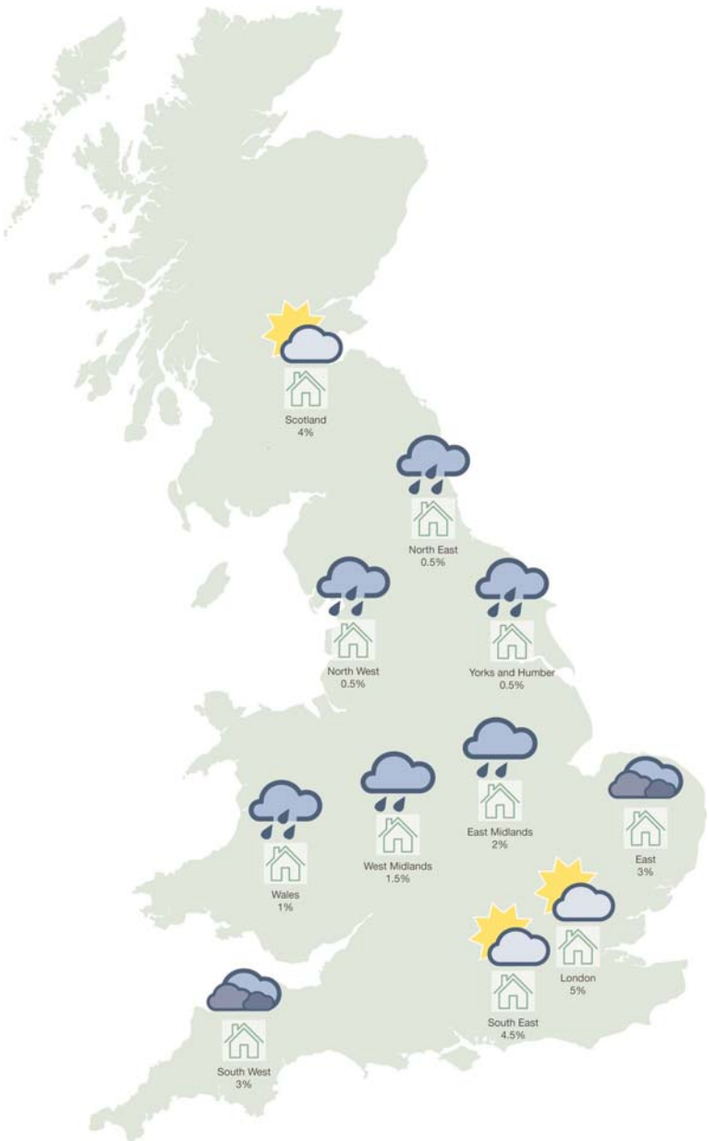
Welcome to the first edition of the new look Residential Property Focus, which has been developed to provide you with a single authoritative reference for informed commentary and opinion on the UK housing market.

A significant part of this issue has been devoted to our forecasts for house price growth next year, but also included are brief summaries of some recently published reports, including the challenge of meeting the Government's housing supply targets and the impact of good schools on local house prices.

This publication comes at a time when house price growth is slowing and house price falls are evident in some areas, but it is important during a time of change to avoid generalisations - there are significant regional variations.

Affordability is the watchword of the moment, but it is only one of several factors affecting the market. For example, accessibility to mortgage finance, particularly in light of the recent credit squeeze, is going to have a significant impact on the market in the future.

Although the outlook is closer to overcast than limitless sunshine it is by no means a severe weather warning. A reduction in bank base rates is now a realistic prospect, which, combined with a period of low house price growth in 2008, presents an opportunity for households to rebuild their monthly finances. Meanwhile we expect most to adopt a "wait and see" approach, similar to that of 2005. This will lead to lower transaction levels and a greater parity between supply and demand.



	Q3 2007	Year to date	Year End Forecast	2008 Forecast
UK Mainstream	1.6%	5.9%	7.0%	3.0%
Prime Central London	3.2%	18.0%	15.0%	5.0%
Prime Country Houses	1.4%	7.3%	7.5%	4.5%

Source: Savills Research and Nationwide

Taking Stock

Mainstream Market

You would be hard pressed to have missed recent media coverage reporting on the slowdown in the UK housing market. Monthly house price indices, new mortgage application rates and repossession figures have all been given a considerable airing with almost daily variety to the degree of positive or negative spin.

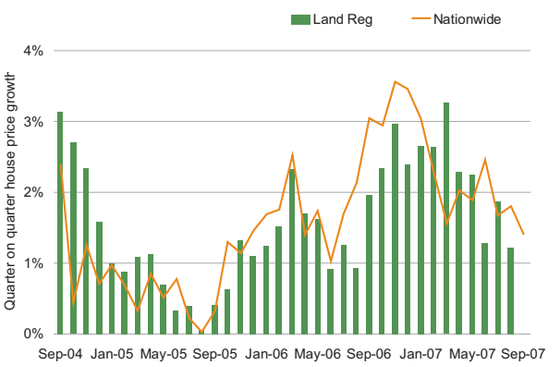
Are we about to witness a downturn similar to that seen in the US? Will the buy to let market grind to a halt? Does a slowdown become a slump?

"There is a chill in the air, house price growth rates have slowed and buyers and sellers are showing signs of caution"

The IMF has suggested that our property market is overvalued by 40% but this takes no account of supply shortages, or the use of equity in house purchases. Yes, there is a chill in the air, house price growth rates have slowed and both buyers and sellers are adopting a more cautious stance but, without a full economic recession, it is almost impossible to forecast a crash. Depending upon which house price index you choose to follow, annual house price growth across the UK currently stands at just below or just above 10%, but annual growth masks short term blips. Any short-term trends that occur tend to be disguised by the 12 month averages.

By looking at shorter time frames, the actual picture is much clearer. The graph below shows how quarterly growth has been declining since the beginning of 2007 on the back of five successive interest rate rises biting into household incomes.

National house price growth (q/q)



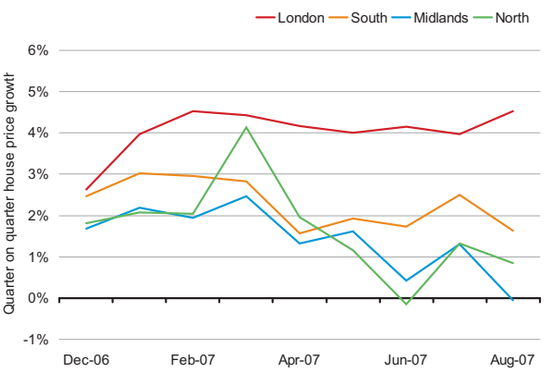
Source: Nationwide, Land Registry

Quarterly analysis of performance across the regions in England shows some marked variations – a north/south divide in house prices seems to be developing. London, and the regions closest to it, show both the highest rates of growth and the smallest reductions when the market slows.

"The Midlands and the North appear to have been the first regions affected by a change in market sentiment"

Regions which were the last to benefit from the upturn in the housing market cycle, namely the Midlands and the North, appear to have been the first to be affected by a change in market sentiment. The possible exception to this is in the North West. In Wales, according to Land Registry data, house price falls were recorded even before the August lull.

Regional house price growth (q/q)



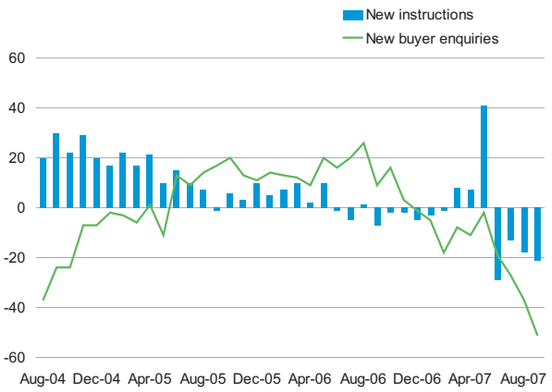
Source: Land Registry

The RICS data on surveyors expectations of the market for the next few months also reflects strong regional differences. A degree of growth is anticipated across the London market with a reasonably neutral outlook for the southern markets whilst, in the Midlands and the North East, opinions are much more negative.

Taking Stock

Mainstream (continued)

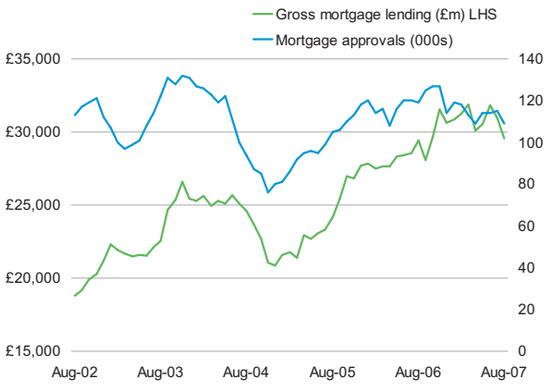
New buyer enquiries and instructions



Source: RICS

The data also suggests that market caution has affected enquiry levels and the number of new instructions, with buyers and sellers alike adopting a "wait and see" approach. This has already filtered through into transaction volumes. A key indicator is the volume of mortgage approvals per month – in August this year 109,000 were approved compared to 127,000 in November last year.

Gross Mortgage Lending and Approvals

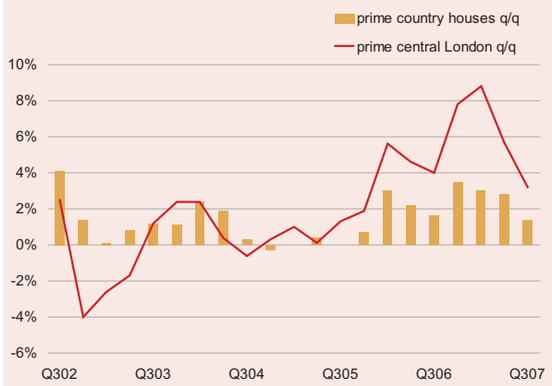


Source: Bank of England

Prime Markets

Growth in the prime property markets has slowed recently, both in central London and the regions with quarterly growth of 3.2% and 1.4% respectively. Annual house price growth figures mask the recent slowdown so still look healthy at 27% for central London and 11.1% for country houses.

Prime property growth in values (q/q)



Source: Savills Research

In prime markets the recent interest rate rises have had little influence. Instead, the catalyst for a change in sentiment has been the volatility in the financial markets and the fall-out from the credit squeeze. This had led to a revision in the expectations of City bonuses. The Centre for Economic and Business Research has stated that City bonuses could be cut by between 10 and 15% this year. Recent announcements of some job losses have also produced an air of caution amongst many potential purchasers.

These changes have had an effect on applicant-to-property numbers. These usually pick up in September, but have fallen this year leading to much less of a demand/supply imbalance compared to the same period in the past two years.

There is still a lack of the very best property to satisfy demand, particularly in London, where the market also benefits from strong overseas demand drawn to a benign tax system for non domiciles, the position of London as a global financial centre, being the best place from which to "work the world" and a stable political environment.

The longer-term prospects for prime central London seem safe whilst global capital still seeks London real estate as a home.

No Pain, No Gain

Economic Backdrop

To understand the rationale behind our forecasts and why we are predicting some growth next year, it is important to have an appreciation of the current economic drivers which will influence the future demand for housing.

Successive interest rate rises appear to have done little to temper consumer spending. The impact on disposable incomes has been significant, with little growth recorded during this year. Growth in total earnings stood at 3.5% per annum in July, well below the five year average of 4%, so housing affordability issues are beginning to emerge. This is likely to impact on short-term house price growth.

"The prospects are for over 2% GDP. This implies no job losses or fear of job losses"

These affordability issues are widely anticipated to be accompanied by a slowing of economic growth. Note: slowdown, not slump. The Treasury is suggesting a growth fall in UK Gross Domestic Product to between 2.2-2.3% by the end of next year, but the important point is that prospects remain above 2%. This implies no job losses or fear of job losses.

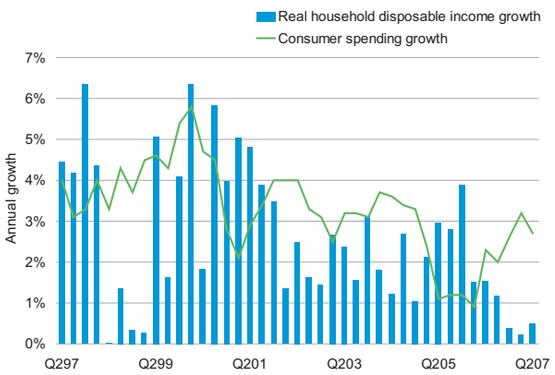
Recent reductions in the headline rate of inflation encouraged the Monetary and Policy Committee of the Bank of England to leave interest rates at 5.75% in October. It now seems more likely that the next move will be downward. Such a move will be welcomed by home owners on variable mortgage rates and those whose fixed rate deals are coming to an end.

That said, the 'credit squeeze' is likely to have two effects:

- A higher margin above base rates at which banks lend to home owners; and
- More restricted lending criteria.

This means that any decrease in base rates may not be fully translated into lower mortgage repayments and, for some buyers, the accessibility to mortgage finance may well be more restrictive, with levels of borrowing reduced. The days of 100% mortgages are almost certainly over.

Real incomes and consumer spending



Source: ONS

Lessons from the US?

Our forecasts are also set against the context of house price falls in some other countries, most notably the US where, according to the Case Shiller Index, prices have fallen by just over 3% in the year to June 2007. So why are we predicting house price growth in the UK next year and what separates the UK from the US?

The exposure of the US market to sub prime lending is well documented. A more extensive, less regulated market has been characterised by more relaxed lending criteria in terms of loan to value ratios, the high proportion of interest only loans and the greater use of discounted rates.

Also, base rate increases have been much more dramatic in the US than the UK. Indications are that affordability in the US is more constrained particularly for first time buyers for whom mortgage payments account for 34.5% of income, compared to 21.5% in the UK.

There are some clear parallels in both markets, the most obvious being regional variations. In the US, the greatest price falls have been in Florida, California, Nevada and Arizona. All these locations have moved from strong house price inflation to significant deflation relatively quickly. Much smaller price falls were recorded in New York and Chicago, where the markets are more stable and supply less elastic. Likewise in the UK, the last regional markets to show significant increases in value, and where supply is less constrained have been the first to weaken.

No Pain, No Gain

Our Forecasts

Turnover will be the first casualty of UK market change. In 2005, UK house price growth was just over 4% and turnover of stock was approximately 15% lower than the five year average. We expect house price growth in 2008 to be similar to that witnessed in 2005 and we also expect market activity next year to reflect the experience of that year.

Although repossession statistics show steady increases since 2004, they remain low in the context of total transaction numbers. They only constitute about 2% of stock turnover and so are insufficient at this level to alter the balance of demand and supply. Repossessions endanger markets where they are concentrated geographically or in particular sectors. There is no sign of this at present.

	YTD	2007	2008	5 year (end 07 - 2012)		YTD	2007	2008	5 year (end 07 - 2012)
UK	5.9%	7.0%	3.0%	4.9%	West Midlands	2.4%	3.0%	1.5%	4.2%
London	11.7%	12.5%	5.0%	6.7%	Yorks and Humber	3.1%	3.5%	0.5%	3.5%
South East	7.2%	8.0%	4.5%	6.1%	North West	2.1%	2.5%	0.5%	3.2%
East	4.5%	5.0%	3.0%	5.1%	North East	2.5%	2.5%	0.5%	2.4%
South West	6.7%	7.0%	3.0%	4.4%	Wales	2.7%	3.0%	1.0%	3.3%
East Midlands	2.6%	3.0%	2.0%	4.2%	Scotland	8.3%	8.5%	4.0%	4.4%
Prime Property									
Central London	18.0%	15.0%	5.0%	7.4%	Country Houses	7.3%	7.5%	4.5%	6.2%

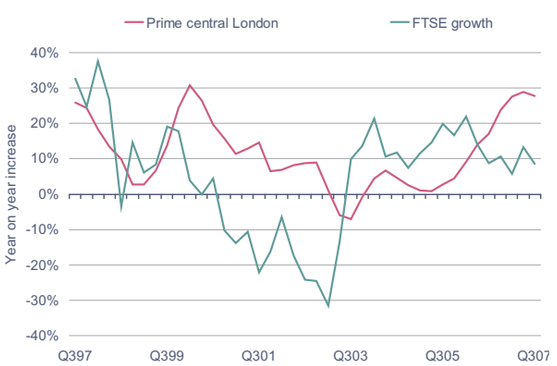
Source: Savills and Nationwide

Prime Forecasts

We know that shocks to global business confidence tend to result in short term blips in the strength of the prime central London residential market. The current situation is akin to that of 1998 when the Russian debt crisis weakened demand and resulted in small price falls for six months. After 9/11, values in the prime central London market fell by 4% in one quarter before rising again during the next nine months.

In 2008, we expect the froth to come off the prime markets with better parity between demand and supply. The prime markets will nevertheless continue to outperform the mainstream market, particularly in London at the very top end, where overseas buyers will continue to invest.

Prime central London versus FTSE



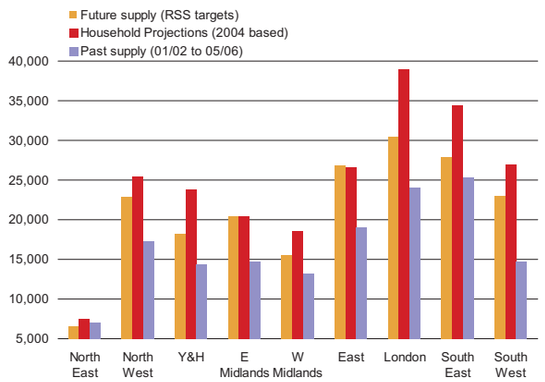
Source: Savills Research

In Brief

Housing Supply

The significantly increased levels of new housing supply proposed by the Government in the Summer will not eradicate housing scarcity, according to our research.

Housing scarcity is greatest in London and South



Source: Savills using DCLG and various planning authority data

This is particularly the case in London and the South East where household growth projections continue to exceed new build targets.

To meet the target of building another 240,000 new homes each year by 2016 (including a higher number of affordable units), a different spatial approach is required. This should include a more-even distribution of new supply, wherever possible in or on the edge of established markets.

This presents a huge challenge for developers who will be required to build greater numbers of lower-value units into markets where the capability to absorb high levels of new supply is untested. Affordability pressures may ease, but at a relatively localised level and, probably, only in certain price bands.

The prospects for a shortfall on Government targets are high, even before land supply issues are factored into the equation. Meeting new housing targets will rely heavily on the availability of more local and public sector land, but the fact remains that housing scarcity will continue in some markets with others having much higher volumes of lower priced housing.

Visit: savills.com/research for the full report

Buy to let - An Essential Investment

The Government would like to see more large-scale landlords operating in the UK, because they bring high standards of professionalism and service to the sector. To encourage this it is important that the imbalance between large and small scale landlords is addressed.

Like most other sectors, the buy to let market is influenced by the tax regime within which it operates. Currently small investors typically pay lower stamp duty (1% compared to 4%) and can avoid many of the costs associated with professional asset management such as paying VAT on repairs and maintenance.

“To penalise investors in property to “level the playing field” with investors in financial assets is neither logical nor sensible”

A recent call for the abolition of mortgage interest tax relief for buy to let landlords to level the playing field between investors in property and investors in financial assets is neither logical nor sensible. We believe that direct property investors have a different appetite for gearing, income and capital growth and there are clearly different investment characteristics between the two asset classes.

The recent pre-budget statement identified potential changes to the capital gains tax regime which will also favour the small investor. For many, the flat rate of CGT will result in lower rates of tax. Lower effective tax rates will no longer be reliant on long-term ownership, so residential property may become a shorter term investment proposition. This is contra to the Government agenda.

A recent report that we published on behalf of the South East of England Regional Assembly (SEERA) concluded that the buy to let sector has:

- generated sufficient demand for housing development projects, including regeneration, to make them viable;
- boosted the house building industry over the past 10 years by forward-funding developments;
- increased the competition between landlords thereby improving the quality and standard of accommodation in the rented sector;
- increased the supply of rental property which has restrained rental growth and made renting an affordable tenure option, and
- decreased the need to buy amongst immature house holds unsuited to owner-occupation.

In Brief

Schools - the Premier League

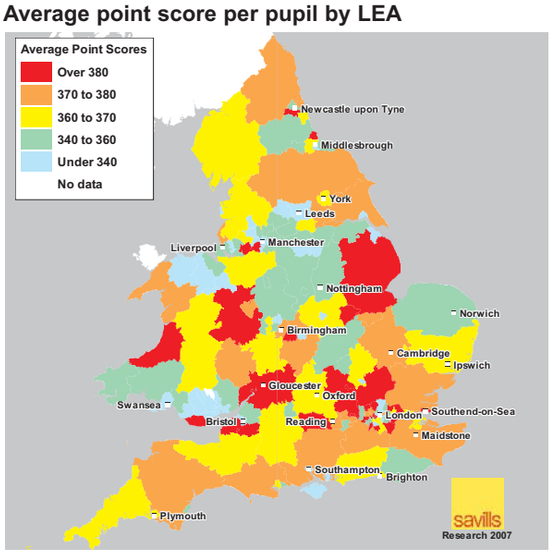
House prices in areas around the best performing state schools are on average, 13% higher than the average house price for the county in which they are located. We looked at house prices in the vicinity of 8 in every 10 secondary schools in England. Our research shows that there are premiums of over 20% in about one third of cases. The greatest premiums were identified in the northern parts of the country

Buyers are prepared to stretch their finances to buy in areas supported by a top performing school. Consequently house price to household income ratios are generally higher in these areas.

The quality of a state school will effect house prices only within the area of that school's catchment. Independent schools, on the other hand, impact on house prices over a wider area. Usually this is related to the length of an acceptable school run.

Prohibitive house prices in those areas of London benefiting from the highest educational standards act as a catalyst for some families to relocate to other areas. High premiums are therefore also found in locations within a reasonable commute of the Capital, which provide access to good schools.

Average point score per pupil by LEA



Development land

A land value slowdown has occurred on the back of developer nerves. These have been set on edge by tax proposals, rising interest rates and a much less vibrant new build housing market in key cities, all of which threaten to put pressure on margins. On top of this, the recent credit squeeze has exacerbated developers' concerns. Growth in development land values has been below that witnessed in the housing market over the past year even though the land market is dominated by an, in some cases extreme, scarcity of supply.

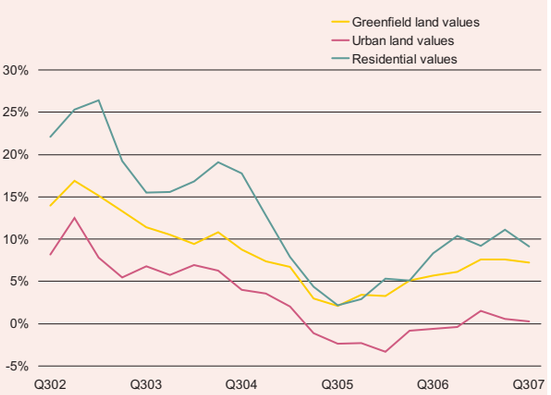
Marginal growth of only 0.8% was reported for greenfield development values in the third quarter of 2007. This is under half that reported in the previous three months.

Urban/brownfield values continue to have a bumpy ride. Over the past quarter, values fell by -0.21%. Not only is this in line with the second quarter, but the negativity is spreading with more areas showing falls in Q3. Some urban areas, where demand for city centre flats is strong and supply of sites is limited, will continue to buck the trend.

We stand by our forecasts of 8% growth in greenfield values and 1% for urban land (excluding London). But for next year we expect lower levels of growth. Urban values outside London will probably fall and we are pencilling in minus 1%. Greenfield land values are likely to grow as they are underpinned by a lack of supply and we are currently forecasting 6% for 2008.

On a more positive note, the setting aside of Planning Gain Supplement in favour of a local planning charge should lift house builder confidence and will help to maintain value growth in the medium term. The local planning charge, which will operate alongside site specific S106s, will be used to finance infrastructure proposed in the development plan for an area.

Year on year movement



Source: Savills Research; Nationwide

Focus on.....

The Thames Gateway

The Thames Gateway presents a unique opportunity to ease the housing shortages in London and the South East and regenerate large areas of derelict land, but the area is already falling short of targets.

The latest of these is for an additional 160,000 new homes between 2001 and 2016. Between 2001 and 2006 only 24% of this housing requirement had been built. This leaves three quarters of the target to be built in the next decade alone. Of this future supply, 75% will be located in London.

The biggest question is whether developers will be able to increase rates of delivery to meet Government targets against a backdrop of:

- intensifying planning negotiations;
- higher construction costs;
- the well documented flood risk to the Gateway;
- the possibility that developments will not generate sufficient value; and
- the risk that supply will outstrip demand for housing in the area.

In combination these factors could threaten the overall viability of the Thames Gateway as a concept. This seems likely unless a realistic view is taken on land values.

Historically, house prices across the Thames Gateway have been lower than the surrounding regions. More recently, as investment has flowed into the area and transport improvements start to kick in, prices have risen quickly - albeit from a low base. Continued house price growth will be dependent on infrastructure, provision of a successful economy and an attractive sense of place. Only these will continue demand for housing in the area.

Key amongst infrastructure requirements will be efficient transport links. In this respect, the Channel Tunnel development will enable a 17 minute journey time between Ebbsfleet and St. Pancras. This bodes well in light of established links between commuter numbers and travel time, and house prices and commuter numbers.

Efficient links to London will need to be supplemented by efficient transport links to and between local centres of employment. These local centres are likely to be heavily reliant upon the continued development of the service sector in the area. The biggest source of employment growth is likely to come from financial and business services, which will be accommodated in the 23m sq ft of office space expected to be developed in the area during the next decade.

Meeting the challenge will also be dependent upon developing a variety and mix of housing to avoid over supply of individual markets. This may see the development of housing types and configurations as yet unseen with a level of building adaptability currently unfamiliar in the UK.

The successful construction of a significant number of high-density flats will be heavily reliant on investor purchasers. Building more larger and family houses would provide developer protection against investor demand waning, particularly in markets furthest from central London. The correct provision and mix of high quality and affordably priced housing is essential to the future of the Gateway; differentiation of product is a key success factor for developers.

Housing Research and Consultancy

Savills Research team is headquartered in London and provides advice and analysis to clients on the rural, residential, commercial and leisure property sectors in the UK and Europe. Savills also provide similar property research services throughout South East Asia and Australia. In the UK, Savills has had a dedicated residential research team for the past 18 years. Over this time, the department has built up a strong reputation for producing accurate, well informed and, above all else, independent analysis and commentary on the UK's housing market. As a result, the team are a leading national commentator on market trends.

The success of the department has been built on a strong market insight, provided by the Savills network, in conjunction with a significant external consultancy business. This market-led approach to our research is vital to our clients. It enables us to provide you with analysis, commentary and forecasting that adds value to both your assets and your businesses. The department has been involved in a wide range of consultancy projects for a variety of public and private sector organisations across the UK. This has involved research into housing of all tenures and across all price ranges and rental levels.

Typical consultancy projects include:

- local area supply and demand analysis
- development feasibility studies
- investment strategy and advice
- place making site studies
- forecasting rents and capital values
- research to inform policy making and best practice statements
- research for property finance and business planning purposes
- research to inform housing-led regeneration initiatives

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The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 180 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

A unique combination of sector knowledge and entrepreneurial flair give clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking organisation backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal. Savills takes a long-term view to real estate and works hard to invest in long term and strategic relationships and is synonymous with a high quality service offering and a premium brand

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