Slow growth hits UK housing market

LONDON, UK: Analysis of projected investment returns to 2020 by PwC's chief economist shows that equities offer higher expected returns than bricks and mortar over the coming decade, but also higher risks.

House prices have fallen by around 17% in real inflation-adjusted terms since their peak in 2007 and, according to a recent analysis by PricewaterhouseCoopers LLP (PwC), they may not regain their previous peak in real terms until 2020.

Nonetheless, this still implies 2% per annum real growth in house prices on average between 2010 and 2020. This reflects the fact that, although demand for housing (and credit availability) may not be as strong as in recent decades, housing supply is likely to remain constrained in the UK.

A 2% average real rise in house prices would nonetheless represent a lower rate of increase relative to historical average real UK house prices growth of around 4% per annum between 1984 and 2007 and around 3% per annum between 1984 and 2010.

PwC has now extended its recent analysis of house price prospects to other asset classes as summarised in the table below.

Illustrative estimates for projected risk and return for housing versus equities/gilts to 2020

Asset type	Median real return (%pa)	90% chance of being within this approximate range (%pa)
Housing (buy to let)	3%*	-1% to +7%
Equities	5%	-5% to +15%
Index-linked gilts (ILG)	1%	1%**
50:50 equity/ILG mix	3%	-2% to +8%

Includes 1% net rental after all costs borne by landlord including voids (with a range of 0-2%)* Assuming that these index-linked gilts are held to maturity and so are effectively risk-free. Source: Illustrative PwC estimates excluding the effects of leverage and tax.

Index-linked gilts currently offer a secure real return of around 1% per annum if held to maturity in 2020. Allowing for a modest net rental yield, housing bought on a buy-to-let basis may beat that with an expected total real return of around 3% per annum, but with considerable risk surrounding this central estimate. The PwC analysis suggests that the '90%

confidence interval' for housing returns over the period to 2020 ranges from around -1% to +7% per annum.

Equities might reasonably be expected to offer returns broadly in line with long-term historic average real returns, which (including reinvested dividends) were around 5.3% per annum on average for the UK over the period since 1900 according to the *2010 Credit Suisse Global Investment Returns Sourcebook* by Dimson, Marsh and Staunton. Global average real equity returns were similar at 5.4% per annum on average over this period.

At present, equity market yields in the UK are around 3.3%, so a 5.3% real return would be consistent with real dividend growth of around 2% per annum, which is close to official Office for Budget Responsibility estimates of plausible trend growth in the UK economy over the next decade. Rounding down for caution, the PwC analysis projects an expected real equity return in 2010-20 of around 5% per annum. But the historic data also shows that equities are significantly riskier than housing, with an estimated 90% confidence interval of around -5% to +15% according to PwC estimates.

The analysis also considers, for the sake of illustration, a 50:50 mix of index-linked gilts and equities. This gives an expected real return in 2010-20 of around 3% per annum with a 90% confidence interval of around -2% to +8%, both of which are very similar to housing.

John Hawksworth, PwC's chief economist, commented: "There remains significant uncertainty in the UK housing market and it seems probable that it is set for a protracted period of relatively slow growth by historic standards. Housing is certainly a significantly riskier asset than index-linked gilts, although not as risky as equities.

"Our analysis suggests that, as an investment, housing is similar in terms of both risk and expected return over the next decade to a 50:50 mix of equities and index-linked gilts."

Notes

1. The analysis extends to other asset classes the assessment of house price prospects to 2020 contained in the July 2010 edition of PwC's UK Economic Outlook report.

2. The analysis does not take account of tax, which would depend on particular investor circumstances as well as the form in which investments were held, as well as the possible effects of leverage in increasing both risks and expected returns on all types of assets. It is also worth noting that transaction costs other than taxes are also not included in this analysis, but will generally be higher for housing than for financial assets.