Residential Quarterly | Spring 2022

Research - Market View

Economic Outlook

After years of the pandemic as the key driver of economic uncertainty, focus has now shifted away from COVID-19. England has avoided drastic restrictions for the last 10 months, helped by the successful vaccination rollout. The government recently released a long-term plan to remove the remaining legal restrictions while protecting the vulnerable population and maintaining resilience. The plan essentially suggests that full-scale lockdowns are highly unlikely, thus limiting any potential for further pandemic-induced economic restrictions.

In the last few months however, confidence in the post-pandemic recovery of the global economy has been negatively impacted by the ongoing geopolitical situation in Europe. The situation has caused great uncertainty amongst markets, businesses, and consumers. From an economic standpoint, the situation runs the risk of causing a "potentially huge global supply shock that will reduce growth and push up inflation."[1] This has materialised through a stringent set of economic sanctions that have placed additional constraints on the global supply of energy. This impact has been largely felt in the UK economy, where approximately two thirds (66%) of adults across the nation have reported an increase in their cost of living, most of which is directly attributable to rising energy prices.[2] This is in addition to the initial rise in UK energy prices, as a nationwide increase in the energy price cap came into effect in April 2022.

The heightened cost of living is reflected in the latest inflationary figures from the ONS, which show that CPI in March 2022 was 7.0%, up from 6.2% in February 2022 and five percentage points above the 2.0% target. This inflation rate is the highest rate since 1992 and has put pressure on households' disposable incomes. The latest OBR forecast in the Spring Statement (March 2022) forecast that inflation will peak at a rate of 8.7% by Q4 2022, double the forecasted peak in the October 2021 Autumn Statement. In response, the government has announced a temporary cut to fuel duty across the UK for 12 months, which is intended to help lessen the burden of the rising cost of living and has announced a package of support worth £9.1bn in 2022-23, equivalent to £200, or more, of support per household.

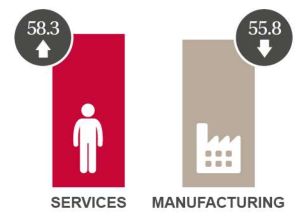
In response to surging inflation, the Bank of England increased the interest rate from 0.5% in February to 0.75% in March to 1% in May 2022. It is the fourth increase since rates were slashed at the start of the pandemic and the first time the bank has increased the rate at four successive meetings in almost two decades. Official forecasts expect further rises in rates over the next four or five years, but only to up to 2% in 2022. The rate increases are expected to be factored into new fixed-rate mortgage deals, whilst variable-rate mortgage holders have already seen their rates increase to reflect the increasing bank rate.

During 2021, the majority of losses experienced during 2020 across the FTSE 100 markets had recovered by the end of December 2021, ending 12% higher than the start of the year, and only 2% below levels at the start of 2020. Markets started this year (January 2022) 2% higher than they left off in December 2021. However, March 2022 saw a -7% negative shock (compared to the start of the year) as a result of the geopolitical situation, but markets have since recovered. In mid-April, the FTSE was 1% up on the start of the year. Nonetheless, uncertainty still remains across global markets because of the ongoing geopolitical situation.

Over 2020, the economy was estimated to have contracted by 10%; the largest yearly fall on record. 2021 saw GDP increase by 7.5%, recovering much of the 2020 losses. The latest HM Treasury forecasts (March 2022) report GDP growth of 4.1% over 2022; a significant downward revision from their January 2022 forecast of 7.1% as a result of the ongoing geopolitical situation. Similarly, the OBR's latest forecast (March 2022), projected 3.8% GDP growth for 2022; 2.2 percentage points lower than the OBR October 2021 forecast. For 2023, HM Treasury predicts growth of 1.6%, slightly lower than the OBR which projects growth at 1.8%. The slow recovery predicted for 2023 has been tied to the "cost-of-living squeeze, withdrawal of fiscal support, and tighter monetary policy."

7.0%

March 2022 inflation (CPI) was at 7.0%, up from February 2022 (6.2%)
Source: ONS (Mar 22)



PMI Services up from 53.3 & PMI Manufacturing down from 57.3
Source: IHS Markit/CIPS (Apr 22)

Real average weekly earnings (total pay, seasonally adjusted) rose to £598 in Feb 2022, compared to £567 in Feb 2021.
Source: ONS (Apr 22)

HM Treasury consensus forecasts (March 2022) predict an average unemployment rate of 4.1% for 2022, decreasing to 4.0% over 2023. These are on par with the OBR (March 2022) forecasts of 4.0% in 2022 and 4.2% in 2023. The furlough scheme has now ended and the anticipated spike in unemployment has not yet materialised. Recent estimates show that the UK unemployment rate actually decreased slightly by 0.2 percentage points between December 2021 and February 2022, now standing at 3.8%.

Concerning Brexit, Politico reported in January 2022 that there have been trade deals and agreements in principle with 70 countries and one with the EU. In December 2021, a deal was struck with Australia, and deals with New Zealand and Singapore were signed in February 2022. 2022 will include negotiations with India, Mexico and Canada. The Foreign Secretary has been appointed as the new Brexit minister and Northern Ireland is one of the focal points of current negotiations.

At the end of Q4 2021, the value of the Pound to the Euro was c.£1.18, 14.5% lower than the 2015 average and a slight increase from the previous quarter (£1.17). In Q1 2022, the value hit a high of £1.22 in mid-March, but since dropped back down to £1.18 at the end of the quarter.

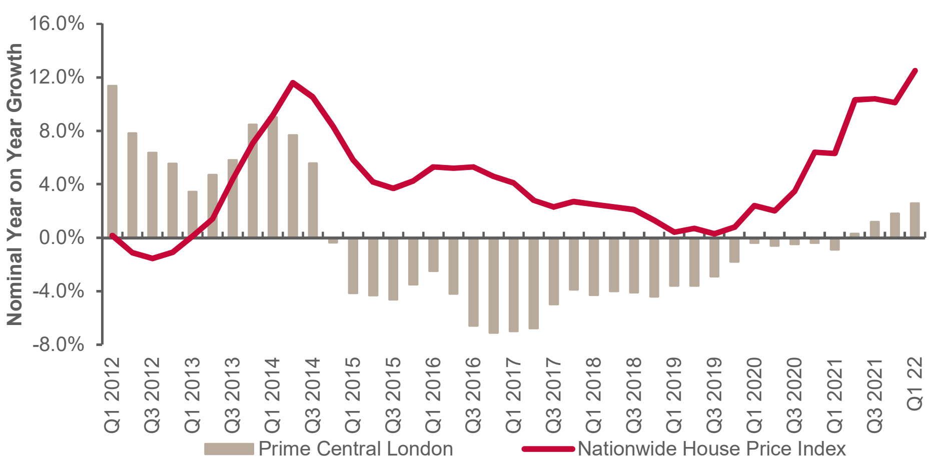
Overall, whilst interest rates are rising, future increases are only expected to be to about 1%-2%, which is still low and is not expected to have a big impact on the housing market. Of more concern is the high inflation which is squeezing disposable incomes and increasing the cost of living. This is exacerbated by the ongoing geopolitical situation, which is causing global economic uncertainty. The economic uncertainty may result in a global slowdown that, in turn, might translate into decreased demand in the housing market with house prices rising at a slower rate. The total realised impact of the current geopolitical tensions on the housing market will depend upon the length of the conflict, which is uncertain at this time.

Property market pricing

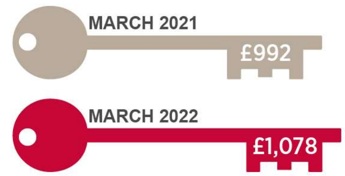
According to the Nationwide House Price Index (NWHPI), UK property prices grew by 12.5% in the year to Q1 2022, exceeding the growth in the year to Q3 2021 (10.4%) and Q4 2021 (10.1%). It is the highest YoY growth since the year to Q3 2014 (10.5%). YoY growth to Q1 2022 shows that, on a regional basis, the best performers were Wales (15.2%), South West (14.4%), and the East Midlands and Yorkshire & the Humber who equally recorded 13.4% growth. London saw the lowest YoY growth at 7.4%, making it the lowest performing region for the fifth consecutive quarter on a YoY basis. No regions saw negative YoY growth.

Figure 1

UK house price growth vs Prime Central London (PCL)



Source: *Nationwide House Price Index, Volterra*



UK Average Rent
£1,078pcm
Source: HomeLet (Mar 22)

UK property prices grew 12.5% YoY to Q1 2022
Source: Nationwide HPI

"Current market sentiment is mainly driven by a hangover of overwhelming pent up demand in 2021, with strong levels of transactions in the sales market during the first quarter of this year. There are headwinds on the horizon, but any impact on house prices has not yet been realised as post-pandemic behaviours continue to fuel a market dominated by a lack of stock."

Guy Robinson

Head of Residential Agency

National residential sales transactions

Housing market demand across the UK has continued to be strong with transactions and mortgage approvals remaining robust. The estate agents report that strength in the UK markets is expected to persist, with prices remaining strong particularly given extreme stock issues in the regions.

Figure 2

Number of recorded properties sold across the UK for 2016 through 2022

** Includes provisional Q1 2022 data*

***Source:** HMRC; Monthly property transactions completed in the UK with value of £40,000 or above as at April 2022.*

Regional residential sales & lettings

For UK sales activity continues to move at pace however, the estate agents continue to report a lack of housing stock, which is driving up prices. It is anticipated that new stock is expected to come onto the market in the latter half of the year, which may cool pricing.

For UK lettings, estate agents report that they have never known a shortage of stock this pertinent in the last 20 years. Almost every property is going over asking price. In the last few years, c. 300,000 private rented sector units have come out of the market, and the build to rent sector is not building fast enough to fill the gap. Builders have been focussed on city centre stock, but are now focussing on single family suburban units. Recent price gains are expected to continue, but continued double-digit growth is not anticipated.

Table 1.

Number of registered properties sold by regions for Q1 in 2019, 2020, 2021

Region	All Property Q1 2020	All Property Q1 2021	All Property Q1 2022
East Midlands	5,707	797	2,250
East of England	7,355	1,413	2,959
Greater London	7,213	1,341	2,915
North East	3,209	438	1,444
North West	8,757	1,071	3,805
Scotland	18,413	28,456	21,553
South East	10,555	2,297	4,429
South West	7,418	1,314	2,969
Wales	3,699	546	1,663
West Midlands	6,467	898	2,720
Yorkshire and Humber	6,602	883	2,778

***Source:** Dataloft, Land Registry 2020 data as at 7th April 2020, 2021 data as at 11th April 2021, 2022 data as at 11th April 2022; Land Registry data has a data lag which is why we compare equivalent registered data for the same reporting period. Registers of Scotland 2019, 2020 and 2021 data as at 2nd May 2022.*

"With a substantial withdrawal of PRS stock, at an estimated 300,000 units, there's been a rise in stiff competition from those who are seeking property across all parts of the UK and a subsequent hike in rents achieved. Meanwhile, sales prices are being buoyed by a lack of stock and continued activity across all regions of the UK."

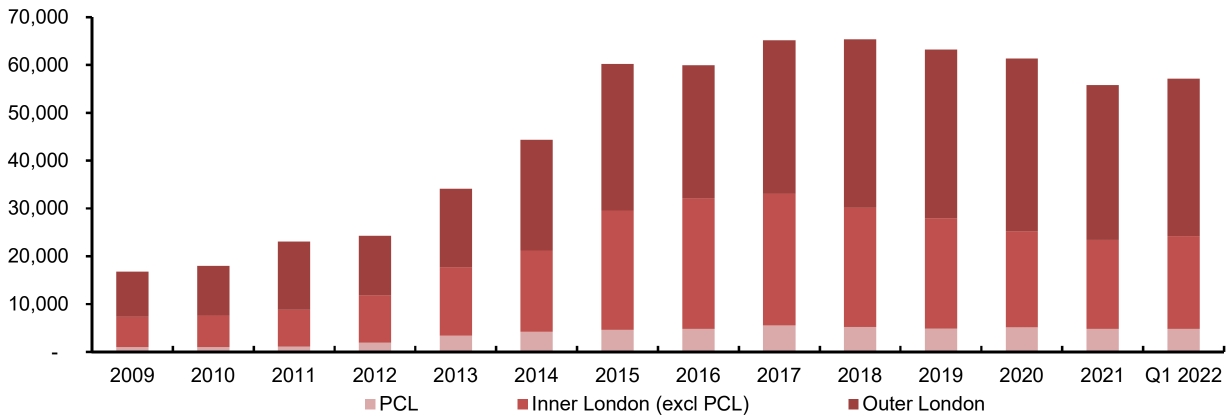
Kate Eales

Head of Regional Agency

Greater London residential new homes

Across Greater London, at the end of Q1 2022 there were just over 57,000 new build units under construction with just over 6,000 new build for sale units sold across London during the first quarter, according to Molior. These figures continue to highlight the significance of the build to rent (BTR) market as it again accounted for a significant portion of activity as confidence has returned in the lettings market.

Figure 3
Number of private sale units under construction in schemes of 20+ private units in Greater London



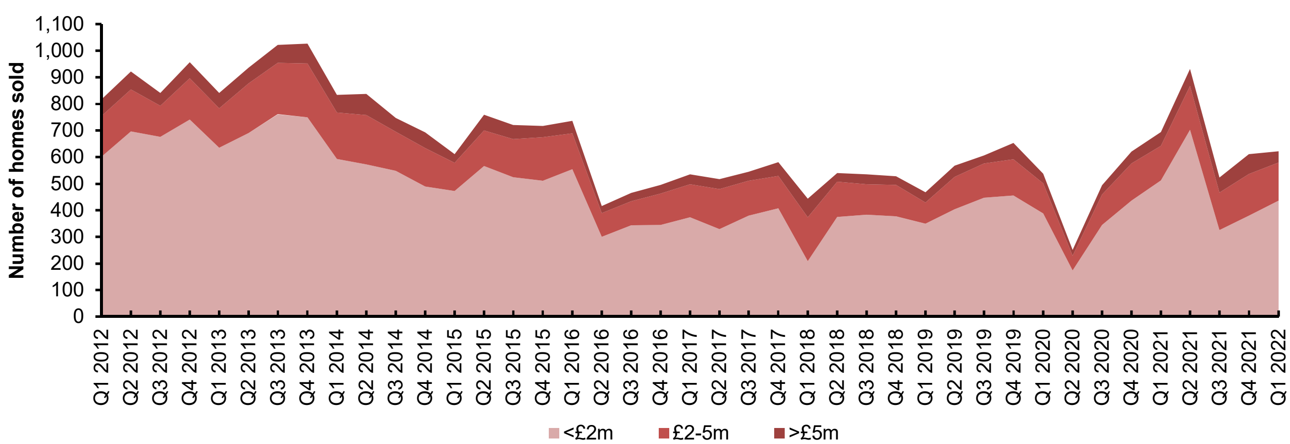
Source: *Molior, Strutt & Parker as at 5th May 2022; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster; Inner London defined as Local Authorities of Camden, City of London, Hackney, Islington, Lambeth, Southwark, Tower Hamlets, Wandsworth; Outer London defined as remaining 22 Greater London boroughs.*

Prime Central London residential sales market

PCL prices grew at 1.1% in the quarter to Q1 2022, compared to growth of 0.7% in the previous two quarters (Q3 2021 and Q4 2021). However, the 1.1% of QoQ growth in Q1 2022 is the first time growth has surpassed the 1.0% mark since Q1 2014 (when it was 2.1%).

Transactions for PCL in the quarter to Q1 2022 grew by 2%, compared to growth of 17% in the previous quarter (Q4 2021). Although substantially positive QoQ growth was recorded in the <£2m price band (15%), this was dampened by the £2m-£5m bracket (-9%) and >£5m bracket (-42%), resulting in the moderate rate of growth across all bands this quarter. Despite this, total PCL transactions in Q1 2022 are now 61% of the previous peak in Q4 2013 – an improvement on the last quarter (59%).

Figure 4
Historic number of homes sold in PCL



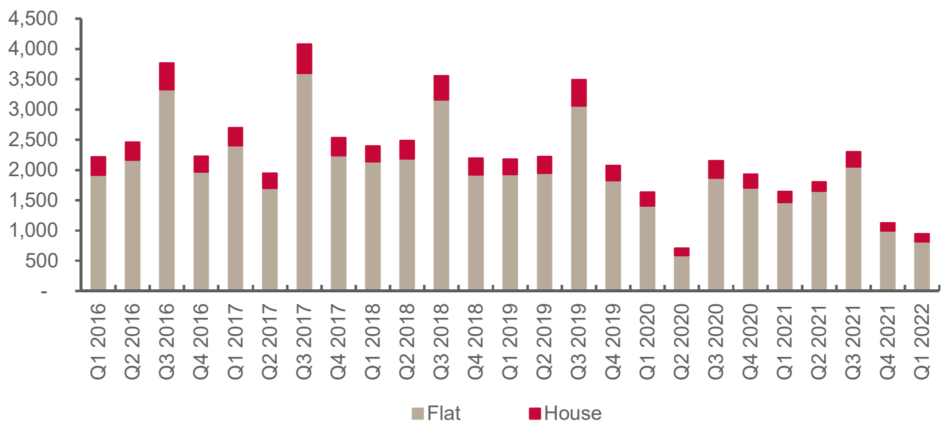
Source: *Dataloft, Lonres.com, Strutt & Parker as at 11th April 2022.*

Prime Central London lettings market

PCL lettings QoQ prices rose by 3.3% to Q1 2022, slightly higher than Q4 2021 at (2.7%), and was the fourth consecutive quarter of positive QoQ growth. YoY growth to Q1 2022 was 10.7%, almost double that of the rate recorded in Q4 2021 (5.7%). PCL lettings transactions declined in Q4 2021 on a QoQ basis (-51%) and somewhat continued into Q1 2022, as transactions fell by -16% (QoQ).

Figure 5

New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 11th April 2022.*

"The PCL rental market is facing an even more acute shortage than the sales market. This is a symptom of tenants renewing contracts in the wake of a lack of suitable sales stock, and a depleted level of property re-entering the lettings cycle. We have also seen a wave of would-be tenants returning to the city as pandemic restrictions have lifted, while some buyers are biding their time in the rental market to see how the current economic situation may affect the sales market, both adding further pressure. Bidding wars for the best rental homes are now common place, rather than a rarity."

Louis Harding

Head of London Residential Agency

Forecast

Over 2021, PCL sales prices ended at 1.8% growth YoY, within our forecast range of 0%-5%. PCL sales prices have since started this year (2022) on good footing, increasing by 2.6% YoY up to Q1 2022. A forecast of between 5% and 10% growth for 2022 is retained, with a five-year cumulative forecast for 2022-26 of 20%-35% expected. Whilst there is high demand and low supply, it is not a one-tier market and geopolitical uncertainty remains.

Over 2021, UK sales prices ended at 10.1% growth YoY, slightly outperforming our best-case forecast of 10%. The start of 2022 has continued this positive trend, as prices increased by 12.5% YoY to Q1 2022. A forecast of between 2% and 7% growth for 2022 is retained, with a five-year cumulative forecast for 2022-26 of 20%-30%. Whilst recent trends appear bullish, the rising cost of living is expected to impact a larger portion of the UK-wide market. Some pockets of the market may achieve the higher end of the range, but many may find themselves in the mid-to-low end of the range.

Considering PCL lettings, prices ended the year at 5.7% growth YoY, outperforming our best-case forecast of 5%. The previous quarter's commentary held a forecast of between 0% and 5% for 2022 and 15%-25% for 2022-26. However, the lettings market has exceeded expectations and the supply constraints are expected to continue to push prices higher in the short term. These forecasts are therefore upgraded to 5% and 10% for 2022. These increases are not expected to persist through the five year period, however, and so the five year forecast of 15%-25% has been retained.

Table 2. Residential House Price Forecast

	2022		5 Years to 2026 inclusive
	Downside Risk	Best Case	
Sales			
Prime Central London	5.0%	10.0%	20.0% to 35.0%
UK	2.0%	7.0%	20.0% to 30.0%
Lettings			
Prime Central London	5.0%	10.0%	15.0% to 25.0%

Source: *Volterra, Strutt & Parker*

Outlook

Despite the positivity experienced in 2021, there is still global economic uncertainty as a result of the ongoing geopolitical situation, and the cost of living is rising across the country, driven by inflationary pressures. There are supply issues across all markets and demand is expected to remain strong, putting pressure on prices. PCL sales transaction levels continue to recover going into Q1 2022, although the rate of recovery has slowed down due to several underperforming price-bands. The regional housing market has seen strong price growth, driven by large demand and low stock availability in the regions. The PCL lettings market has also experienced impressive price growth in recent periods despite a reduction in transactions levels.

Economic and market indicators underpin our house price forecasts. The 2022 economic outlook is optimistic but the indicators are currently subject to a significant level of uncertainty from external and internal pressures.

"While wider economic commentary has shifted away from the pandemic and into the 'new normal', there's an undeniable backdrop of geopolitical uncertainty in hand with rising costs of living and inflation. Despite exceptional growth over the past two years across the national market, the brakes may well be applied as households tighten their purse strings and tap into savings in the face of soaring household costs."

Vanessa Hale

Head of Residential Research

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[1] Fitch Ratings, 2022. Global Economic Outlook – March 2022
[2] ONS, 2022. Energy prices and their effect on households

Methodology
As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q1 2022 in light of changes since Q1 2021. Data may also be compared on a rolling month on month basis. When referring to the PCL market it includes those markets which Strutt & Parker operate in (Knightsbridge, Belgravia, Kensington, Chelsea, Notting Hill & Fulham) and as such is reflective of London's most prime markets. Economic views are attributed to Strutt & Parker's retained economic advisors, Volterra. Registers of Scotland does not have a data lag at end of quarter compared to Land Registry data and therefore transaction figures at end of quarter for Scotland may appear abnormally high in comparison. Additionally, Lonres.com data is used to assess the London sales and lettings market. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.