Residential Quarterly | Autumn 2022

Research - Market View

Economic Outlook

On 23rd September, Liz Truss released a ‘mini-budget’ which provided a package of tax cuts, including an increase in the nil-rate of Stamp Duty and expanded Stamp Duty relief for first-time buyers. This was done in an attempt to combat the cost of living crisis and likely economic downturn. The ‘fiscal event’ had a tumultuous effect on the economy, resulting in; a surge on 10-year government bond yields, a £65bn bond-buying intervention from the Bank of England, a -1.8% fall in the FTSE, and the crashing of Sterling against the US Dollar.

All of this led to a surge in interest rates and caused such uncertainty in the financial SWAP markets that high street banks withdrew hundreds of mortgage products as they faced uncertainty over the future of bank rates.

The market has since calmed somewhat, assisted by the changing of the Prime Minister, to Rishi Sunak, and the chancellor, to Jeremy Hunt; along with the reversal of the majority of the tax policies initially proposed in the mini-budget. The FTSE has recovered back to its position before the shock-related fall and Sterling has also recovered but continues to be extremely sensitive to political rhetoric as market uncertainty is still high.

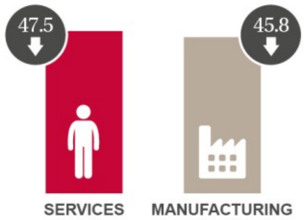
The political shock was on top of already existing inflationary pressures, weaker growth and tighter financing conditions. In general, this will make it harder for households and businesses to repay or refinance debt as well as being more vulnerable to economic shocks. The UK economy is feeling this, with 87% of adults in Great Britain reporting an increase in their cost of living in August 2022 (most recent data available). The heightened cost of living is reflected in the latest inflationary figures from the ONS, with the CPI rising by 10.1% in the 12 months to September 2022. In response, the government has announced a £37 billion support package, including a £400 energy grant for all households and payments of £650 to households on means-tested benefits.

Confidence in the post-pandemic recovery of the global economy continues to be negatively impacted by the ongoing geopolitical situation in Europe. The situation has caused great uncertainty amongst markets, businesses, and consumers. The latest Business Confidence Monitor shows business confidence index weakening to -5, the first time it has been negative since 2020. All sectors have experienced declines and firms are facing significant supply-side challenges. GfK’s Consumer Confidence Index set a new record low in September with an index score of -49, largely driven by a fall in confidence over the general economic situation over the last 12 months. A stringent set of economic sanctions as a result of the invasion of Ukraine has placed additional constraints on the global supply of energy and worsened global inflation. 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.

In response to surging inflation, the Bank of England increased the interest rate; as of 3rd November the rate was increased by 0.75 percentage points to 3% – the largest increase since 1989. It is the eighth increase since rates were slashed at the start of the pandemic. Official forecasts expect further rises in rates over the next four or five years, as the Bank of England has vowed to start getting prices down and making life more affordable again. 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. Forbes report that average interest rates for two and five-year fixed rate mortgages in early October 2022 topped 6% for the first time in over a decade.

10.1%

Sept-22 inflation (CPI) was at 10.1%, up from Aug-22, when it was 9.9%.
Source: ONS (Sep-22)



PMI Services fell from 50.9 as did Manufacturing, down from 47.3 Source: IHS Markit/CIPS (Aug-22 to Oct-22)

Real average weekly earnings (total pay, seasonally adjusted) rose to £617 in Aug-22, compared to £582 in Aug-21.
Source: ONS (Sep-22)

Many macro variables are pointing to a slowing economy: GDP growth is slowing (QoQ growth was 0.7% in Q1 2022 and is 0.2% in Q2 2022, provisional figures show a drop in August of -0.3%), the FTSE ended Q3 2022 8% below the start of the year and the Euro exchange rate has been in slow decline since Q1 2022 (from 1.20 to 1.18). However, unemployment stands at an almost 50-year low at 3.5%. There are an estimated 627,000 more people in payroll employment compared to pre-pandemic levels. That being said, it is said that at least 3.7 million people are in insecure jobs, up from 3.6 million in 2021.

UK Average Rent
£1,113pcm
Source: HomeLet (Oct-22)

Concerning Brexit, the UK has signed two trade agreements with Australia and New Zealand along with digital trade agreement with Singapore. Furthermore, there are negotiations in progress for the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which is a free trade agreement between 11 countries around the Pacific Rim as well as ongoing negotiations with the US.

The latest HM Treasury forecasts expect GDP growth of 3.6% over 2022; a significant downward revision from their January 2022 forecast of 7.1%. For 2023, HM Treasury predicts growth of 0.1%, again significantly down from their January 2022 forecast. The downward revisions reflect the ongoing geopolitical situation. The latest available forecast from the OBR at the time of writing was from March 2022 as the October forecast is not yet available. We would expect there to be a considerable downward revision to the OBR October forecast to be more on par with HM Treasury. The slow recovery predicted for 2023 has been tied to the "*cost-of-living squeeze, withdrawal of fiscal support, and tighter monetary policy*."

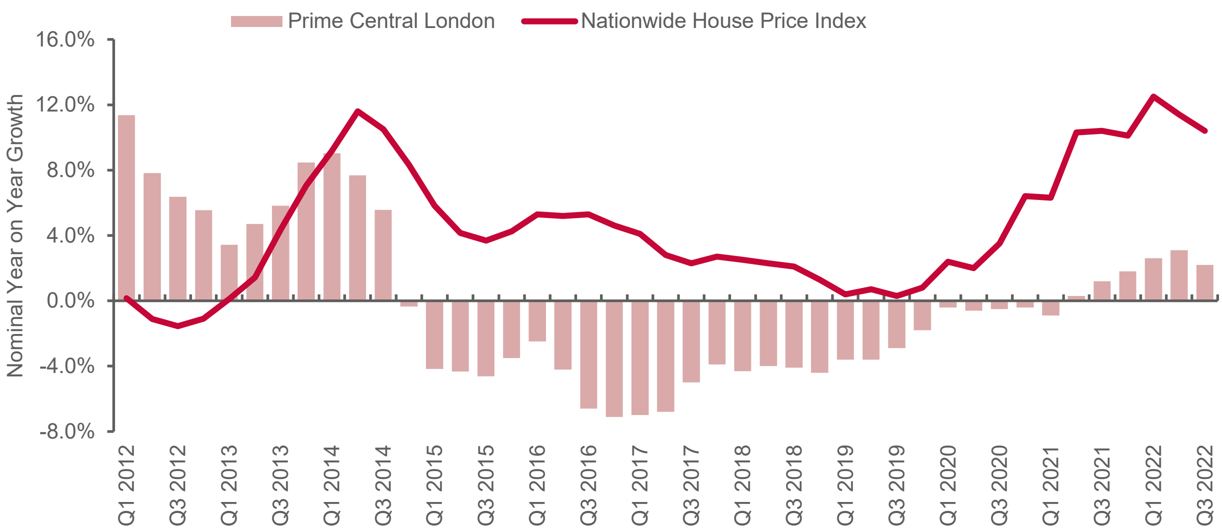
OBR March 2022 unemployment forecasts are reasonably on par with HM Treasury; 4.0% in 2022 and a slight increase to 4.2%-4.3% in 2023. Similarly, for inflation, both forecasts expect high peaks this year, decreasing to 4%-4.5% in 2023 which is still above the target 2%. The inflation forecasts for this year have increased as the cost of living crisis has progressed. HM Treasury forecasts for the Bank rate this year are clearly lower than the current bank rate. They forecast an increase in the bank rate in 2023.

UK property prices grew 10.4% YoY to Q3 2022
Source: Nationwide HPI

Property market pricing

Nationwide House Price Index (NWHPI), reports that UK property prices grew by 10.4% in the year to Q3 2022. QoQ growth was 1.3% - the fourteenth consecutive quarter of positive QoQ growth. On a regional basis, the best YoY performers were the South West (12.5%) and the East Midlands (12.4%). Greater London saw the lowest YoY growth at 6.7%, making it the lowest performing region for the seventh consecutive quarter. No regions saw negative YoY growth. On a quarterly basis, Greater London experienced the smallest QoQ growth to Q3 2022 at 0.1% and at the national level price growth in the UK was 1.3%.

Figure 1
UK house price growth vs Prime Central London (PCL)



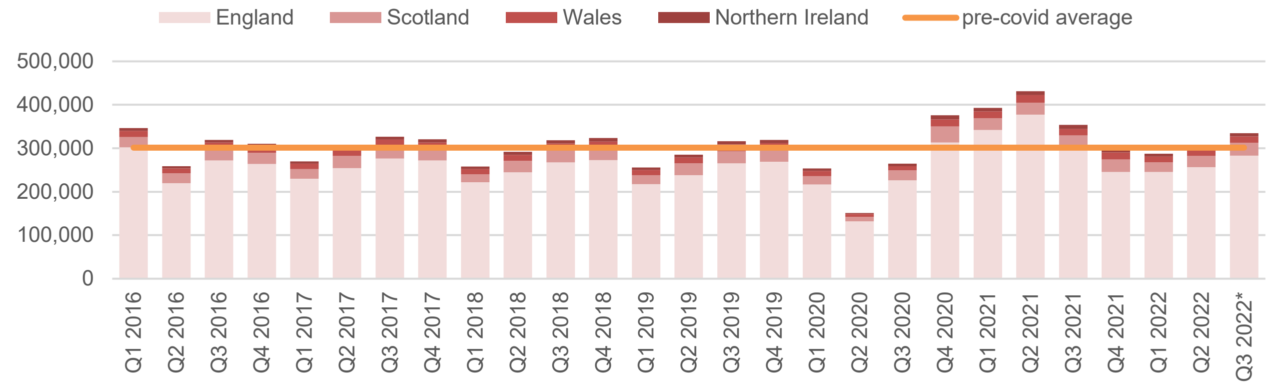
Source: *Nationwide House Price Index, Volterra*

National residential sales transactions

Housing market demand across the UK was strong in Q3 pushing transaction level above their pre-covid average. However with the uncertainty caused by the 'mini-budget', inflation and interest rate rises these transaction levels are unlikely to continue. Some buyers will enter the market looking for opportunities as well as those trying to buy on already secured rates.

Figure 2

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



** Includes provisional Q3 2022 data*

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

Regional residential sales & lettings

For UK sales, house prices saw an immediate knee-jerk reaction to the economic shocks. There are some people who still need to transact, but the regional market does not have a large pool of cash buyers or international purchasers to take advantage of a currency play. It is difficult at the moment, particularly for markets below the £1m mark – where affordability is more of an issue.

However, the fact remains that supply is still not sufficient for demand for both sales and letting stock. People will still want to move – either as post-Covid change in lifestyle or because costs are now too high – but this may simply mean that people transact on less expensive houses. People who can, will hold on to properties as they anticipate the shocks to be short term not long. Renters will look to hold onto their homes which will continue to dampen supply. Accidental landlords help to add supply but this is unlikely to match the inflated demand.

Table 1.

Number of registered properties sold by regions for Q3 in 2020, 2021, 2022

Region	All Property Q3 2020	All Property Q3 2021	All Property Q3 2022
East Midlands	17,361	22,048	4,414
East of England	21,741	25,914	5,982
Greater London	21,814	20,932	5,847
North East	9,916	12,652	2,591
North West	26,938	33,628	6,730
South East	32,558	37,338	8,916
South West	21,454	26,191	5,766
Wales	8,413	11,747	2,977
West Midlands	18,231	23,148	4,835
Yorkshire and Humber	19,768	24,643	4,986
Scotland**	20,607	31,663	28,271

***Source:** Dataloft, Land Registry 2020 data as at 15th Oct-20, 2021 data as at 7th Oct-21, 2022 data as at 7th Oct-22; Land Registry data has a lag which is why we compare equivalent registered data for the same reporting period. Registers of Scotland 2020, 2021 and 2022 data as of 1st November 2022.*

***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 appear high in comparison*

"Looking ahead to 2023, those looking to sell can take some reassurance from three key factors. First, while values are likely to soften, this adjustment is coming off the back of solid quarterly growth for over nearly three years. Secondly, regardless of economic headwinds, there will always be buyers who need to move, and they will be looking to transact in the coming 12-months. Lastly, we remain in a very supply constrained market, where even if buyer demand falls, it will still outweigh the number of available homes."

Kate Eales

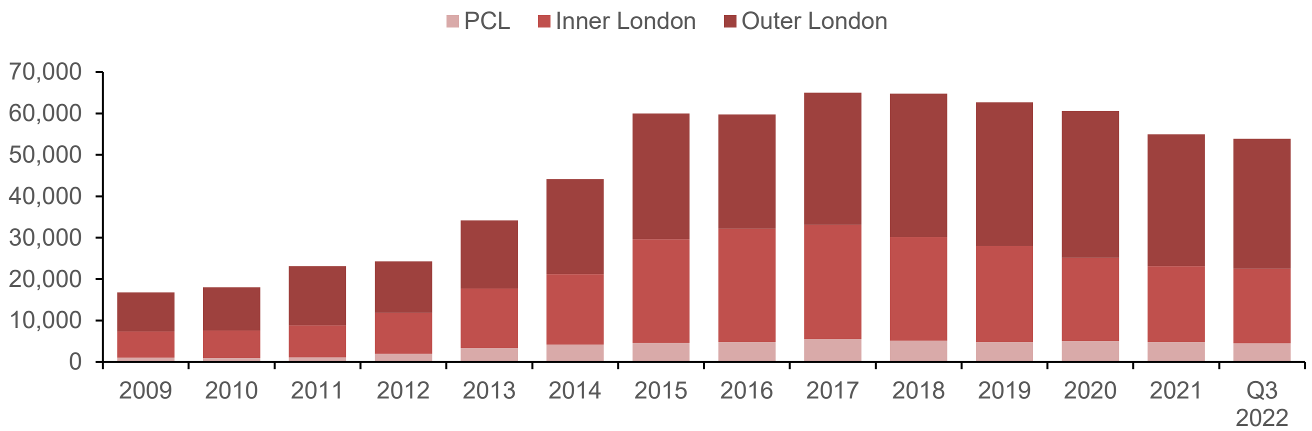
Head of Regional Agency

Greater London residential new homes

Across Greater London, at the end of Q3 2022, there were over 53,800 new build units under construction with 16,000 new build for sale units sold according to Molior. Interestingly, per borough, there are more units under construction in Inner London than Outer London. Approximately 14,300 of the units under construction in London are BTR showing the strength of confidence in the lettings market and how BTR is trying to fill the void left by private landlords exiting the market.

Figure 3

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



Source: *Molior, Strutt & Parker as of 25th October 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.*

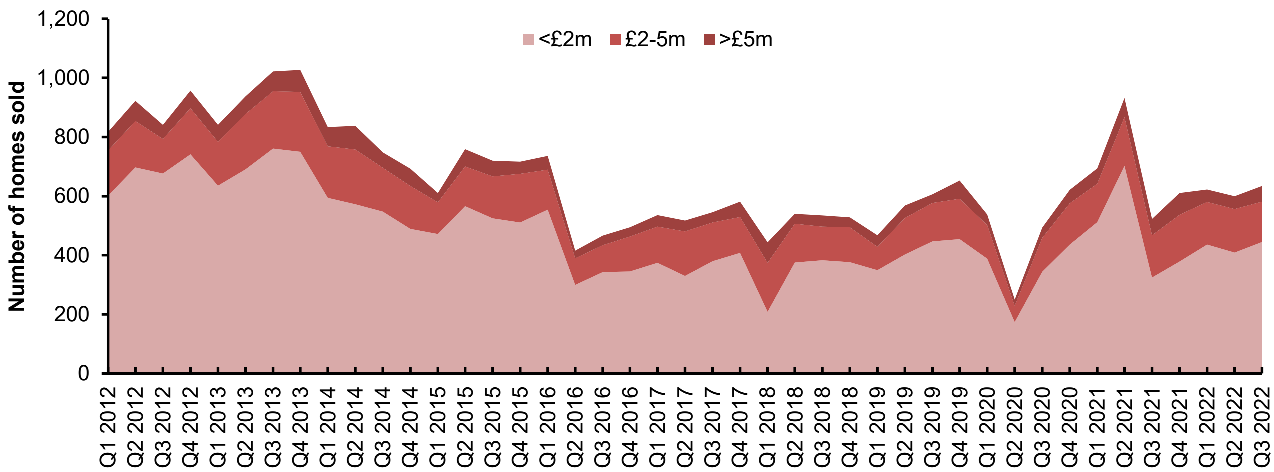
Prime Central London residential sales market

PCL prices fell marginally (-0.2%) over the last quarter – the first quarter of negative growth for two years. No further growth is expected this year, and so given the modest price rises felt in the first half of the year, 2022 is expected to finish with 0% to 2% growth. The PCL market is expecting less of a correction and is less sensitive to economic factors, with some parts of the market likely to continue to see modest growth during 2023 and others slight falls. Our forecasts expect between -3% and +3% growth for 2023 and a five-yearly outlook of 10-15% for PCL.

For PCL sales transactions, QoQ growth to Q3 2022 was 6% - recovering the QoQ losses over Q2 2022 (-4%). YoY growth was 21% which is positive but still not enough to recover the YoY losses to Q2 2022 (-36%). QoQ growth was driven by the >£5m bracket (20%) and YoY growth was driven by the <£2m bracket (37%). Total PCL transactions in Q3 2022 are now 62% of the previous peak in Q4 2013.

Figure 4

Historic number of homes sold in PCL



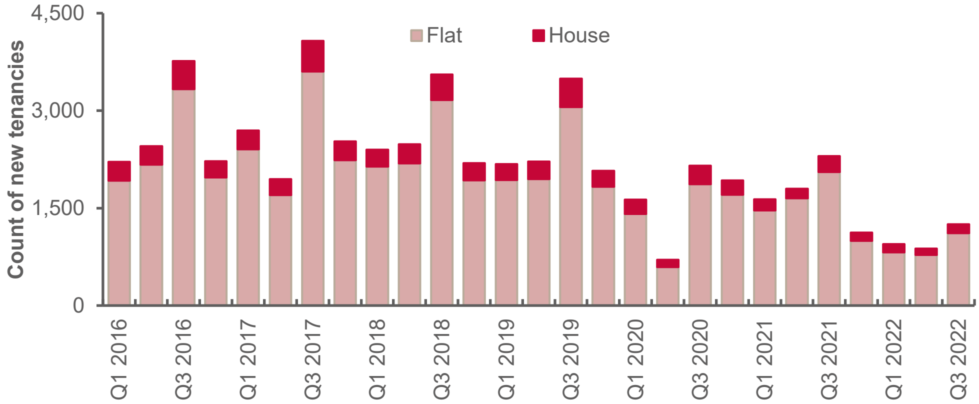
Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th October 2022.*

Prime Central London lettings market

With regards to PCL lettings, quarter on quarter prices rose by 3.4% to Q3 2022, the sixth consecutive quarter of positive rental growth. Annual growth to Q3 2022 was 13.6%, over double that of the rate recorded in Q4 2021, which sat at 5.7%, and the fifth consecutive quarter of positive year on year growth. PCL lettings transactions grew by 41% in the quarter to Q3 2022, recovering losses from Q1 2022 of -16% and Q2 losses of -6%. Transactions decreased by -45% YoY – the fourth consecutive quarter of negative YoY growth.

Figure 5

New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th October 2022.*

"In Prime Central London, the main barriers to the market for the next six months will be uncertainty and sentiment, rather than borrowing concerns. Multi-million-pound buyers will adapt according to what they can borrow, and the fall-out of rate rises is unlikely to be as big as anticipated thanks to opportunistic buyers adding to the pace of the market by purchasing in dollars or cash. Despite this, buyers at all levels are more conscious of pricing which is by no means insurmountable, however, flexibility and sensible expectations remain key for motivated sellers to secure a successful outcome."

Louis Harding

Head of London Residential Agency

Forecast

UK property prices have now seen six consecutive quarters of annual growth above 10%. The risk of recession coupled with rising interest rates are expected to temper this growth. We are not expecting further growth in 2022; prices are likely to either stagnate or begin to fall, continuing into 2023. For this reason the year is expected to finish between 5% and 8%, and a drop in prices of up to 5% is expected in 2023 for the UK. Recovery is expected from 2024 onwards, with a five-yearly outlook of 10-15%.

PCL prices fell marginally (-0.2%) over the last quarter – the first quarter of negative growth for two years. No further growth is expected this year, and so given the modest price rises felt in the first half of the year, 2022 is expected to finish with 0% to 2% growth. The PCL market is expecting less of a correction and is less sensitive to economic factors, with some parts of the market likely to continue to see modest growth during 2023 and others slight falls. Our forecasts expect between -3% and +3% growth for 2023 and a five-yearly outlook of 10-15% for PCL.

PCL lettings growth has been particularly strong, with 13.6% annual growth to Q3 2022. The persistent shortage of stock is expected to continue to put upward pressure on prices, lettings growth of between 10% and 15% is expected in both 2022 and 2023. After this, more modest increases are expected, with a five-yearly outlook of 25%-35%.

Table 2. Residential House Price Forecast

	2022		2023		5 Years to 2026 inclusive
	Downside Risk	Best Case	Downside Risk	Best Case	
			Sales		
Prime Central London	0.0%	2.0%	-3.0%	3.0%	10.0% to 15.0%
UK	5.0%	8.0%	-5.0%	0.0%	10.0% to 15.0%
			Lettings		
Prime Central London	10.0%	15.0%	10.0%	15.0%	25% to 35%

Source: *Volterra, Strutt & Parker*

Outlook

Despite 2022 starting on a good footing, local and global economic conditions have worsened as the ongoing geopolitical situation causes more disruption to global energy and food markets. Nationally the series of tax cuts announced at the mini-budget, which have now been rescinded, prompted a shock to the economy. Their retraction and the changing of the chancellor have somewhat calmed the sterling and the financial markets.

Economic and market indicators underpin our house price forecasts. The 2022 economic outlook is considered realistic based on trends seen in the first three quarters of the year but the indicators are currently subject to a significant level of uncertainty from external and internal pressures which will continue into 2023.

"The housing market can be compared to a cruise liner; in that it does not turn subtly yet it does so incredibly slowly. The past two months have been dogged by negative rhetoric in the housing market, however Q3 has been remarkably positive but much is still to play out. Recent sales volumes show strong market activity, although the bulk of these transactions were reliant on mortgages secured pre the 'mini-budget' and the subsequent mortgage rate hikes. This level of transactions is unlikely to be sustained in the short term. As such, we can expect negative pressure on house prices as the market responds to increased rates and living costs."

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Methodology

As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q3 2022 in light of changes since Q3 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.