Residential Quarterly | Spring 2023

Research - Market View

Economic & Political Outlook

The global economic outlook has worsened slightly, however the UK's has stabilised somewhat since our last commentary. In the UK, real incomes are expected to fall as the cost of living crisis persists, with inflation remaining at over 10% in March 2023. Several support packages have been put in place by the government including maintaining the Energy Price Guarantee (EPG) for three months from April 2023.

The Spring Budget 2023 was released in March 2023 and the topic of residential property was almost entirely avoided except for the promise of reduced stamp duty charges in investment zones. It laid out the government's plan to deliver on three of the five key priorities set out by the Prime Minister in January: to halve inflation; to grow the economy and make sure that national debt is falling.

These key measures include:

- Halving inflation: EPG being maintained at £2,500 for a further three months from April 2023; supporting investment in the energy system by launching Great British Nuclear to support new nuclear builds (to increase resilience to future energy price shocks); providing an average of £3,300 per household to support rising costs, including maintaining fuel duty, increasing Draught Relief and reforms to childcare.

- Growing the economy: supporting people back into the labour market through new support for Universal Credit claimants, tax incentives for older workers and childcare support; boosting education through new funding for skills including: Returnships; supporting businesses by introducing full expensing for 3 years from 1 April 2023; and encouraging innovation by providing support for R&D intensive businesses.

- Make sure UK national debt is falling so that the future of public services can be secured and there can be investment in defence.

The Spring Budget was accompanied by the OBR's March economic forecast which commented that developments since their November forecast have been largely positive. Stronger real wage growth, alongside the drop in interest rate expectations since November, resulting in a shorter and much shallower economic downturn this year. The economy narrowly avoided contracting in the final quarter of 2022, escaping a recession. The near-term outlook for demand has improved; it is expected to regain its pre-pandemic peak in the middle of 2024. As such, the OBR revised down its forecasts for the short term.

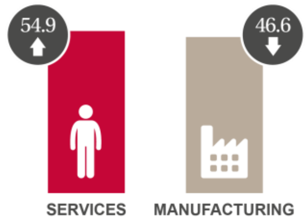
However, the economy still faces significant structural challenges. A recent rise in labour market inactivity, and the slowdown in productivity growth since the financial crisis, means that there remains weak underlying momentum. Unemployment is expected to rise, and consumer and business confidence monitors are both low. Inflation is forecast to decrease over 2023 but is proving harder to tame than initially expected.

With regards to inflation, HM Treasury and the OBR both forecast inflation to fall sharply by Q4 2023, 3.5% and 2.9% respectively. Both forecasts have come down in their latest interactions.

This is driven by a reduction in energy price - wholesale energy prices have come down at the start of the year which will be reflected in bills in the next few months, and the Spring Budget household support measures. Demand is also expected to fall as disposable incomes reduce. Both forecasts expect a further fall in inflation to around or below the Bank of England target in 2024 – HM Treasury to 2.5% and the OBR to 0.9%.

10.1%

Mar-23 inflation (CPI) was at 10.1%, down from 10.5% in Sep-22
Source: ONS



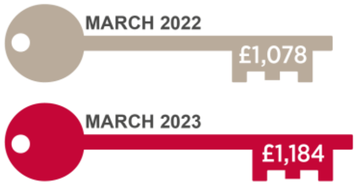
Apr-23 PMI Services rose to 54.9 & Manufacturing fell to 46.6 (against last month)
Source: IHS Markit/CIPS

Real average weekly earnings (total pay, seasonally adjusted) rose to £638 in Feb-23, compared to £597 in Feb-22.
Source: ONS

Interest Rates

In response to inflation, the Bank of England increased the Bank Rate; it was raised to 4.50% in May 2023 – the highest rate since 2008. Mortgage rates rose dramatically after the 'mini-budget' and the subsequent hikes in the base rate at the end of 2022. However, over the start of 2023 mortgage rates have fallen, even as the base rate has continued to rise.

The average 5 year fixed rate mortgage (at a 75% loan-to-value) increased from 1.6% in Q1 2022 to 5.6% in Q4 2022; since then, they have fallen to 4.2% as of April 2023. This is the average rate below the base rate and with some more extreme examples below 4%. Some of the rates do have conditions attached, however they show the banks available capital and willingness to lend. Mortgage lenders are offering products below the Bank Rate as they compete on price and have the long term expectations that the Bank Rate will reduce over the fixed term offered. Consensus is that there will be a further Bank Rate increase beyond 4.5% in 2023. Longer term the HM Treasury and the OBR forecasts expect the bank rate to decrease to 3.5% by the end of 2024.



UK Average Rent is £1,174pcm, a 9.8% increase on last year
Source: HomeLet

Economic Indicators & Forecasts

Economic and market indicators and forecasts underpin our house price forecasts. It is still early in the year to see key trends, and forecasts are subject to a significant level of uncertainty from external and internal pressures.

The March HM Treasury forecasts expect GDP growth of -0.5% over 2023; a slight upward revision from -0.7% in February, with growth of 0.8% in 2024. The March OBR forecasts for GDP are slightly more optimistic at -0.2% for 2023 and 1.8% for 2024. HM Treasury and the OBR are aligned on unemployment forecasts at 4.4% and 4.1% respectively in 2023. Both predict increases in 2024 to 4.6% and 4.4%, respectively. It is typical that increases in unemployment lag the forecast decreases in GDP.

Many UK macro variables have remained in a similar position to our previous commentary; please see below.

UK property prices fell 1.0% YoY to Q1 2023
Source: Nationwide HPI

Table 1
Economic Indicators Summary Table

Indicator	Value	Date	Comment
Inflation Rate (CPI)	10.1%	Year to Mar-23	Steady rise from 3.1% in Sept 2021. Inflation has been at above 10% for the past six months. Although inflation was starting to fall slightly, in February it saw an unexpected rise.
Bank Rate	4.50%	May-23	Increased to 4.50% in May 2023. It was the twelth rise since December 2021 to combat rising inflation.
Unemployment Rate	3.7%	Nov-22 to Jan-23	Has been at or below 5% since 2015 (apart from just over 5% at the end of 2020) and has been almost consistently declining since 2020 until mid-2022. The Nov-22-Jan-23 figure is unchanged on the on the Sept-Nov-22 figure.
Exchange Rate (GBP to Euro)	1.14	[End] Mar-23	After a fall to 1.11 in early Feb-23, the exchange rate has climbed back up to 1.14 –in line with where it sat for much of Q4 2022.
FTSE: QoQ FTSE: YoY	1.6% 1.8%	[Start] Q2 2023	The FTSE was essentially flat over 2022. However, Q2 2023 started 1.6% above the start of Q1 2023 and 1.8% above start of Q2 2022.
GDP: QoQ	0.1%	Q4 2022	A return to positive quarterly growth after small negative growth in the previous quarter of -0.1%.

Sources: ONS, Bank of England, European Central Bank & Wall Street Journal

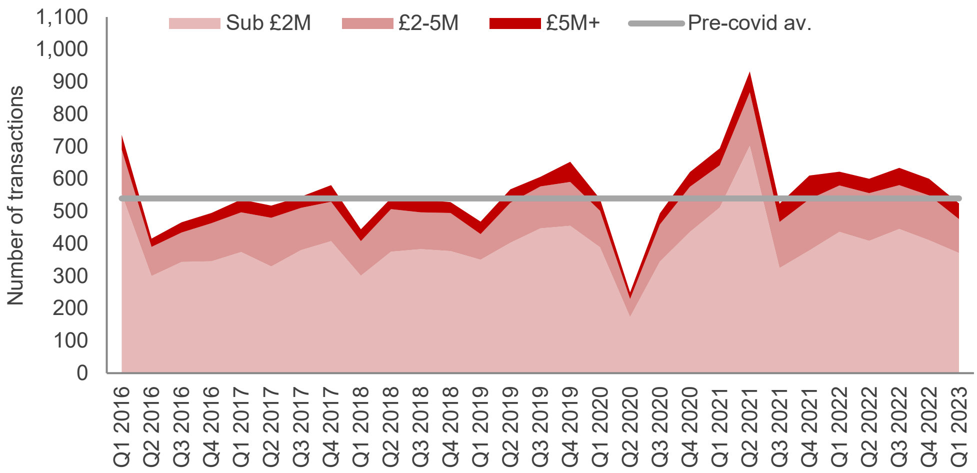
Prime Central London – Sales market

Over Q1 2023 Prime Central London (PCL) prices were flat, when compared to last year values are down -0.3%; the first-time annual growth had been negative since Q1 2021. Within PCL transaction volumes have been falling, -13% down on last quarter and -16% down on Q1 last year. Against the same point last year transaction volumes fell in the <£2m and £2-£5m brackets (-15% and -27%, respectively) but transactions over £5m are up 14% on Q1 2022.

Agents reported that there was low activity in the early part of the quarter, but it increased significantly in the last few weeks. The second half of the year is expected to be more positive than the first, as this prime section of the market is generally more resilient to economic headwinds.

Figure 1

Historic number of homes sold in PCL



Source: *Dataloft, Lonres.com, Strutt & Parker as at 9th April 2023.*

"We are beginning to see clear signs of a rebound in Prime Central London. Demand for property over £5 million has significantly increased which demonstrates the strength of the market. Buyers in this bracket are less dependent on debt and favour property as an asset class in high inflationary markets. If the momentum continues, which we are confident it will, the PCL market should begin to see sustained value growth over the medium term.

Mortgage rates have stabilised and new products are enticing buyers back in to the market. Likewise, motivated sellers who need to move are coming to the market with realistic expectations and this presents an opportunity for buyers in the coming 12-months."

Louis Harding

Head of London Residential Agency

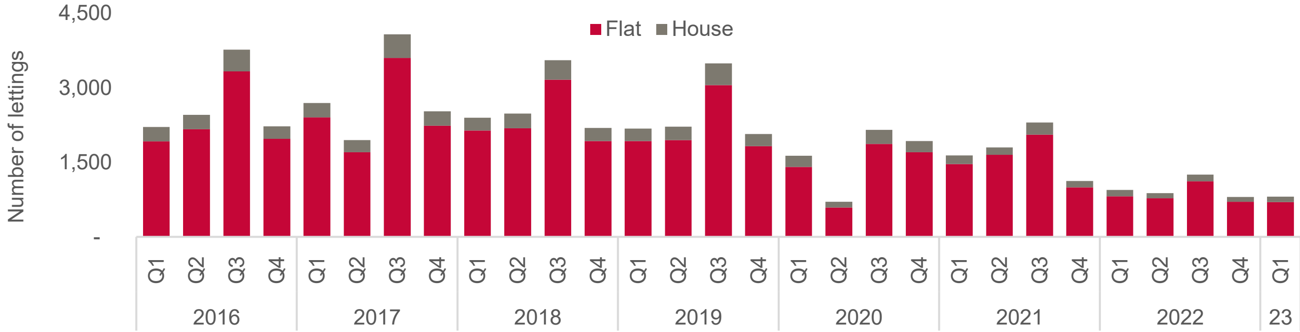
Prime Central London – Lettings market

Annual rental growth to Q1 2023 was 9.3%, after four consecutive quarters of YoY growth above 10% in PCL. However, rental growth is slowing with quarterly growth at 0.8% in Q1 2023. The number of lettings transactions stayed relatively flat from the end of last year but is -14% down on Q1 2022.

This quarter has seen landlords forced to sell because they no longer have tenancies which can cover their costs due to increased mortgage rates. This is further exacerbating the chronic undersupply issues in the lettings market, which our agents do not see improving any time soon. This undersupply has driven rents which are now hitting the affordability ceiling of what tenants are able to pay.

Figure 2

New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th April 2023.*

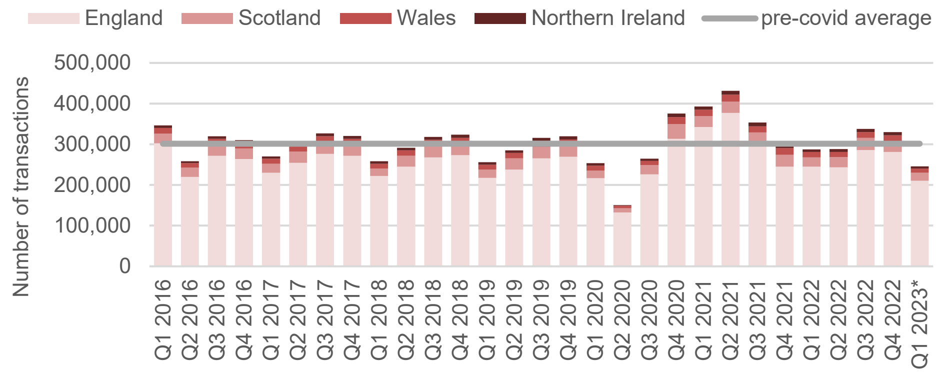
National - Sales market

UK annual property price growth was negative in Q1 2023 (-1.0%), the first quarter of negative YoY growth since Q4 2012, according to the Nationwide. On a regional basis, the best annual performers were Northern Ireland (1.6%), West Midlands (1.5%) and the South West (0.6%) and East Midlands (0.5%). These were the only regions with positive YoY growth. This is the first time any regions have seen negative year-on-year growth since Q2 2020, with Scotland seeing the greatest fall in values of -3.1%.

The February 2023 Bank of England report states that housing market activity has fallen. Mortgage approvals declined sharply in November and December to levels not seen since the onset of the pandemic. Weakness in the economic outlook and higher mortgage rates are expected to weigh on housing investment this year and in 2024. However, as inflation starts to fall in Q2, more people will look to transact, which should begin to put positive pressure on prices. Mortgage lenders are already offering products below the Bank Rate allowing buyers cheaper entry to the market.

Figure 3

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



Source: *Strutt & Parker, HMRC; Monthly transactions in the UK with value of £40,000 or above as at Mar-23.*
**Includes provisional Q1 2023 data*

Regional highlight – South East & East of England

Across the South East and East of England Q1 and Q2 2021 saw record transaction levels with over £30 billion worth of stock transacting in each quarter. These quarterly transaction volumes fell back to pre-COVID levels at the end of 2021 and throughout 2022.

Since the start of 2022 the proportion of total stock sales made up of properties sold at over £1m has been growing from 11% in 2020, 14% in 2021 to 16% in 2022. Provisional data for Q1 2023 shows this proportion climbing further to 18%. Along with the Nationwide house price index, this shows how house prices have been growing since the 2020 lockdowns pushing more properties into these higher price brackets. In line with the rest of the country values have fallen away around between 5% and 6% for each region over the past three quarters.

"We are starting to see a pivot in regional property markets following nearly 3-years of unprecedented growth. Buyers with budgets of up to £2m remain more cautious because of the increased costs of borrowing. However, there is more certainty and stability in the market than six months ago, and confidence is returning, evidenced by a strong pipeline of new properties coming to the market.

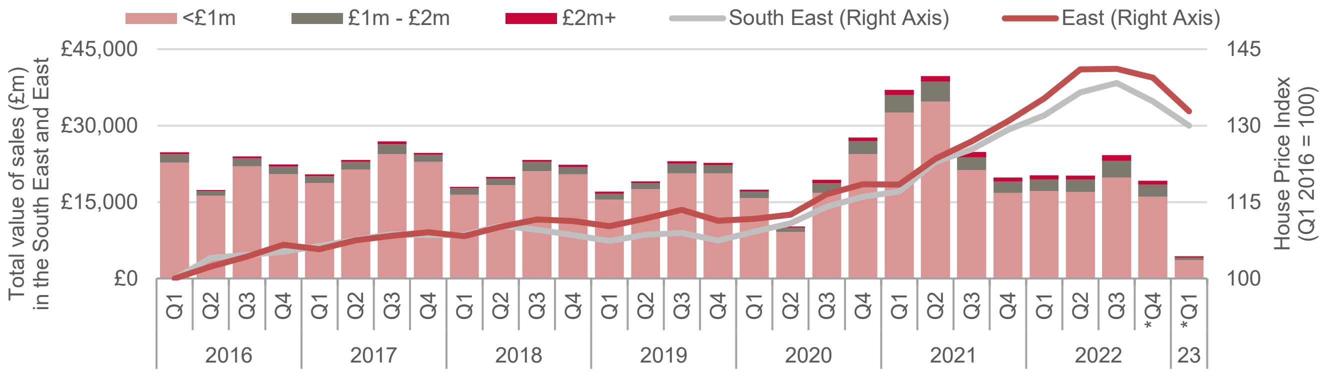
The market is also seeing the return of buyers who want to be in the South East and East of England, demonstrated by the recovery in transaction volumes in these regions. Urban locations with excellent commuting links are once again a priority. While hybrid working is still having a transformational effect on overall buyer criteria, there are some signs that people want to have a closer connection to their workplaces.

Kate Eales

Head of Regional Agency

Figure 4

Value of total sales in South East and East of England, House Price Index



Source: *Strutt & Parker Research, HM Land Registry, Nationwide* **provisional data*

New Home Sales - England & Wales

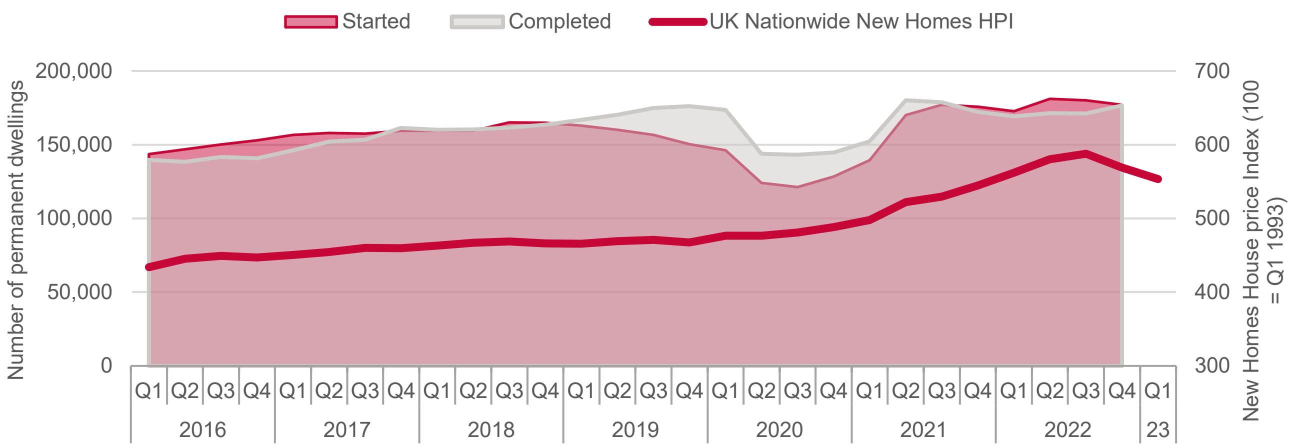
The new homes house price index from Nationwide shows that values have increased by 10% since the start of 2021, peaking at 11%; however, new home values have fallen 5.9% since their latest peak in Q3 2022. A high proportion of new homebuyers are also first-time buyers who rely heavily on debt. The increasing cost of debt since the 'mini budget' in Q3 2022 has meant these first-time buyers cannot afford to borrow as much, nor pay as much for their new home. The knowledge that there are less buyers means that developers slow down their production of new homes so that their supply does not overwhelm the market.

For this reason, in Q4 2022 start levels fell below completion levels for the first time in 2022 shrinking the supply pipeline. Along with disruption to supply chains and increased costs of labour and materials it is very unlikely that developers will produce the 300,000 per year homes that the government state England & Wales need. Only 176,600 homes were built in 2022 – the latest available data point – 59% of the government's annual target.

Homes completed in 2022, up from 172,360 2021

Source: DLUHC & MHCLG

Figure 5
Number of new homes started, completed & new homes house price index

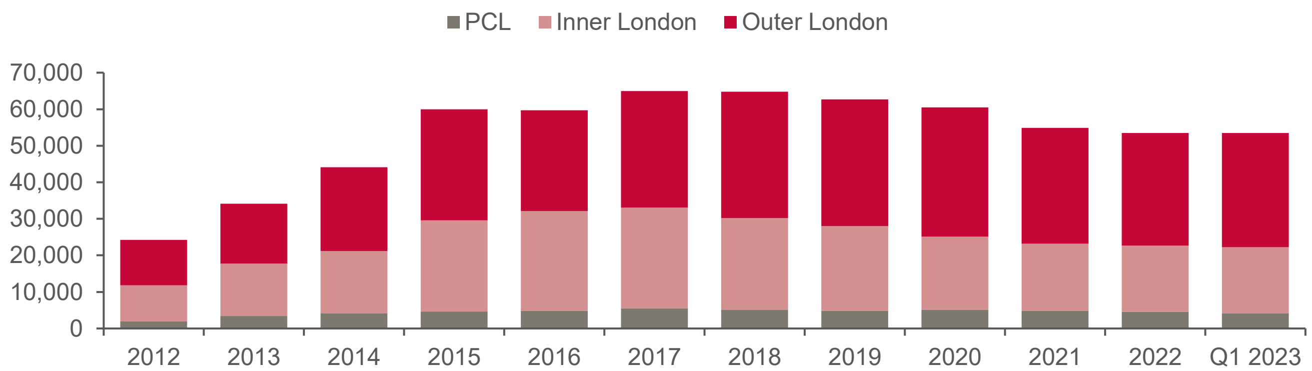


Source: *Strutt & Parker Research, ONS, Nationwide*

New Home Sales – Greater London

Across Greater London, at the end of Q1 2023, there were over 53,500 new build units under construction. The number of units that were completed in Q1 2023 is a third down on the same period last year. The slowing of the market over the last two quarters has slowed construction for sale rates to make sure supply doesn't swamp demand. Alternatively, some developers may convert units to rentals. Approximately 16,400 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 6
Number of private sale units under construction in schemes of 20+ private units in Greater London



Source: *Molior, Strutt & Parker as of 19th April 2023; 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.*

Forecasts & Outlook

UK mainstream prices ended the year at -1.0%, this is in line, and slightly above, our expectations. Hence our previous forecasts are retained with price changes of between -5% and 0% for 2023 and a five-year outlook of 10% to 15%.

PCL price growth was very marginally negative for the first time since Q1 2021 however our agents report that the previous few weeks of good activity has driven optimism for the 2023 outlook. So again, we are keeping our forecasts of -3% to 3% for 2023 and a five-year outlook of 10% to 15% the same.

PCL lettings growth continues to be strong, with high annual growth but a slowing this quarter. With seasonal rental market activity expected to pick up over the spring and the summer pushing prices further, our previous forecasts of between 5% to 10% rental growth for 2023 are still likely. We are keeping our year and a five-year outlook of 20% to 30% the same.

Table 2
Residential House Price Forecasts

	2023	5 Years to 2027 inclusive
	Sales	
Prime Central London	-3.0% to 3.0%	10.0% to 15.0%
UK	-5.0% to 0.0%	10.0% to 15.0%
	Lettings	
Prime Central London	5.0% to 10.0%	20.0% to 30.0%

"The first quarter of 2023 has seen a stand-off between buyers and sellers, each waiting for the other to move on price first. This stand-off has affected transaction volumes more than it has house prices, however, in real terms house prices have fallen over 11% since August 2022. Recently released data shows that nominal house prices rose in April and with annual inflation set to fall considerably next month, this is likely to indicate a turning point in the market. Assisted by the seasonality of the market, we expect transactions to pick up over the next two quarters which will inevitably prompt house prices to start climbing again."

MATT HENDERSON

Residential Research

The global economic outlook has worsened slightly, but the UK outlook has stabilised somewhat since our last commentary. In the UK, real incomes are expected to fall as the cost of living crisis persists, with inflation remaining at over 10% in March 2023. Mortgage rates have come down after peaking in Q4 2022, early 2023 and the market has fared much better than many predicted.

Prices may see some fluctuations later in the year as inflation comes down, mortgage rates continue to stabilise, and more people begin to transact. The stand-off between buyers and sellers has held up the volume of transactions so far. In the rental market the affordability ceiling, of what renters can afford to pay, seems to have been reached with rental growth slowing rapidly. However, the continued supply demand imbalance will continue to put pressure on this.

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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 Q1 2023 in light of changes since Q1 2022. 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.