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RESEARCH

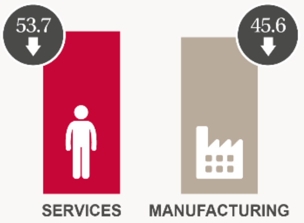
UK Residential Market Review

Summer 2023

7.9%

June's CPI inflation was down from 8.7% May-23

Source: ONS



Both UK services & manufacturing contracted over June

Source: IHS Markit/CIPS

Real average weekly earnings* rose to £651 in May-23, compared to £605 in May-22

*(total pay, seasonally adjusted) Source: ONS

Economic & Political Outlook

The UK economy has so far been resilient to interest rate rises, though it will take time for the full impact of higher rates to come through.

Considering the macroeconomic indicators, there are things that give cause for concern but not panic. Inflation is high at 7.9% but the latest figures show that it has started to decrease quicker than expected, after months of stagnating around 10%. June's inflationary figures also showed a reassuring fall in services inflation, typically a good indicator of domestically generated inflationary pressure.

The decrease is partly driven by falling wholesale gas prices and falling demand due to the cost of living. However, the HM Treasury outlook has worsened its inflation outlook since the March 2023 forecast from 3.7% to 5.0% for 2023 in their June forecast. They also shifted from their forecasts 2.5% to 2.8% for 2024.

The level of inflation feeds directly into the UK's the most commonly reported issue, the cost of living, with 91% adults in Great Britain reporting it as an important issue facing the UK today (June 2023). 62% of adults reported an increase in their cost of living compared to the previous month – this is a decrease from 76% in April 2023 suggesting that the problem is at least stabilising, despite its prevalence.

Unemployment increased slightly from 3.7% to 4.0% over Mar-May 2023, where it is broadly expected to remain for 2023 and 2024. This is still far below the 2009/10 levels of approximately 8.0%.

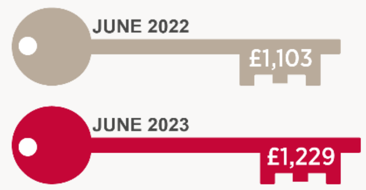
For unemployment, both HM Treasury and OBR forecasts are reasonably aligned, expecting over 4% in 2023 and 2024. The HM Treasury June 2023 forecasts are slightly more optimistic than the HM Treasury March 2023 forecasts, indicating an improved outlook for the labour market.

The FTSE has recorded small negative growth of 1.9% over Q2, but this represents growth of 5% year-on-year. In addition the latest Business Confidence Monitor of 2.5 in Q1, was a big improvement from -23.4 in the previous quarter. GfK's Consumer Confidence Index increased six index points to April 2023, with all measures up from the previous month.

All of this has created a relatively sluggish economic outlook for the UK. GDP has seen very little positive growth in Q4 2022 and Q1 2023, of 0.1%. Growth is forecast for 2023 at 0.2% which, whilst small, is an improved outlook compared to the March forecast which predicted a contraction of the economy.

Concerning Brexit, only one update has been made since the previous commentary, which is that negotiations with Switzerland were launched in May 2023 to update the existing UK-Switzerland agreement which largely replicates the EU-Switzerland agreement. No new agreements have been signed.

AT A GLANCE **Q2 2023**



UK average rent increased 10.4% on last year

Source: HomeLet

UK property prices fell 3.1% in the year to Q2 2023

Source: Nationwide HPI

Interest Rates

The Bank of England (BoE) increased the bank rate a 14th time in August, to 5.25% – the highest rate since 2008. The base rate is forecast by the Treasury, as of July, to reach 5.7% this year before decreasing to 4.9% next year.

Reflecting these rises, mortgage rates also started to increase over 2022. The average five-year-fixed-rate mortgages have increased from 1.63% in January 2022 to 4.95% as of June 2023, and variable rate mortgages increased from 1.51% to 5.11% over the same period according to the BoE's database at a 75% LTV. Fixed rate mortgages are starting to come to an end, which may put more pressure on homeowners. On average, households are typically facing monthly payment increases of £200-£500.

Many are concerned about a mortgage crisis as more and more fixed rate mortgages come to an end. Between 400,000 and 450,000 households per quarter will come to the end of a fixed rate in 2023 – according to the BoE – which while a lot is not a large proportion of the total market.

Further to this, rates are still expected to be bought down once inflation is under control however with previous inflation forecasts incorrect it is unknown when this will be. However, June's figures have increased positivity around when rates might start to come down and the odd example has occurred. HSBC have bought down their mortgage rates since the latest inflation figures were released, possibly a sign of them being overly cautious when the base rate rose to 5%. But it also systematic of a wider trend around the bank being competitive, trying to win business and having the capital to deploy.

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 latest HM Treasury forecasts, as of June 2023, expect the economy to grow by 0.2% in 2023; this is an improvement on their March forecast of -0.5%. There is a feeling that interest rates have not fed through to growth as quickly as expected, however that does pose the risk of muted growth for next year. In 2024, growth is expected to increase to 0.7%, the most recent OBR forecast is March 2023.

The HM Treasury forecast is more optimistic than the OBR forecast for 2023 growth but is less optimistic than the OBR forecast for 2024 growth. It is worth noting that the OBR forecasts have not been updated since March of this year.

Economic Indicators Summary Table

Indicator	Value	Date	Comment	HM Treasury Forecast *(as of July 2023)*	
				for 2023	for 2024
Inflation Rate (CPI)	7.9%	Year to June 2023	Inflation (CPI) has fallen further than expect this month, with CPIH also falling, to 7.3%. Core inflation has fallen too (6.9% in June) after an expected climb to 7.1% in May.	5.0%	2.7%
Bank Rate	5.25%	August 2023	The rise in August was the fourteenth rise since December 2021 to combat rising inflation.	5.7%	4.9%
Unemployment Rate	4.0%	May-23 - Mar-23	Unemployment has been at or below 5% since 2015 (apart from just over 5% at the end of 2020). Since mid-2022, it has been slowly rising from 3.5%. The May-23-Mar-23 figure is the highest it has been since the end of 2021.	4.1%	4.4%
Exchange Rate (GBP to Euro)	1.17	[End] June 2023	After a fall to 1.11 in early Feb-23, the exchange rate has climbed back up to 1.17 – similar to where it sat at the beginning of Dec-2022.	-	-
FTSE	QoQ: -1.9% YoY: 5.0%	[Start] Q3 2023	After good growth since Q4 2022, the FTSE has levelled off over Q2 2023.	-	-
GDP	QoQ: 0.1%	Q2 2023	Monthly real GDP is estimated to have fallen by 0.1% in May 2023 after growth of 0.2% in April 2023.	0.2%	0.7%

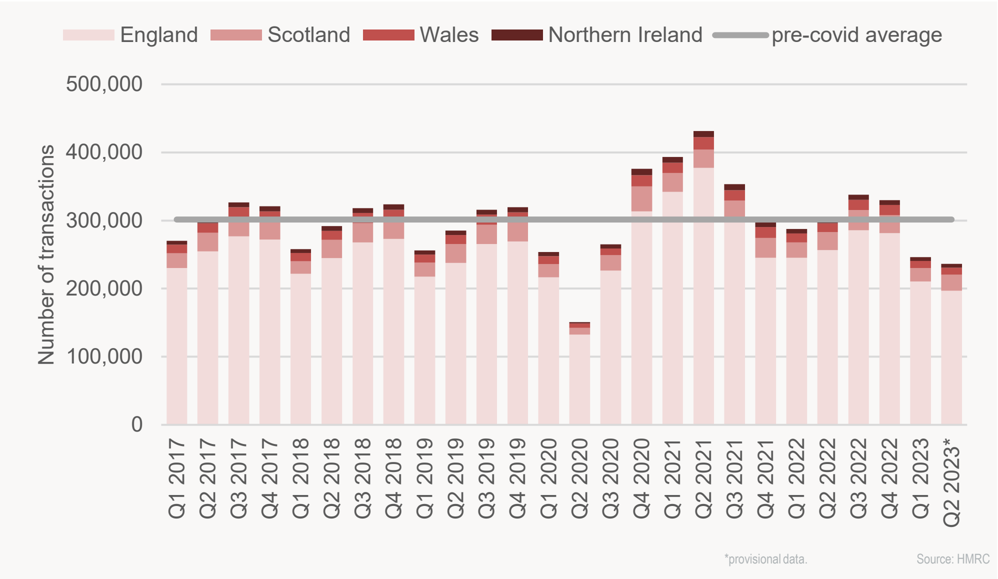
AT A GLANCE Q2 2023

National residential sales transactions

The UK average property price fell 3.1% in the year to Q2 2023, according to the Nationwide House Price Index. This is the second consecutive quarter of negative annual growth. On a regional basis, all regions saw price falls except for Northern Ireland which saw 0.5% positive growth. The worst regional performers were East Anglia, London, and the North West respective, all with negative growth of between -4% and -5%.

On a national basis, the Nationwide House Price Index fell 0.2% this quarter with more varied performance across the regions. The best performer was still Northern Ireland – with growth of 2.4% – Wales also saw positive growth of 0.7% in Q2. The largest quarterly falls in house prices were in South West, at -1.2%, and London, -1.1%. According to HM Revenue & Customs, UK (seasonally adjusted) residential transactions in May 2023 were at 80,020. This was 20% lower than May 2022.

Number of recorded properties sold across the UK for 2017 through 2023



*provisional data.

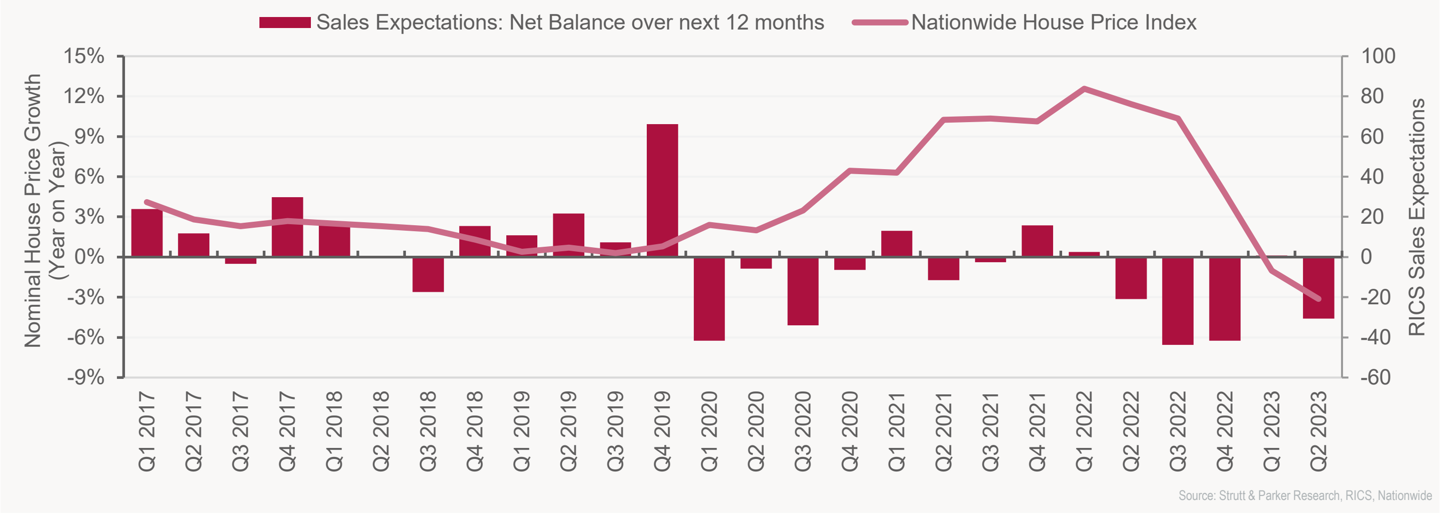
Source: HMRC

There is likely to be a fall in the number of sales that take place over the next 12 months, shown by the sentiment of agents in the RICS survey. Sales expectations are at -30 meaning that around two-third of agents surveyed expect conditions for transaction levels to be tricky over the next year.

This is in line with what our own agents are seeing; applicants are down 30%, viewings are also down, and price reductions are becoming more frequent. With sellers and buyers in a stand-off over varying price expectations, those that need to transact will likely have to having comprise on value. Agents expect to start seeing some distressed sales now. Stock issues do still persist to some extent, but this is not anticipated to be enough to offset the interest rate and inflationary pressures. We expect to see prices continue to fall for this year.

> *"The market is certainly in a more challenging place than it was 18 months ago, driven by increasing cautiousness amidst shifting mortgage markets. Pricing is much more sensitive and while the 2021 peak of the market is fresh in many vendors' minds, buyers are readjusting their budgets in the face of higher costs of living and increasing mortgage repayments. This standoff in negotiations has prompted a cooling in the market and a softening of transaction numbers in the short term.*
>
> *September is a typically busy time, particularly with the return to cyclical markets with increasing pressure through the autumn for those keen to sell before the end of the year. In the country market, where no two homes are the same, property prices are more protected from sudden fluctuations with buyers less able to delay their purchase until the following year. After buyers adjust budgets and the Bank of England continues to push down inflation we should see greater stability and, with that, improved sentiment."*
>
> **Kate Eales**
>
> Head of Regional Agency

Nationwide House Price Index & RICS Price Expectations



Source: Strutt & Parker Research, RICS, Nationwide

AT A GLANCE Q2 2023

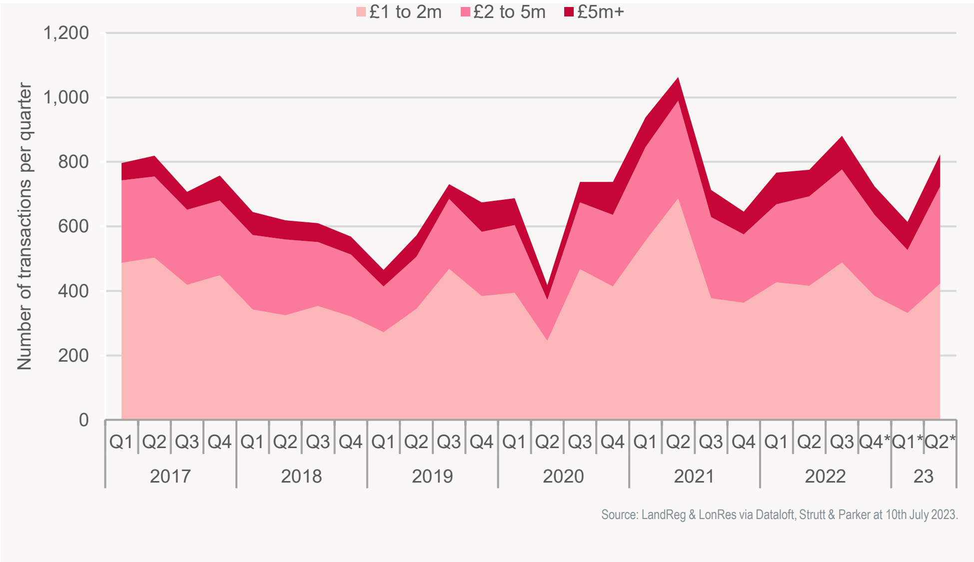
Prime Central London – Residential sales market

Transactions levels, at over £1m, in Prime Central London (PCL) picked up 34% on Q1, however this was a weak quarter for transactions. Q2 figures for total number of sales is back in line with Q3 and Q4 last year. The majority of the growth came in the £2m to £5m price bracket, up 55% on Q1; £1m to £2m sales were up 27%. Sales over £5m were up 13% on Q1 and now make up 12% of this market.

Despite the more positive figures PCL sales rates have struggled since the June interest rate hike, which appeared to catch many off guard. It sparked a three-week period which saw a noticeable drop in new applicant registrations by about a third, and a significant number of transactions falling through.

This will have a knock on effect into Q3. Prices are quite likely to hold steady unless vendors need to sell however this will create a stand-off with buyers holding up transaction volumes.

Historic number of homes sold in PCL



Source: LandReg & LonRes via Dataloft, Strutt & Parker at 10th July 2023.

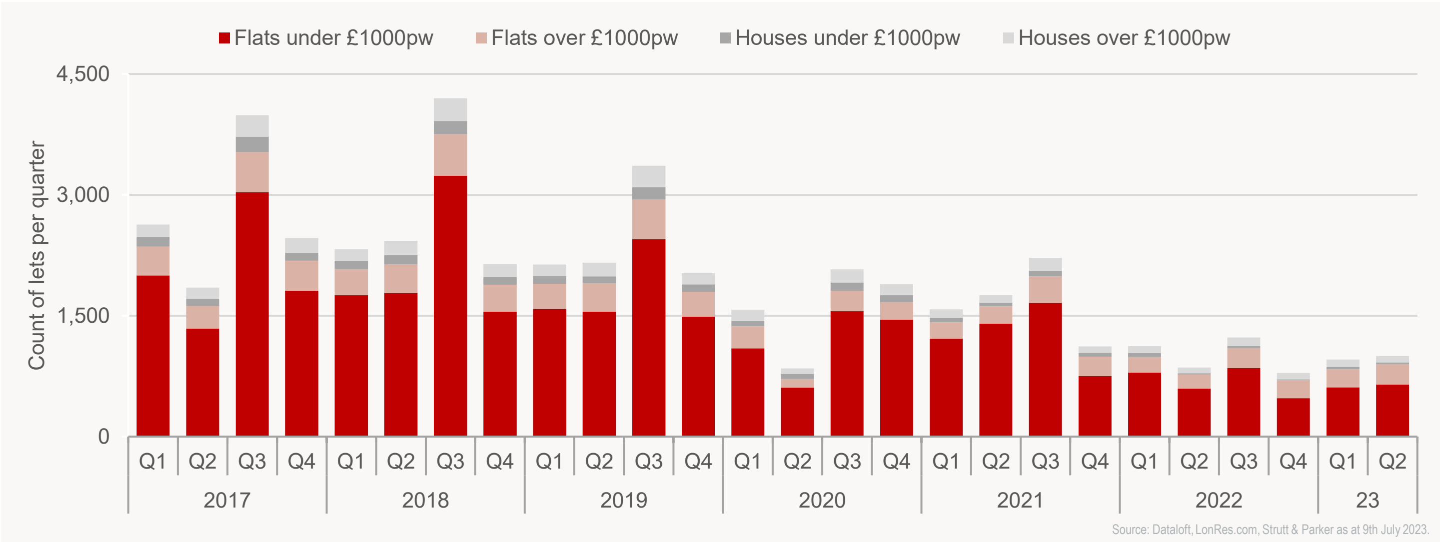
> *“Since the start of the year, Prime Central London has continued to represent good value for money, and still stands tall compared to other European cities. Foreign investment has been re-entering the market, while delays in the building industry have only supercharged the market for prime, turn-key homes.*
>
> *However, the biggest impact interest rates have on the prime and super-prime markets is not affordability, it’s sentiment. People aren’t running away from the market, they’re just more likely to put a pause on decision making – it’s the same thing we witnessed at the end of last year following the fall-out of the ‘mini-budget’.*
>
> *The sub £4M PCL market is more exposed to high interest rates, where transaction numbers are likely to soften more quickly than at prime levels. “A side-effect of this is a possible spike in accidental landlords, with vendors opting to let out their property rather than sell if they are in no rush to do so, with lets still in chronic short supply particularly for family houses in prime locations.”*
>
> **Louis Harding**
>
> Head of London Residential Agency

Prime Central London – Lettings market

PCL lettings pricing saw 6.3% annual growth but only 0.8% during Q2. Rental growth has been slowing since Q2 2022 although this was the ninth consecutive quarter of positive rental growth. Chronic undersupply issues persist which is maintaining prices. The bearish view on the sales market may assist lettings stock if vendors cannot achieve the prices they desire, they may temporarily let out the property while the sales market adjusts.

The number of lets in PCL increased by 5% on Q1 and is 17% up on Q2 last year. However, the volume of lets have been extremely low over the past two years, as a result of the undersupply and unwillingness of tenants to move, scared of rental hikes or simply not being able to find a new home.

New rental tenancies in PCL by house type



Source: Dataloft, LonRes.com, Strutt & Parker as at 9th July 2023.

AT A GLANCE Q2 2023

New Homes – England & Wales

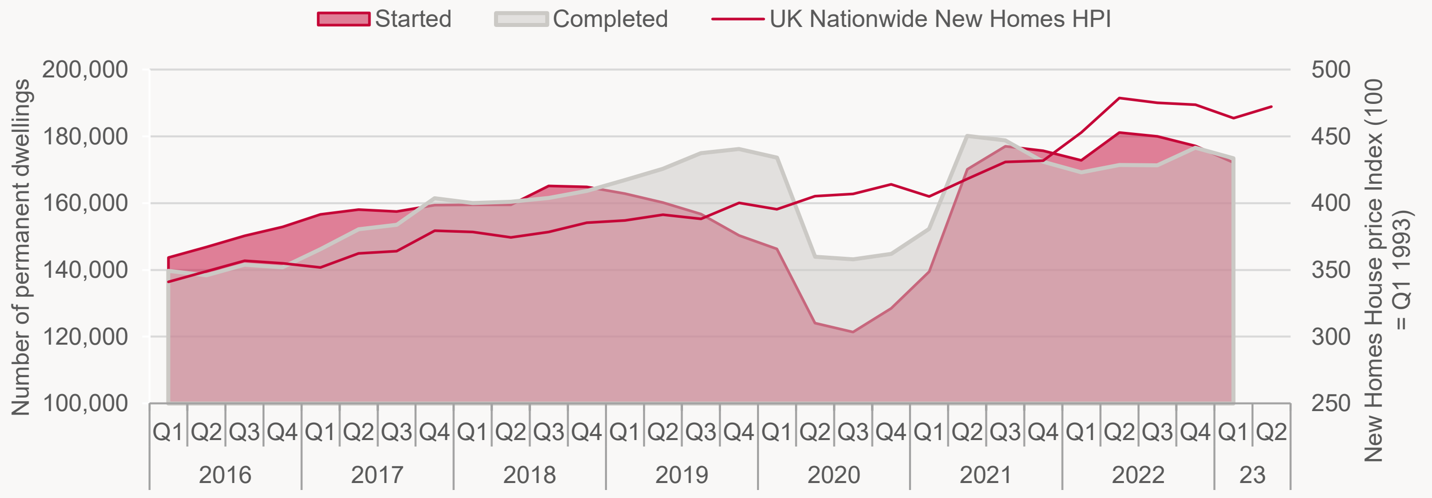
The new homes house price index from Nationwide shows that values have increased by 16.6% since the start of 2021, however, new home values have fallen -1.4% since their latest peak in Q2 2022. A high proportion of new home buyers are also first-time buyers who rely heavily on debt. The increasing cost of debt since the BoE increased the base rate to help tame inflation has meant that first-time buyers cannot afford to borrow as much, and subsequently not pay as much for their new home. The knowledge that there are fewer buyers means that developers slow down their production of new homes so that their supply does not overwhelm the market.

This is part of the reason that completion and levels are down in Q1 (the latest available data), however start levels have ticked upwards. 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 states England & Wales need. Only 173,420 homes were built in the four quarters to Q1 2023, 57% of the Government's annual target.

homes completed in Q1 2023, down from 50,020 Q4 2022

Source: MHCLG

Number of new homes sold by region (excl. London) & new homes house price index

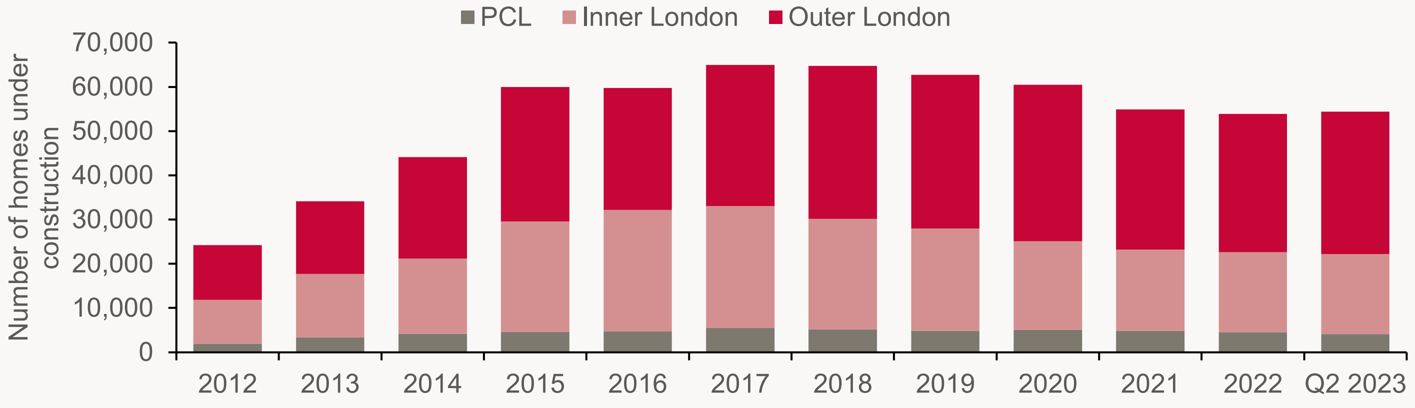


Source: Strutt & Parker Research, ONS

New Homes – Greater London

Across Greater London, at the end of Q2 2023, there were over 54,400 new build units under construction. The number of units that were completed in H1 2023 were down approximately a third on same period last year. The slowing of the market over the last two quarters has inhibited sale rates to make sure supply doesn't swamp demand. Alternatively, some developers may convert units to rentals, or sell on units to institutional landlords. Approximately 15,700 of the units under construction in London are Build to rent (BTR) showing the strength of confidence in the lettings market, however the demand for these units is outweighing the current supply.

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.

AT A GLANCE Q2 2023

Forecasts

UK house prices have had a second consecutive quarter of negative annual growth. In 2023 so far values have fallen -1.9% in Q1 and -0.2% in Q2. Stock issues do still persist to some extent, but agents expect to see further price falls this year. The 2023 forecast of -5% (downside) to 0% (upside) is retained. No growth is expected in 2024, and as such the cumulative forecast is downgraded to 5% to 10%.

Prime Central London (PCL) house prices have been effectively stagnant so far in 2023; -0.1% in Q2 and 0% in Q1. The end of Q2 saw a drop off in transactions after the May and June interest rate rises, however this in unlikely to heavily effect prices. The 2023 forecast of -3% to 3% is retained but prices less likely to climb over the next couple of years – due to the increased mortgage rates. Therefore, our 5 year cumulative forecast is downgraded to 5% to 10%.

PCL lettings pricing saw 6.3% annual growth however only grew 0.8% in Q2. Chronic undersupply issues persist which is creating rental price growth, however, the growing unaffordability of these rents is causing this growth to slow. The bearish view on the sales market may have a positive impact on lettings stock; if vendors cannot achieve the prices they desire, they may look to let their property so it doesn't stand vacant for too long. This will boost supply and help to temper rents. Due to this our forecasts are downgraded to 2% to 7% for 2023, and 10% to 15% for the five-year forecast.

	2023	5 Years to 2027 inclusive
	Sales	
Prime Central London	-3.0% to 3.0%	5.0% to 10.0%
UK	-5.0% to 0.0%	5.0% to 10.0%
	Lettings	
Prime Central London	2.0% to 7.0%	10.0% to 15.0%

> *“"In the first half of this year, we've observed a modest decline in nominal house prices. This is a less dramatic change than what was initially predicted when mortgage rates experienced a significant increase during Liz Truss's brief period as Prime Minister.*
>
> *It seems that moderate fluctuations in house prices may become a consistent pattern. This year's gentle dip in value could likely be succeeded by a similarly moderate increase in the coming years once the market sentiment shifts. The era of drastic falls and rises might be receding, as the growth of house prices is kept in check by affordability constraints, and the severe shortage of homes preventing any significant value reductions.*
>
> *Moreover, the demand remains robust. Aspiring first-time buyers are eager to escape the mounting pressures of the rental market, while cash buyers are on the lookout for potential bargains.*
>
> *The prime markets are less limited by these affordability constraints, although still suffer from undersupply, creating a greater potential for value rises.”*
>
> **MATT HENDERSON**
>
> Residential Research

Outlook

The UK's economic outlook is currently heavily contingent on the ONS' monthly inflation figures. The latest figures were below the market expectations, with the all important core inflation falling for the first time in months. This bought down the projected terminal base rate which significantly improves the country's economic outlook for the next 18 months. However, all this new found optimism could vanish next month if inflation figures don't continue their new downwards trajectory. Real incomes are expected to fall as the cost of living crisis persists, and increased mortgage rates will place financial pressure on those looking to get a mortgage, or having to re-mortgage.

House prices will likely see some fluctuations later in the year as those who need to transact have to break the current stand-off between buyers and sellers, which continues to hold up the volume of transactions. In the rental market there is an affordability ceiling, of what renters can afford to pay, which will limit the growth of rents. However, the continued supply demand imbalance will continue to put pressure on this and areas, such as PCL, where the affordability ceiling has not been reached will likely continue to see rental growth.

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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 Q2 2023 in light of changes since Q2 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. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.

PCL Methodology
PCL figures are formulated of HM Land Registry data and adjusted LonRes data – quarters denotated with an asterix. The LonRes adjustment is made to account for an undercount of sales, typically in the lower price brackets, and to correct for a variance in geographical areas. The adjustment takes the median difference, as a percentage, for each price bracket between Land Registry and LonRes sales over the past 2 to 4 years (to avoid the data lag within Land Registry). This proportion is then used to adjust the most recent quarters of LonRes data.

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