Residential Quarterly | Winter 2022/23

Research - Market View

Economic Outlook

The economic outlook for the UK and the global economy has worsened, with the ongoing geopolitical situation in Europe continuing to disrupt supply chains and putting excessive pressure on inflation. As a result, disposable household income is tighter. Interest rates across the world continue to rise. There is global uncertainty over the economic outlook for the future. Existing pressures could persist, and there are still threats around Covid as outbreaks continue in China. As a result, economic growth could weaken further still.

In the UK, households are feeling the effects, with 92% of adults in November & December 2022 reporting an increase in their cost of living compared to the same period in 2021. Inflation has steadily risen since the start of 2022 and has been at over 10% since September, although it has been decreasing slightly over November and December 2022. In response, the government has spent around £43bn to address the cost of energy this year through warm home discounts, fuel duty reductions and the Energy Price Guarantee.

Confidence in the post-pandemic recovery of the global economy continues to be negatively impacted by the ongoing war in Europe. The situation has caused great uncertainty amongst markets, businesses, and consumers. The latest Business Confidence Monitor shows the Business Confidence Index weakening to -16.9, a big decrease from -5 in the previous quarter. GfK's Consumer Confidence Index increased by 2 index points over the most recent quarter, after setting a new record low in September with an index score of -49. It is the eighth month in a row where the index has been at -40 or worse, however it is worth noting that the British public are notoriously pessimistic. A stringent set of economic sanctions has placed additional constraints on the global supply of energy.

In response to surging inflation, the Bank of England increased the interest rate; it was raised to 4.0% in February 2023 – the highest since 2008. Rates have now increased ten times since they were slashed at the start of the pandemic. Reflecting these rises, mortgage rates also started to increase over 2022. Fixed rate mortgages have increased from 1.87% in Q1 to 5.03% (two-year fix), 4.77% (three-year fix) and 4.60% (five-year fix) in Jan 2023. However, this is a fall from the highs of more than 6.50% in October 2022. However, agents report that mortgage lenders have recently started to compete on price in order to meet their targets, and some five-year mortgages have seen a decrease in rates.

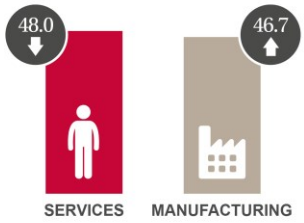
Many macro variables are pointing to a slowing economy. GDP growth was negative at -0.3% over Q3 2022 and the unemployment rate has risen very slightly to 3.7%. At the end of Q4, the FTSE was -0.7% down compared to the start of the year but had recovered by 7.9% against the start of the quarter.

Concerning Brexit, the UK has signed two trade agreements with Australia, New Zealand and a digital trade agreement with Singapore. An Agreement in Principle for a digital trade agreement with Ukraine was announced at the end of November 2022. There are also 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.

In mid-October, Jeremy Hunt was appointed Chancellor. In his 17 October 2022 statement, he cancelled a planned 1p reduction in the basic rate of income tax in 2023. Hunt also reversed many of the "mini-budget" initiatives set out by the Truss government earlier that month. Cuts to Stamp Duty Land Tax and increases to seed enterprise investment scheme limits remained in place. National Insurance rates were increased in April – a policy which was reversed in November 2022.

10.5%

Dec-22 inflation (CPI) was at 10.5%, up from Sep-22, when it was 10.1%. Source: ONS (Dec-22)



PMI Services fell from 48.0, however Manufacturing rose to 46.7 Source: IHS Markit/CIPS (Dec-22 to Jan-23)

Real average weekly earnings (total pay, seasonally adjusted) rose to £629 in Nov-22, compared to £590 in Nov-21. Source: ONS (Dec-22)

The Autumn Statement was released in November 2022 and focused on approximately £25bn of increased taxation and approximately £30bn of reduced spending. Key initiatives starting in 2023 include:

- From January, the Energy Profits Levy will be increased from 25% to 35% and a new, temporary 45% electricity generator levy will be introduced. From April, the additional rate of income tax threshold will be decreased from £150,000 to £125,140 (all other personal tax thresholds frozen for two years longer than planned, until April 2028). There will be a reduction in dividend allowance and Capital Gains Tax exempt amount, and there will be an increase in Corporation Tax to 25% (accompanied by a reduction in the Bank Corporation Tax surcharge from 8% to 3%).

- Business rates relief amounting to £13.6bn over the next five years.

- Increased spending in the short term for the NHS and the core schools' budget until 2024/25. However, a reduction in spending across the board from 2025/26.

- An increase in the Energy Price Guarantee from £2,500 to £3,000.

- A 9.7% increase in the National Living Wage to £10.42 per hour and a capping of rent increases for social housing at 7%.

The Autumn Statement was accompanied by the OBR November economic forecast. The OBR commented that interest rates are now at levels akin to the 2008 financial crisis. They expect the UK to be in a recession lasting approximately five quarters, from Q4 2022 through to Q4 2023. After 2023, inflation is expected to come down to below 1% in 2024 and 2025, and growth is expected to rally to 1.3% in 2024 and above 2% for 2025. Whilst nominal earnings are expected to grow in 2022 and 2023, real incomes are expected to fall as a result of high inflation.

UK Average Rent
£1,174pcm
Source: HomeLet (Dec-22)

UK property prices grew 4.8% YoY to Q4 2022
Source: Nationwide HPI

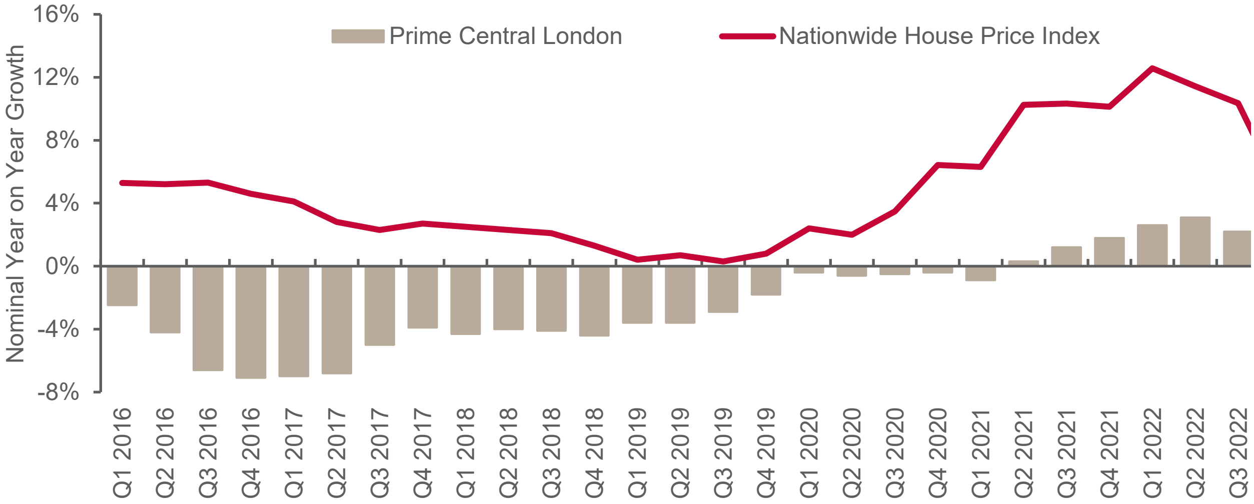
Property market pricing

According to the Nationwide House Price Index (NWHPI), UK property price YoY growth dropped to 4.8% in Q4 2022, after six consecutive quarters of growth above 10%. Quarterly growth was at -1.8%; the first quarter of negative growth since Q2 2020.

On a regional basis, the best YoY performers were East of England (6.6%), West Midlands (6.2%), the North East (6.1%) and the North West (6.0%). Scotland saw the lowest YoY growth at 3.5%, followed by London at 4.2%. No regions saw negative growth over 2022. On a quarterly basis, all regions experienced negative growth for the first time in at least four quarters with the most marginal of these being East of England (-0.3%) and London (-0.5%).

Figure 1

UK house price growth vs Prime Central London (PCL)



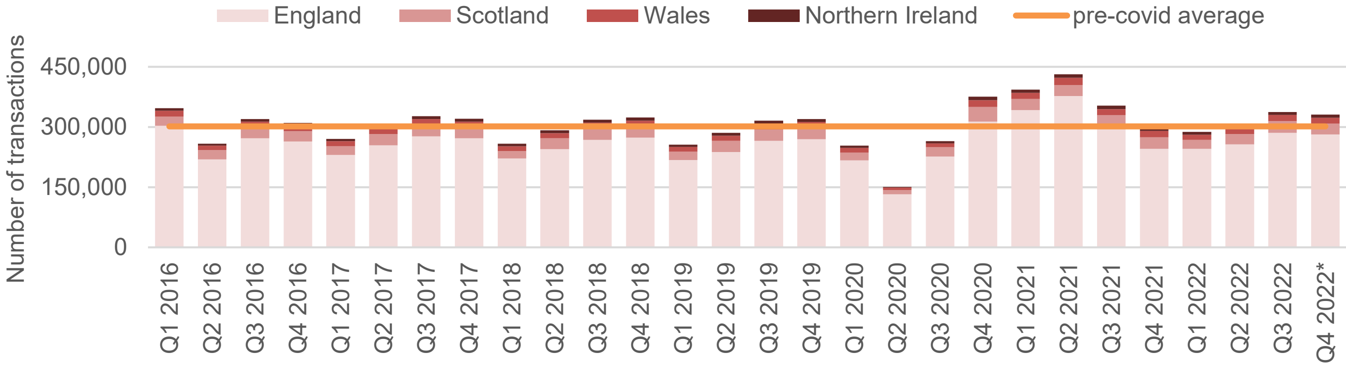
Source: *Strutt & Parker Research, Nationwide House Price Index, Volterra*

National residential sales transactions

The November 2022 Bank of England Report stated that housing demand has continued to slow due to rising borrowing costs and increased uncertainty. Supply of properties for sale has increased, although smaller house builders have reported cutting back on projects due to demand concerns. According to HM Revenue & Customs, UK (seasonally adjusted) residential transactions in November 2022 were at 107,190. This was 13% higher than November 2021 and less than 1% higher than October 2022.

Figure 2

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



***Source:** Strutt & Parker Research, HMRC; Monthly property transactions completed in the UK with value of £40,000 or above as at December 2022. * Includes provisional Q4 2022 data*

Regional residential sales & lettings

For UK sales, activity is almost the same as last year; there is approximately 20% more stock, and the level of pitches and offers agreed is the same. People who bought houses within the last year or so at inflated prices may be expected to see their house price fall, but those that bought five years ago will not see the same decrease. Most mortgage deals have factored in an increase in the Bank Rate in 2023, so the forecast rate rise is not expected to have a significant impact.

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, are likely hold on to properties as they anticipate the shocks to be shorter term. Renters will look to extent tenancies which will continue to dampen supply, which will be bolstered by accidental landlords, but this is unlikely to match the inflated demand.

Table 1.

Number of registered properties sold by regions for Q4 in 2020, 2021, 2022

Region	All Property Q4 2020	All Property Q4 2021	All Property Q4 2022
East Midlands	1,831	1,743	3,845
East of England	2,737	2,054	5,283
Greater London	2,491	1,857	5,176
North East	1,007	1,185	2,337
North West	2,857	2,941	999
South East	3,911	3,122	8,296
South West	2,628	2,130	5,396
Wales	1,171	1,662	2,699
West Midlands	2,058	1,956	4,219
Yorkshire and Humber	2,177	2,089	4,392
Scotland**	37,064	31,131	28,271

"The market is one of conflicting messages at present, despite applicant numbers and instruction rates within 10% of those at this point last year, the rise in cost of living, inflation and disrupted mortgage markets means that consumer cautiousness remains high.

"That said, as stability begins to return to the mortgage market, as seen by some reductions in five-year fixed rates and a leaning back into non-variable products, those who are in a position to be able to transact this year will have their confidence bolstered somewhat. While some have forecast downturns of up to 10% this year, around half of this negative growth has potentially already been witnessed in the turmoil that followed the mini-budget and resulting mortgage markets."

Kate Eales

Head of Regional Agency

***Source:** Dataloft, Land Registry 2020 data as at 7th Jan-20, 2021 data as at 11th Jan-21, 2022 data as at 6th Jan-23; 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 February 2023.*
***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*

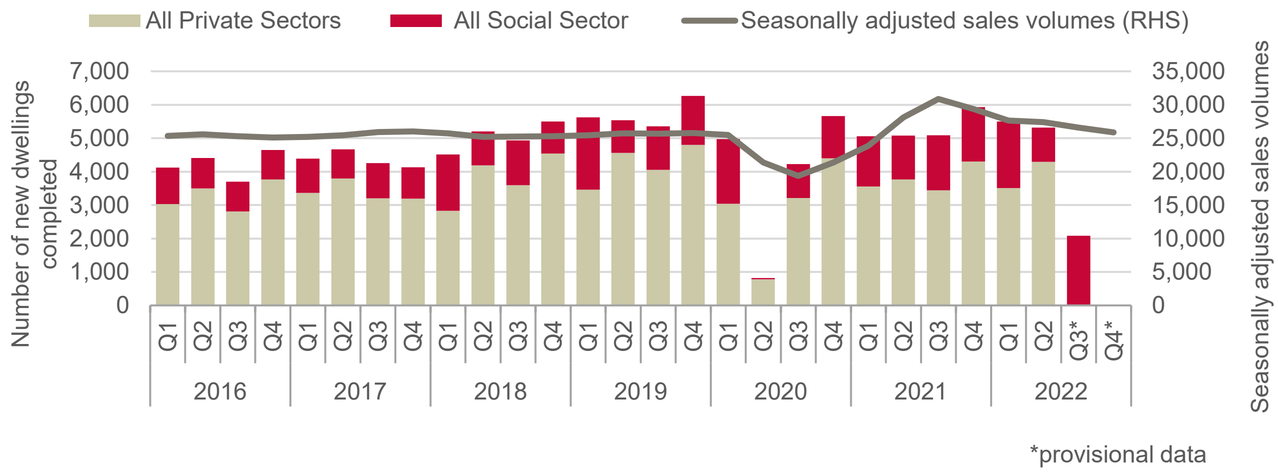
Regional delivery & sales - Scotland

New build delivery in Scotland a made returned to pre-COVID levels in Q4 2020 and have continued at above 5,000 per quarter from then until Q2 2022 – Q3 & Q4 data for 2022 has not been released. On average 75% of the delivery has come from the private sector, this hit a post COVID peak of 85% in Q2 2022.

Over 2022 house prices in Scotland have grown by 6.5%, according to the Registers of Scotland. Dumfries & Galloway and Glasgow City both exceeded this with 7.6% and 8.3% growth respectively, City of Edinburgh achieved house price growth of 6%.

The volume of seasonally adjusted sales in Q4 2022 was 16% below the peak of 30,700 that was reached in Q3 2021; this peak happened due to the pend up demand that developed during the pandemic lockdown. However, this is back in line with the pre-COVID average of 25,400.

Figure 3.
Number of new build completions and sales in Scotland

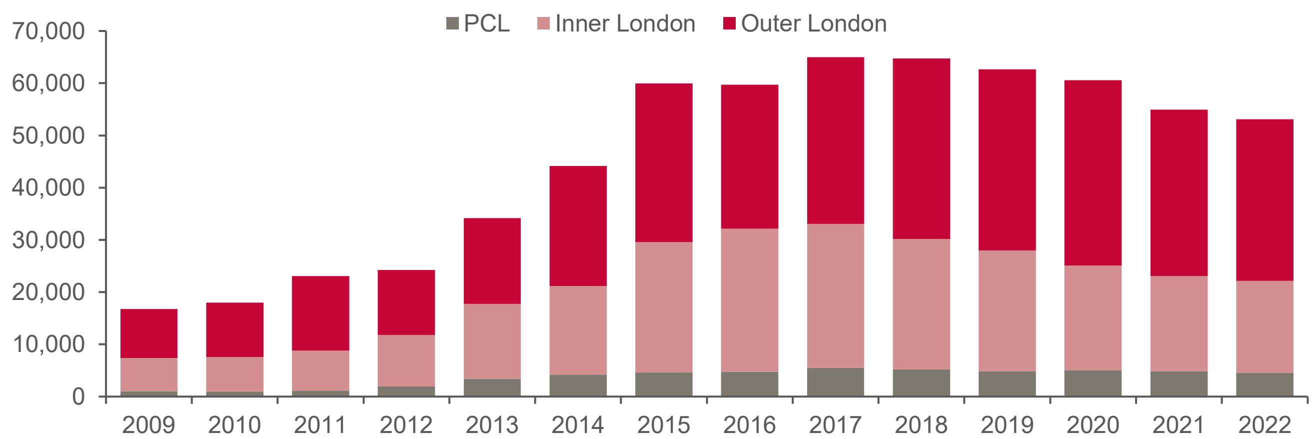


Source: *Strutt & Parker Research, Registers of Scotland, gov.scot*

Greater London residential new homes

Across Greater London, at the end of 2022, there were over 53,000 new build units under construction and a further 20,000 new build for sale units sold according to Molior. Per borough there continues to more units under construction in Inner London than Outer London. Sutton and Richmond have by far the fewest units under construction, 53 and 56 respectively, even falling below the City of 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 19th January 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.*

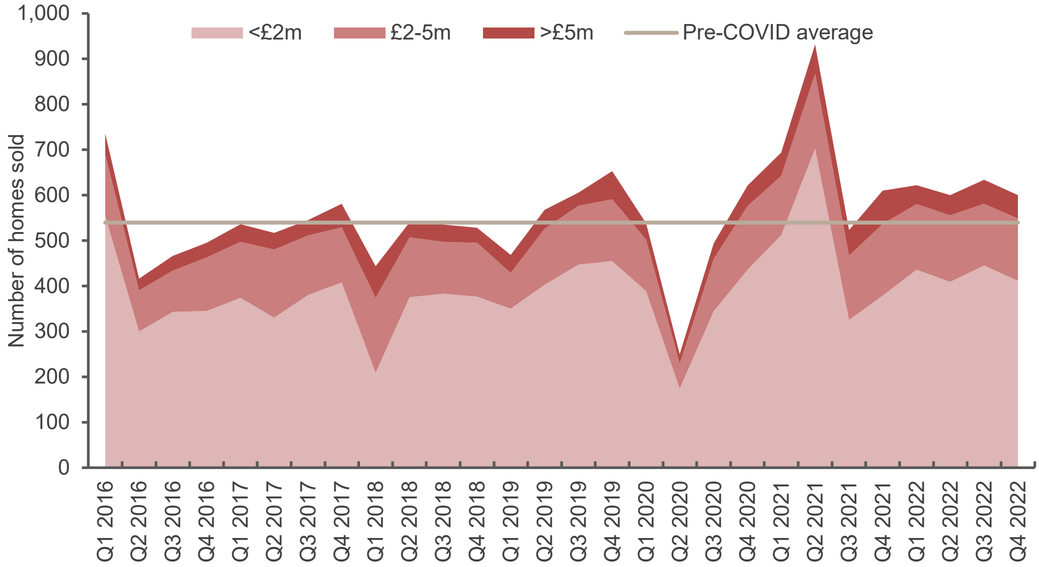
Prime Central London residential sales market

In the year to Q4 2022 PCL values grew 0.8% – line with our previous commentary forecast. It represents the seventh consecutive quarter of positive annual growth but also a slowing compared to previous recent quarters. PCL sales prices grew at -0.6% in the quarter to Q4 2022, the second quarter of negative growth. Prices are circa 19% down from their 2014 peak.

Quarterly PCL sales transactions grew 3% to Q4 2022, with yearly growth up at 7%; however, this is a steep slowing against the year-on-year to Q3 which hit 21%. This quarter's growth was driven by the £2-£5m and >£5m brackets (15% and 21%, respectively) with a contraction in the sub £2m market of -3%. By contrast, yearly growth was driven by the <£2m bracket (14%) with mild negative growth in the £2-£5m and >£5m brackets (-1% and -12%, respectively). Total PCL transactions in Q4 2022 are now 63% of the previous peak in Q4 2013.

Figure 4

Historic number of homes sold in PCL



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

"We're in a similar position to last year: a scarcity of stock will continue to uphold premiums in the prime London sales market and create disconnect between those markets above £4M and those below. More peripheral and mainstream London markets are likely to not be as robust as those less reliant on borrowing constraints.

"The rental market was well and truly exhausted by autumn last year with the drop off in the last three month's transactions effectively wiping out gains on the previous quarter. It's evident that tenants are unable to continue to prop up the rate of climbing rents and, with the sales market a space of uncertainty and frustration, we may see vendors putting their homes into the rental market until stability resumes which will help low stock levels."

Louis Harding

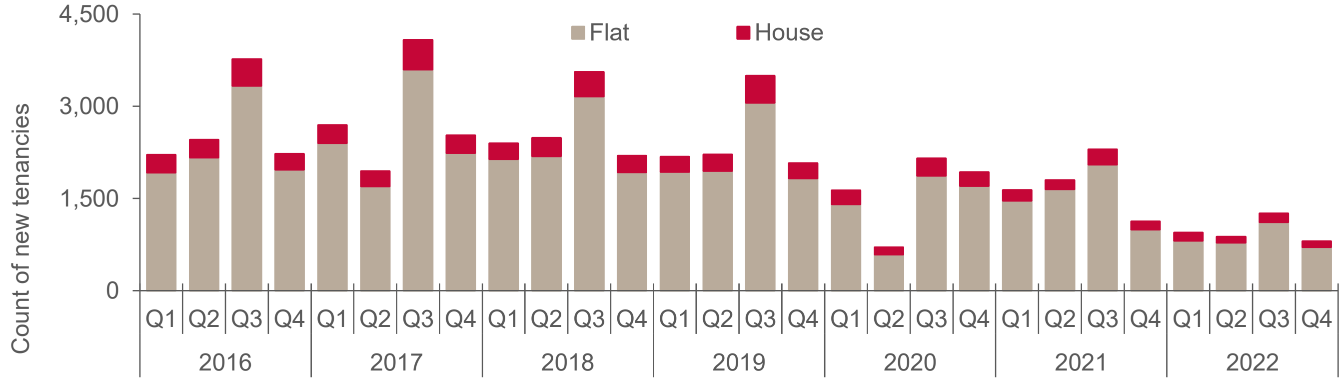
Head of London Residential Agency

Prime Central London lettings market

PCL rents grew 11.7% over 2022, over double that recorded in 2021 (5.7%). It led to the seventh consecutive quarter of positive quarterly growth with rents increasing 0.9% in Q4 2022, however this was a large slowing in the rate of rental increases. PCL lettings transactions decreased by 36% against Q3 2022, more in line with Q1 and Q2. Transaction volumes in 2022 were 28% down against 2021. This reduction in liquidity in the lettings market has caused a spike in rental values; in 2021 38% of PCL rents were less than £500pcm, in 2022 this fell to 19% of lets.

Figure 5

New rental tenancies in PCL by house type



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

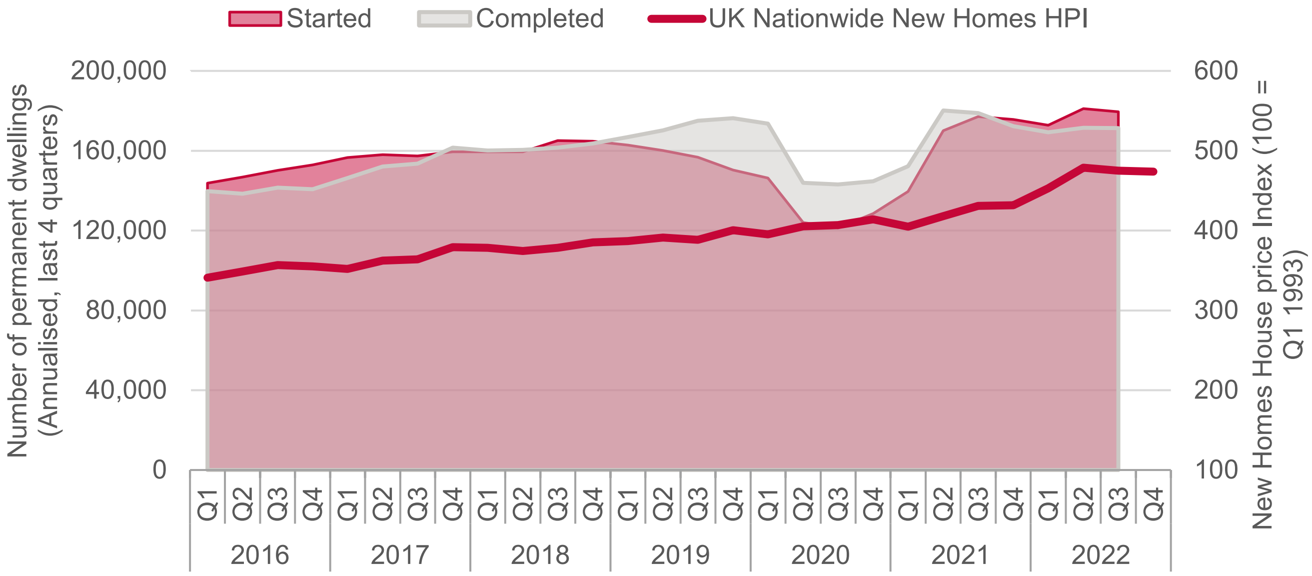
England & Wales new homes

Only 171,000 homes were built over the four quarters to Q3 2022 – the latest available data point – 57% of the government's target. Even with the numbers of completions quickly returning to pre-COVID levels current the disruption to supply chains and increased costs of labour & materials means that developers will have a difficult time providing the 300,000 per year homes that the government state England & Wales need. Start levels have been marginally above completions over 2022 increasing the size of the pipeline; nevertheless, this is not enough to provide the required homes, nor does it consider the location of these homes.

This lack of supply plays out in value. 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 fell marginally (-0.3%) over Q4 2022. London has typically provided around 14% of the new homes sold in England & Wales. This is the second most with the South East typically providing 16%; and the North West typically 13%. Wales and the North East the least.

210,070 new build homes built in 2021-22, up from 194,060 new homes in 2020-21

Figure 6
Number of new homes sold by region (excl. London) & new homes house price index



Source: Strutt & Parker Research, ONS

Forecasts

UK prices ended the year at 4.8% growth, after six consecutive quarters of annual growth above 10%. This was just below our forecast (5%-10%). Our previous commentary forecast price changes of between -5% and 0% for 2023 and a five-yearly outlook of 10%-15%. Agents have been expecting prices to drop down from their recent peaks, and this has partly been seen in this quarter's drop of over 5%. As such, our previous forecasts are retained.

Table 2. Residential House Price Forecast

	2023	5 Years to 2026 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%

Source: *Volterra, Strutt & Parker Research*

Forecasts continued

PCL prices ended the year at 0.8%, at the bottom end of our forecast (0% to 2%). QoQ growth was negative (-0.6%) for the second quarter in a row. Our previous commentary forecast price changes of -3% to 3% for 2023 and a five-yearly outlook of 10% to 15%. Agents report that there are still strong supply issues, and that the PCL market is more robust to shocks than other markets. Historically, prices have not moved by much, and this is expected to continue. Therefore, our previous forecasts are retained.

PCL lettings growth has been particularly strong, ending the year at 11.7% growth, in line with our forecast (10% to 15%). Quarterly growth, however, dropped below 1% after three consecutive quarters of growth above 3%. Agents report that there are still supply shortages but that the market may see a price softening as rising rents become less and less affordable. Agents expect increases, but not as high as we have been seeing for the past few quarters. Given this, the previous forecast is downgraded slightly to 5% to 10% in 2023 and 20% to 30% in the five-year outlook.

Outlook

The economic outlook for the local and global economy has worsened as the ongoing geopolitical situation causes more disruption to global energy and food markets. Considerable uncertainty remains, including a potential threat from China of another Covid outbreak. The cost-of-living crisis persists in the UK, with inflation remaining at over 10% in December 2022.

Several support packages have been put in place by the government. However, the Autumn Statement focused on higher taxes and decreased government spending, which will put further constraints on household budgets. Inflationary pressures, weaker growth and tighter financing conditions will make it harder for households and businesses to repay or refinance debt as well as being more vulnerable to economic shocks.

"The start of 2023 has seen more activity than most expected and there are signs that the rest of the year may follow suit. Inflation has peaked, with the Bank of England expecting inflation to fall to between 5 and 6% by the end of 2023. This tenth and latest rise in the base rate is likely to be one of the last increases, and economists expect both the Federal Reserve and Bank of England to likely start reducing rates at the end of this year, or early next.

"The recent rate increase will do very little to affect mortgage rates as lenders have already priced in these rate hikes. As such, we'll likely witness increased stability and certainty in the market encouraging transactions and stabilising prices."

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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 Q4 2022 in light of changes since Q4 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.