UK Residential Forecasts

Q4 2022

Housing set for a correction, not a crash

The last 15 years have seen UK house prices reach new highs on the back of a period of record low borrowing costs. Never prior to 2008 had the UK base interest rate dipped below 2%. But in the period since the Global Financial Crisis (GFC) it has averaged 0.5% and hit a low of 0.1% during Covid.

A spike in borrowing costs – and an anticipated further steep rise in mortgage rates - alongside continued high inflation and a rising cost-of-living have prompted predictions from the most bearish forecasters of 20%-30% falls in UK house prices.

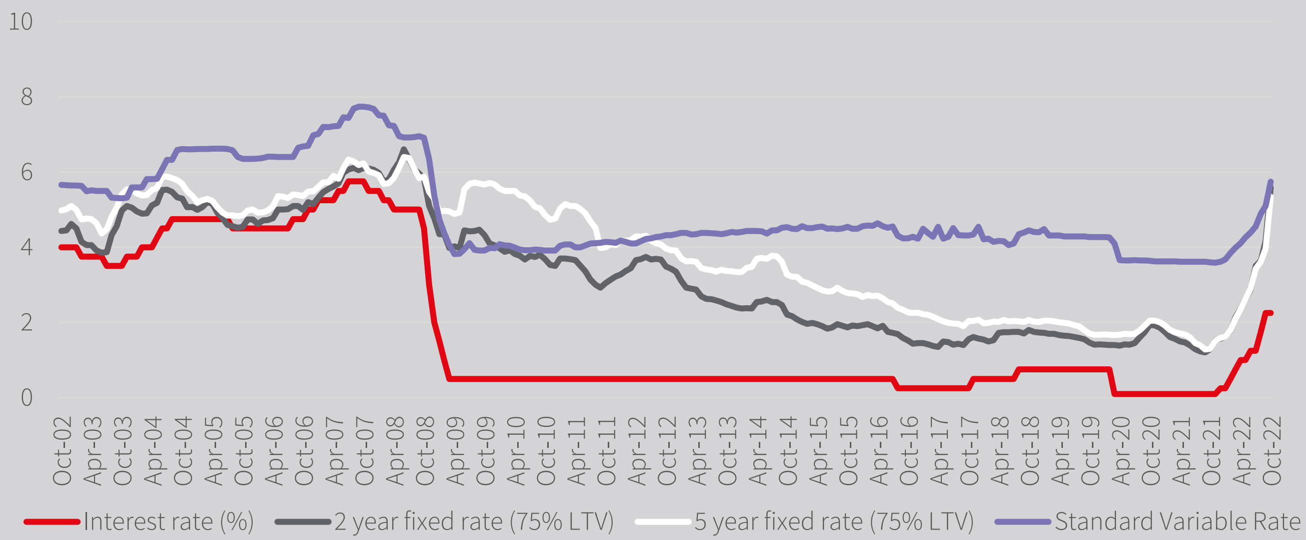
But UK house prices have never fallen by more than 20%. And this prompts a question of whether the underlying market prospects are now truly worse than the early 90s recession where house prices fell 20% cumulatively between 1989 and 1993; and the GFC where prices fell by 15% between January 2008 and May 2009.

In the early 90s, inflation was high (like today) and GDP was low (also like today). But a key differentiator was that unemployment was extremely high at circa 10% in the early 1990s – today, it is at a record low of 3.5%. And while unemployment is expected to rise in the coming 18 months, it is expected to reach only 4.9%, below the average of 6.7% since 1971 and the past 10-year average of circa 5.2%.

Meanwhile, the GFC was fundamentally a credit crisis built on poor lending practices through the early 2000s, which saw people with poor credit history and no equity lent sums of money they could ill-afford to repay. Ultimately the ‘house of cards’ collapsed, banks failed, millions lost their jobs and people were forced to walk away from mortgages they could never afford in the first place.

In the period since, lending practices have been tightened significantly, and the housing market is now built upon much stronger foundations.

Historic interest rates and mortgage rates



Source: JLL/ Bank of England

Lack of distress

JLL analysis of the Bank of England Mortgage and Lending Report found that 62% of the UK's 8.4m mortgaged owner occupier households have at least 25% equity in their home. Another 34% have between 10-25% equity and 4% have between 5% and 10% equity.

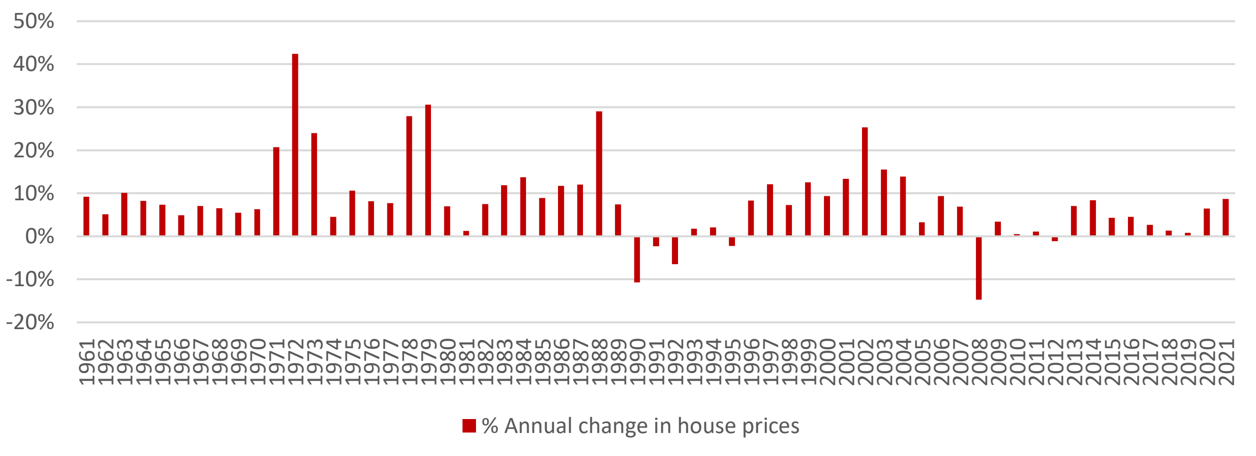
Just 0.2% or circa 17,000 owner occupied households in the UK have less than 5% equity – and, statistically at least, there are no households with zero equity. Meanwhile, more than 95% of the circa 3m UK buy to let landlords who own with a mortgage, own at least 20% in their property.

But ultimately the amount of equity the UK's homeowners possess tells only half of the story. An era of cheap borrowing is ending, and mortgage affordability is about to become squeezed. However, mortgaged households in the UK have the highest incomes by tenure – averaging £80,000 per annum. Before the recent rise in UK interest rates, the proportion of average household income spent on a UK mortgage was equivalent to 18%. With the average two-year fixed rate mortgage cost having risen to circa 6%, that income to mortgage expenditure percentage has, in theory, risen to circa 27% - the level it was around the time of the Global Financial Crisis. And if mortgage rates hit 7%, the average household income to mortgage cost ratio would hit 30% - the rate it was in the early 1990s. But merely spending 30% of a household income on housing costs is not a reason to assume a collapse into distress. With low unemployment and the highest average incomes, the UK's mortgaged households are on a far more stable financial footing than in either the GFC or the early 1990s recession.

The vast majority should therefore be able to ride out a squeeze on their household incomes avoiding the need to sell their home to make ends meet. But it will be a further extension of the current cost of living crisis.

Circa 1.1m households were on a standard variable rate mortgage coming into this recent rate rise. Another 1.2m households will come to the end of their fixed term over the next year. JLL calculates that those 2.3m households combined will be spending an additional £8bn on mortgages by Q4 2023. This could ease some of the current high inflation, but it could also hamper GDP growth. The customers spending that extra on their mortgage would perhaps most likely be transferring that from their previous savings/investment allocations or from their typical discretionary spend on food, leisure and entertainment.

House price crashes have been rare in the UK



Source: ONS, Nationwide

Low risk of repossessions

Furthermore, banks currently have a low appetite for repossessions. In the early 1990s, banks repossessed circa 100,000 homes per annum. In the GFC, the rate was about 50,000 per annum. Currently there are about 4,000 repossessions per annum which out of the UK's circa 11m mortgaged properties represents a rate of about 0.04% per year. It takes two years to repossess a home – and in the current cost of living crisis, it could be a difficult public profile position to be seen to be adopting a repossession strategy.

However, banks are regulated entities, so they cannot turn a blind eye to customer defaults. But there are other options that can be explored such as tracker rates or interest only periods and it is highly likely that banks will exhaust all these options before pursuing a route of foreclosure.

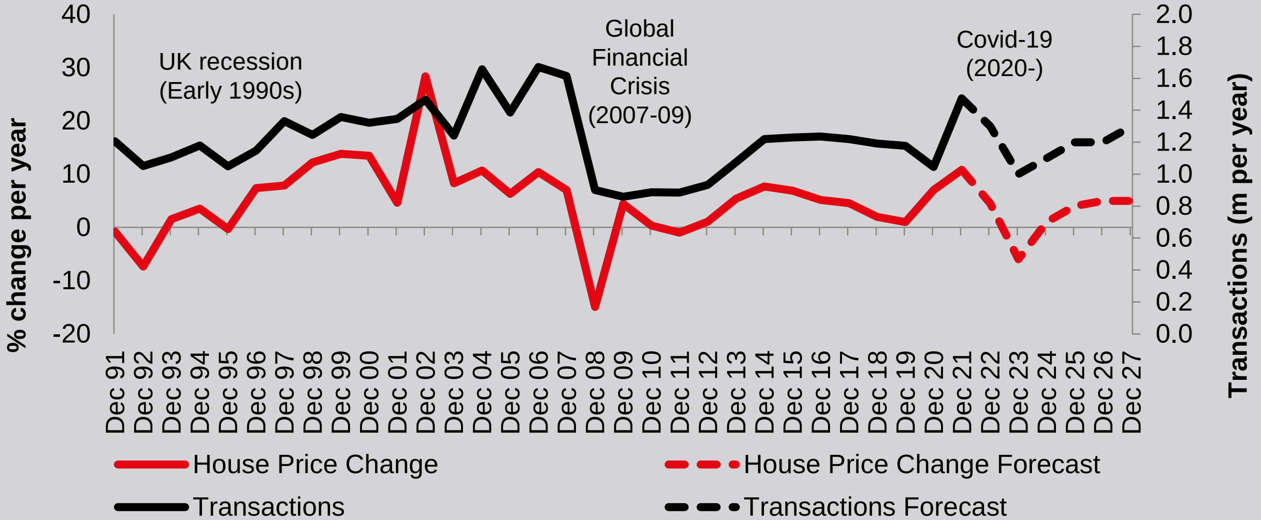
Ultimately, we expect that there will be far less distress in the market than there was in previous housing market downturns – as long as there is no sharp rise in unemployment. But JLL predicts there will be a steep fall in UK housing transactions.

The number of first time buyers (FTBs) before the GFC typically totalled 400,000 per annum out of a total of circa 1.5m annual transactions.

Post GFC, FTBs fell to 325,000 and total transactions to 1.2m. JLL predicts there will now be circa 200,000 viable FTBs with sentiment among aspiring homeowners taking a hit, mortgage affordability becoming stretched to new homeowners and the ending of Help to Buy, which typically helped circa 50,000 FTBs onto the ladder per annum. This cocktail of transactional headwinds will see overall transactions fall to circa 1m in 2023.

The transactions that do occur will be dominated by slightly more motivated sellers (but not financially distressed) faced with a higher proportion of 'opportunistic' buyers (such as cash buyers who will account for about 25% of all transactions, up from the current 18%). These opportunistic buyers will not expect to pay asking price. But the vendors who are not distressed will only accept a fall in values to a certain level – ie more of a discount than a fully blown house price correction.

Transactions are forecast to fall sharply with price falls to follow



Source: JLL/ HM Land Registry

New homes in short supply

JLL expects a sluggish market to emerge in which buyers and vendors haggle over price, and ultimately less transactional activity occurs with the supply of new homes for sale gradually becoming constrained.

Against this backdrop, JLL is forecasting that UK house prices will fall in value in 2023 by 6%, which equates to an average discount of £17,500 from the average UK house price of circa £290,000.

Of course, as in any market, there will be winners and losers. Not all types of home, cities or regions will be impacted to same level.

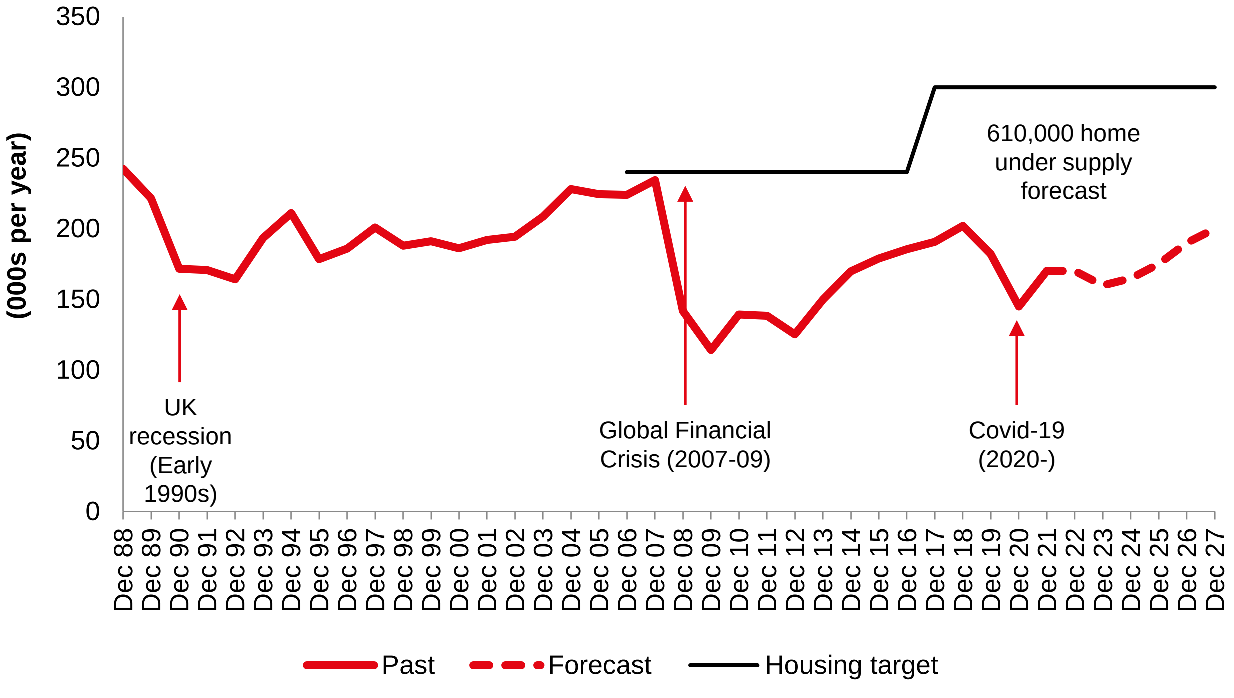
On a regional level JLL's forecasts falls ranging from circa 4% across Greater London to around 8% in Wales, the North East and Yorkshire & The Humber.

However, in many of the housing supply constrained UK city centres, where there is a greater concentration of equity rich buyers, price growth is still expected.

Ultimately, new housing supply is expected to fall even further behind target as a result of the tightening market conditions.

JLL forecasts that there will be a national shortfall of 610,000 homes over the next five years alone – up from JLL's previous expectations for an already stark shortfall of 500,000 homes. In London private new home starts are forecast to average circa 16,000 per annum – well below the Greater London Authority target for 52,000 new homes per annum.

UK housing supply will continue to fall well short of target



Source: JLL

Strong rental markets

The persistent lack of quality rental housing is an ongoing issue for the UK, highlighted by recent rental growth and students and renters struggling to find accommodation. This fundamental demand for quality rental housing stock remaining at unprecedented levels is reflected in ongoing strong institutional investor appetite for purpose built rental homes.

Annual investment in the UK living real estate sectors has exceeded £10bn in the third quarter of 2022, putting living on track for a record year.

This ongoing strong investment has funded 63,800 rental homes in over 200 deals so far in 2022. The current supply demand imbalance across the UK rental market looks set to endure as fewer households move across into owner occupation and demand for rental properties increases further.

We expect that prospective buyers, as well as those who would under normal circumstances have transacted under Help to Buy, will remain in the rental market. This adds further fuel to an already constrained rental market and will, we expect, mean the supply demand imbalance and resulting rental growth will continue. Rental growth is expected to be particularly strong at the front end of the five-year period before falling back in line with historic norms of circa 2% - 3% as inflation is brought back under control.

Demand for rental properties looks set to continue, and forecasts of rising rents and falling prices suggest we could see a rise in yields across the board. But the cost to service debt will remain a key issue for more highly geared landlords.

The purpose-built UK BTR sector is expected to outperform the wider UK rental market in terms of rental value growth.

Emergency legislation in Scotland - under the Cost of Living (Tenant Protection) (Scotland) Bill 2022 - has been passed, to freeze rents and establish a six-month moratorium on evictions for both the private rented and social sectors, until at least 31 March 2023. We expect this to limit rental growth in Scotland in the short term, followed by higher growth once restrictions are lifted.

City centres to outperform

The outlook for the UK's city centres is much stronger. House prices are still expected to grow in the centre of many of the UK's largest cities.

Central London is predicted to see the highest level of house price growth of any UK housing market in the 12 months to Q4 2023 with values forecast to rise by 2.5%.

This relatively strong performance will be driven by a significant shortage of homes for sale. In the most exclusive central markets strong overseas buyer demand on the back of a weaker Sterling will also underpin price growth.

Prices in Central London are then expected to steadily rise through the five-year period to Q4 2027 with cumulative price growth of just under 20%.

Across London as a whole, the continuing and long running housing undersupply is expected to worsen. JLL forecasts that construction will commence on just 83,000 new homes over the next 5 years in London, which equates to just 32% of the 260,000 new homes that will be needed over the period.

Manchester and Birmingham are expected to be the next strongest housing markets in terms of price growth followed by Edinburgh and Bristol. All of these cities have seen demand significantly outstripping housing supply in the period since Covid-19 as students and young professionals have looked to return to the UK's major cities.

Energy efficient new build city centre homes are expected to prove popular with renters looking at ways to minimise their energy bills. This will boost demand for new urban rental homes underpinning stronger rental value growth.

Manchester City Centre, which is one of the fastest growing economies in the UK, is expected to see the strongest rental value growth over the next five years as increasing numbers of young professionals are attracted to live and work in the city.

House price forecasts

UK and regional forecast

Sales price growth (% pa)	2023	2024	2025	2026	2027	Cumulative 2023-27	Average pa 2023-27
UK	**-6.0**	**1.0**	**4.0**	**5.0**	**5.0**	**8.9**	**1.7**
Central London	2.5	3.0	3.5	4.0	5.0	19.3	3.6
Greater London	-4.0	2.5	4.0	5.0	6.0	13.9	2.6
South East	-6.0	2.0	4.5	4.5	5.5	10.5	2.0
East of England	-6.0	2.0	5.0	4.5	4.5	9.9	1.9
South West	-7.0	1.5	4.0	4.0	4.5	6.7	1.3
East Midlands	-6.0	2.0	5.5	5.0	4.0	10.5	2.0
West Midlands	-7.0	2.0	5.0	5.0	4.5	9.3	1.8
Yorkshire & The Humber	-8.0	1.0	4.0	4.5	3.0	4.0	0.8
North West	-7.0	1.5	4.0	4.0	3.0	5.2	1.0
North East	-8.0	0.0	3.5	5.0	3.0	3.0	0.6
Wales	-8.0	0.0	3.0	5.0	4.5	4.0	0.8
Scotland	-5.0	1.0	3.0	5.0	5.0	9.0	1.7

UK City Centres

Sales price growth (% pa)	2023	2024	2025	2026	2027	Cumulative 2023-27	Average pa 2023-27
Bristol	0.5	2.0	3.5	4.0	6.0	17.0	3.2
Birmingham	1.0	2.0	4.0	4.5	6.5	19.2	3.6
Manchester	1.5	2.5	4.0	4.0	6.0	19.3	3.6
Leeds	0.0	1.5	3.0	4.0	5.0	14.2	2.7
Liverpool	-1.0	1.5	3.0	3.5	4.5	11.9	2.3
Edinburgh	1.0	2.0	3.5	4.5	5.5	17.6	3.3
Glasgow	0.0	1.5	3.0	4.0	5.0	14.2	2.7

Source: JLL Research

Rental growth forecasts

UK and London rental forecast

Rental growth (% pa)	2023	2024	2025	2026	2027	Cumulative 2023-27	Average pa 2023-27
UK	**4.0**	**3.5**	**2.5**	**2.5**	**2.5**	**15.9**	**3.0**
Central London	6.0	4.5	3.0	2.5	2.5	19.9	3.7
Greater London	4.5	4.0	3.0	2.5	2.5	17.6	3.3
UK BTR	6.0	5.0	4.0	3.0	3.0	22.8	4.2

UK City Centres rental forecast

Rental growth (% pa)	2023	2024	2025	2026	2027	Cumulative 2023-27	Average pa 2023-27
Bristol	4.0	4.0	3.5	2.5	3.0	18.2	3.4
Birmingham	5.0	4.0	3.5	3.0	2.5	19.3	3.6
Manchester	6.0	5.0	3.5	3.0	2.5	21.6	4.0
Leeds	3.5	3.5	3.0	2.5	2.5	15.9	3.0
Liverpool	3.5	3.0	3.0	2.5	3.0	15.9	3.0
Edinburgh	1.0	5.0	3.5	2.5	3.5	16.4	3.1
Glasgow	1.0	5.0	3.5	2.5	2.5	15.3	2.9

Housing starts and transactions

Private housing starts	2022	2023	2024	2025	2026	2027
Greater London	18,000	15,000	16,000	17,000	17,000	18,000
UK	170, 000	160,000	165,000	175,000	190,000	200,000

Housing transactions (millions)	2022	2023	2024	2025	2026	2027
UK	1.3	1.0	1.1	1.2	1.2	1.3

Source: JLL Research

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