Market Commentary

Residential Analysts

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United Kingdom – November 2022

- Rising Waves
- Quicker To Sink
- New Build – New Lifeboats Needed?

There have been rising waves threatening to sink the UK housing market all year but they have stayed just below the surface – until now. House prices continued rising and transactions stayed above their pre-pandemic levels despite rising rates and the cost of living crisis. However, the mini-budget was the turning of the tide and the surface is starting to look a lot more turbulent. The waves are now threatening to sink the housing market – an outcome that will probably hit transactions hardest and suggests the new build sector will need support.

Rising Waves

There are multiple rising waves threatening to overwhelm household finances and they are now starting to affect the housing market. While the high mortgage rate wave has fallen from its recent post mini-budget peak, it is still much higher than at the end of the summer and there are multiple signs it is now hitting activity and prices. The Bank of England reported mortgage approvals for house purchase were 11% below their pre-pandemic average in October while Zoopla reported (PDF) a 28% fall in sales agreed during November– the fall was bigger in more expensive areas where higher rates hit borrowers harder. Meanwhile, the many waves created by the cost of living crisis are still rising and households are finding it harder to stay afloat. Just one of these waves might be manageable when combined with government support. However, in combination, they are big enough to sink the finances of many households. Waves combining to make a bigger one might be called constructive interference in physics but this outcome will prove entirely destructive to household finances and the housing market.

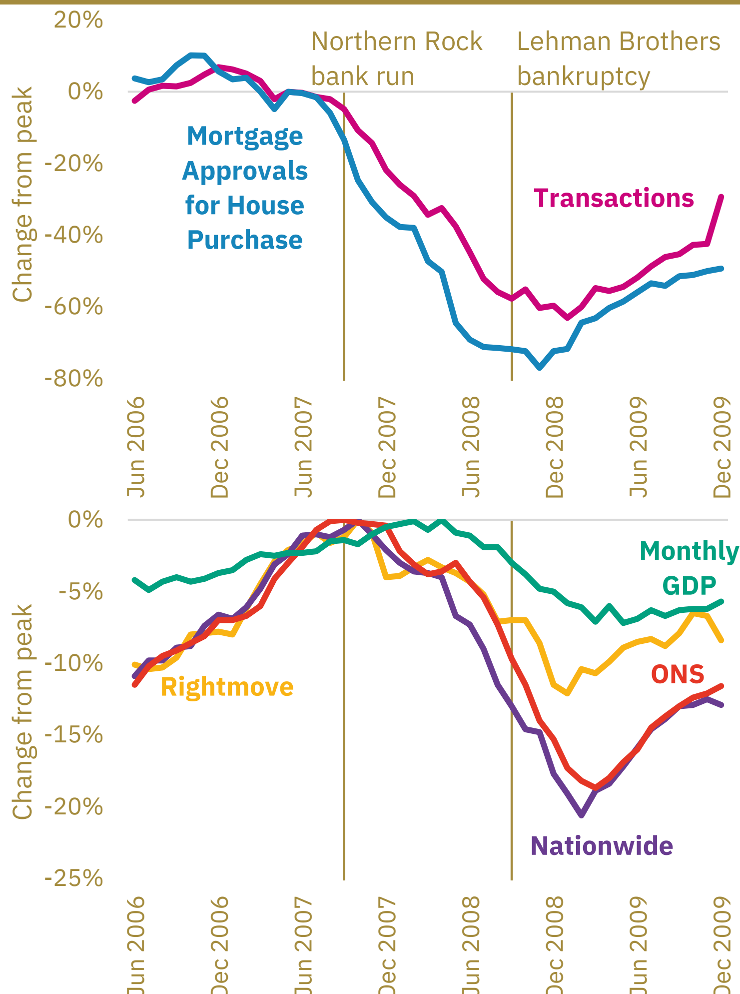
Quicker To Sink

It is still highly uncertain what will happen to the housing market next year but this year has shown it can be incredibly buoyant and take a long time to sink. This is not unique and, as Figure 1 shows, it was activity levels that fell first in the last downturn – they had already fallen from their highs in 2006 but rebounded slightly in early 2007. It then took almost six more months for house prices to start falling but even then the falls were less than 5%. House prices only fell sharply through the latter half of 2008 as the recession hit with rising unemployment and repossessions.

This time the market could be quicker to sink. The last downturn was initially caused by the credit crunch - directly affecting transactions. This one is being led by rising rates, so the time between activity and prices falling could be quicker if not simultaneous – Nationwide is already reporting house prices are down 3.6% since August. However, it is possible that we might now see something similar in terms of price falls – a relatively large fall in activity but smaller falls in house prices over the next few months. This would effectively create a stagnant housing market. However, the danger is that the combination of higher mortgage rates and the cost of living crisis lead to a combined hit on consumer spending that further worsens the prospects for the economy in 2023. A consumer-led recession could then lead to rising unemployment and create the conditions usually required for a large fall in house prices later in the year or in 2024.

Fig 1: 2006-09 Transactions, Prices, & GDP

Source: HMRC, BoE, ONS, Rightmove, Nationwide



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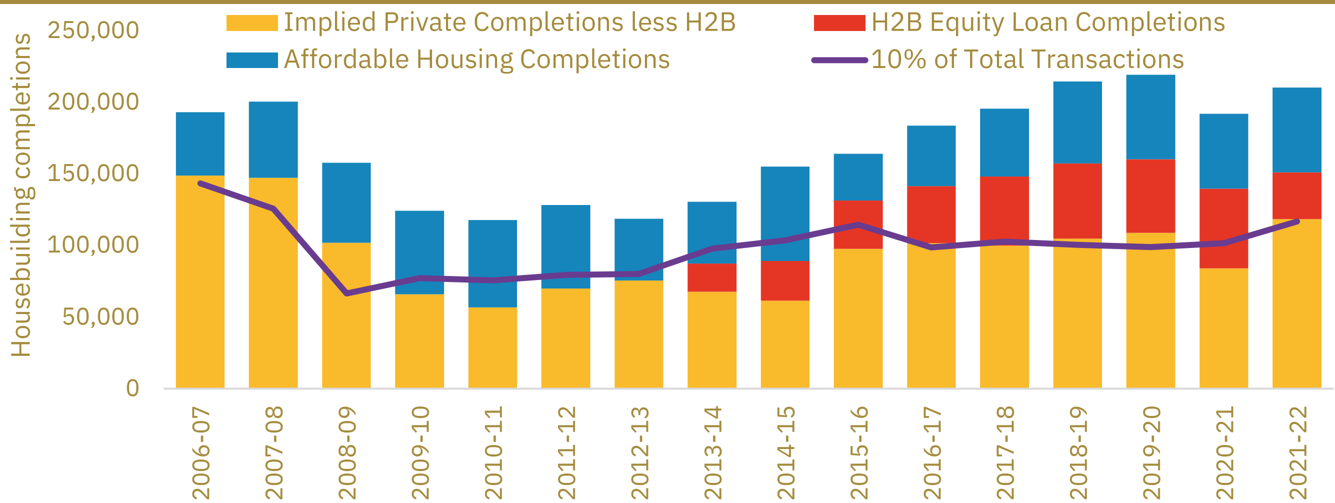
New Build – New Lifeboats Needed?

House prices are likely to fall next year but the more immediate risk is to housing market activity and new supply. With fewer buyers able to meet the high price expectations of the current market thanks to higher mortgage rates and the cost of living crisis, housing market activity will fall. With a large proportion of new housing supply dependent on market sales, a fall in housing market activity could be disastrous for new supply. As Figure 2 shows, private housebuilding completions (excluding affordable housing) have tended to make up around 10% of total transactions. This is a pattern that appears to have held since at least the 1980s. However, recent years have seen the housebuilding sector increase its market share, largely thanks to Help-to-Buy equity loan but also due to the growing diversity of organisations involved – e.g. build-to-rent. However, Help-to-Buy is ending and market activity is slowing. There are growing signs that housebuilding is too and it may need significant support.

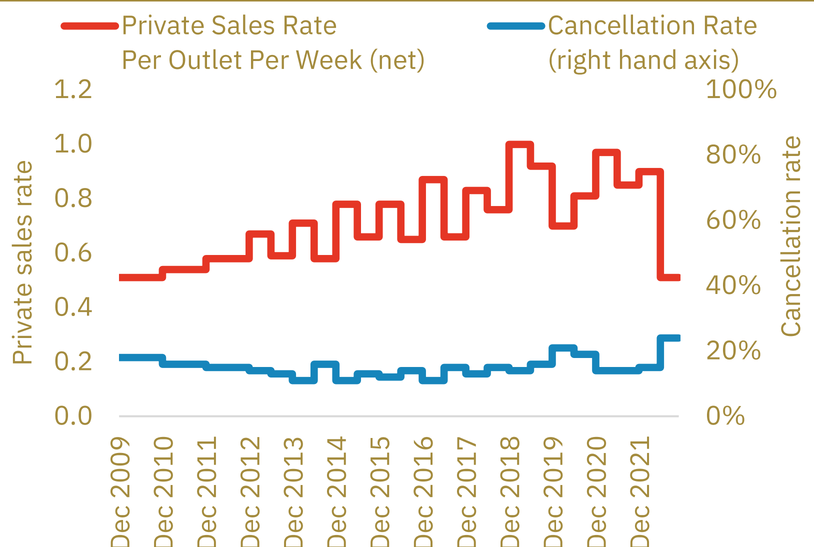
Fig 2: New Housebuilding Completions, England
Source: DLUHC



Recent listed housebuilder updates have made for sobering reading in recent months. For example, Taylor Wimpey (Figure 3) have reported a big fall in sales rates and an increase in cancellation rates since the summer – predating the mini-budget fiasco but worsening since. However, the volume housebuilders are in a far healthier financial position than they were in 2007 – with very large profit margins, limited debt, and land held at relatively low cost. The immediate danger is they just cut back on delivery – leading to another cycle of housebuilding collapsing during a downturn and taking years to recover. While the volume housebuilders are unlikely to contribute to any forced sales, the situation in city centres could be more severe. Uncertainty around where investment yields will settle, along with rising costs, will put this sector – also usually more dependent on development finance – at much greater risk of collapse and distressed sales over the next couple of years.

The usual route for interventions in the new build sector during downturns is via housing associations. Unfortunately, this sector has its own existing challenges that could limit their ability to contribute during this downturn. Many housing associations now face the same challenges as the wider market. They have been forced to become much more dependent on the market due to the need to cross-subsidise their affordable delivery programs by building market rent and shared ownership homes. Some have paid too much for development land in the process. Meanwhile the need to improve their existing homes is a urgent priority. It appears the government might have to look elsewhere when designing any policies to support the supply of new homes during the likely downturn.

Fig 3: Taylor Wimpey Sales & Cancellation Rates
Source: Taylor Wimpey annual reports and presentations



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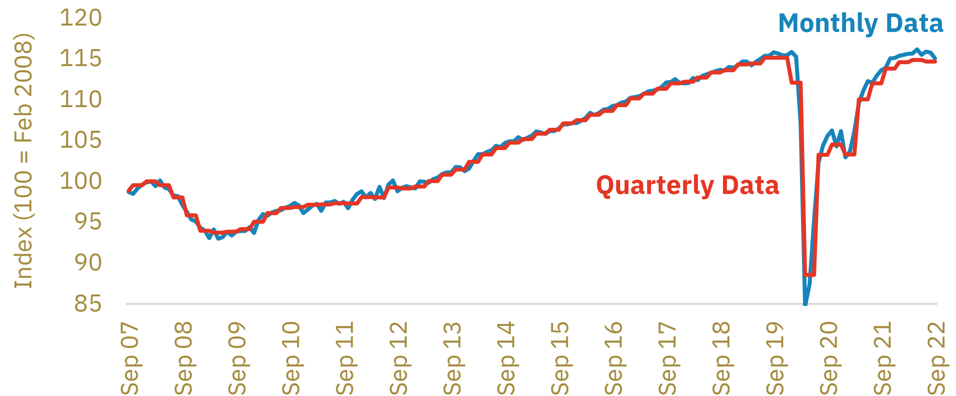
Market At A Glance

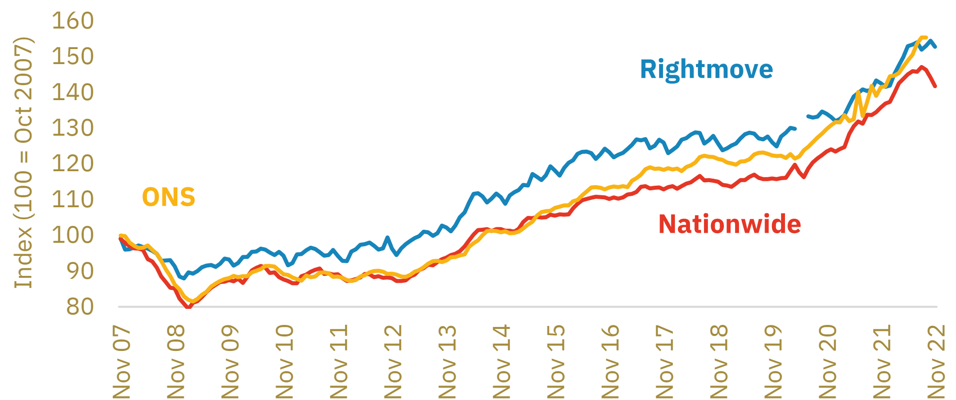
Economy - UK

The ONS monthly estimates reported GDP was 1.3% higher in September 2022 than the same month in 2021. This left monthly GDP 0.7% below the pre-pandemic peak recorded in January 2020. However, this data will inevitably be revised in coming months and years.



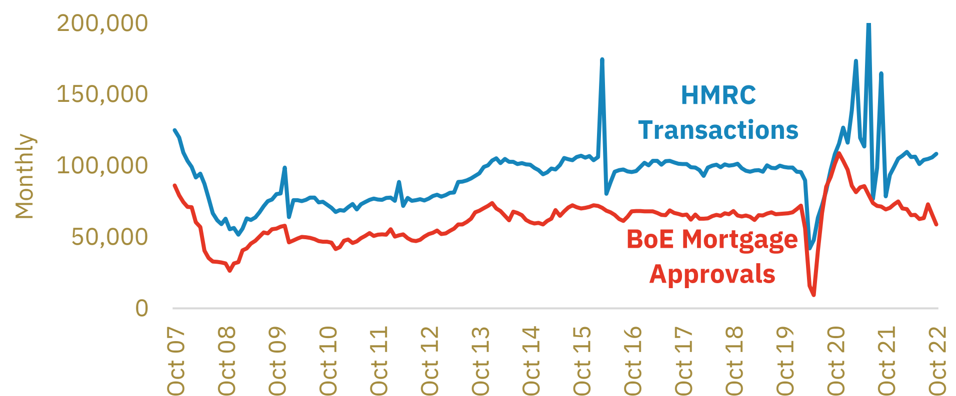
House Prices - UK

Rightmove reported a 7.2% annual rise in asking house prices in November 2022 while Nationwide reported a 4.4% annual rise in their mortgage approval based index in the same period. Meanwhile, the ONS reported 9.5% annual growth in its sales agreed index for the year to September 2022.



Transactions – UK

HMRC provisionally reported 108,500 residential transactions in October. This was 9.4% higher than the same month in 2019. Meanwhile, the Bank of England reported mortgage approvals for house purchase were 11.5% lower in October 2022 than the same month in 2019.



New Supply - England

The latest net additions data for 2021/22 reported 233,000 net new homes in England with 210,000 new build completions. The latest quarterly house-building data suggests there were 216,800 completions in the year to Q2 2022 while there were 246,200 new build Energy Performance Certificates in the year to Q3 2022 – a leading indicator for net housing supply.