

Market Commentary

Residential Analysts

United Kingdom – 2022 Review

- **Back To Normal From Near Zero**
- **Three Periods: Before Truss, During Truss, and After Truss**
- **Renting Versus Buying**

The UK's housing market during 2022 can be split into three key periods: Before Truss, During Truss, and After Truss. The Before Truss period covered the first eight months of the year and saw the housing market continue to boom despite increasing interest rates and the cost of living crisis. The During Truss period was short and traumatic but with long-lasting consequences. The After Truss period is still ongoing but early signs suggest the housing market could be in real trouble during 2023 as higher interest rates and a recession hit activity and prices.

Back To Normal From Near Zero

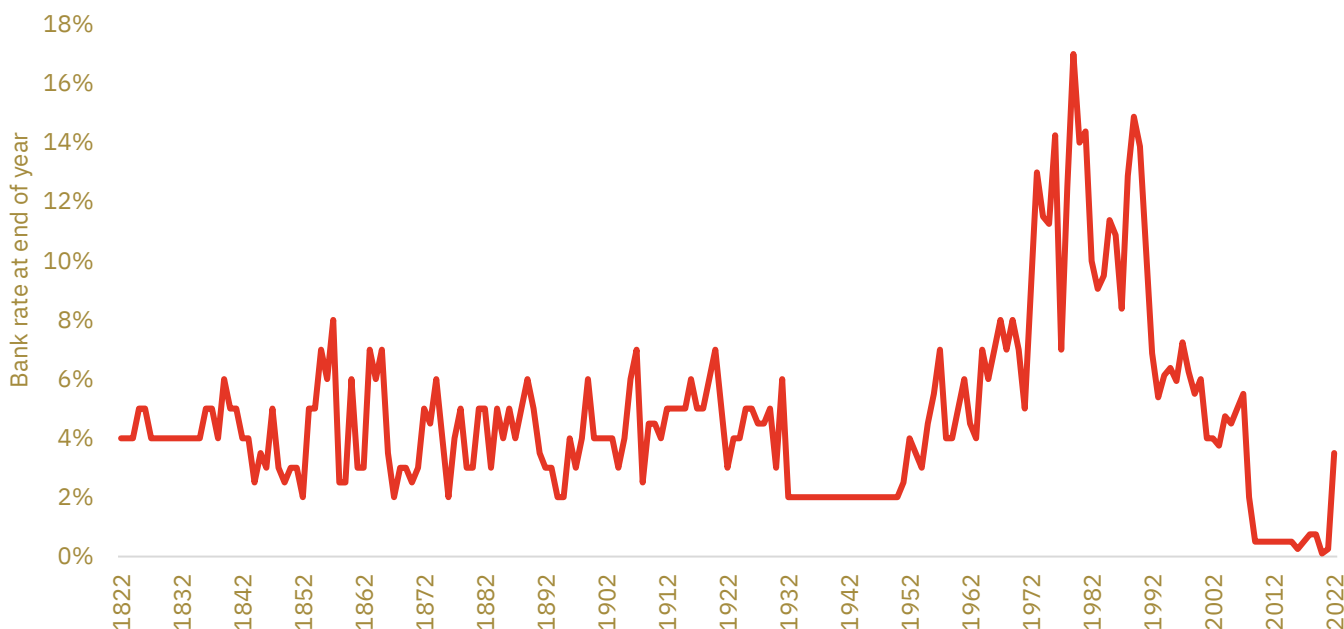
After over a decade of record low interest rates, 2022 was the year they finally rose significantly away from near zero (Fig 1). The substantial fall in interest rates during the 2008/09 financial crisis was a key support for the economy and households during the period. Large numbers of mortgaged homeowners (there were lots more of them back then) benefitted from what was effectively a cash giveaway thanks to the prevalence of floating rate mortgages linked to a suddenly much lower base rate. However, despite repeated predictions for interest rates to rise over the years, they remained near zero for over a decade with mortgage rates falling to record lows in 2021.

2022 was the year it actually happened. As inflation shot up, the Bank of England increased base rate rapidly, hitting a 14 year high of 3.5% in December. Comparisons with historic rates (Fig 1) might suggest this is simply a return to "normal". However, the economy and especially the housing market have become incredibly reliant on record low interest rates over the last decade or so. Mortgage borrowers have used lower mortgage rates to increase how much they borrow while maintaining affordable repayments. Unfortunately, this situation means the consequences of a return to higher interest rates could be severe with a recession and housing market downturn looking very likely for 2023 (if they haven't started already) as both new and existing borrowers struggle.

However, rising interest rates are just one of the features of previous housing market downturns. Back in [April](#) we highlighted that "changes in interest rates, rising energy costs, and policy mistakes have all been key factors in previous housing market downturns". Unfortunately, 2022 was the year that ticked off all three and more. Not all of this was the fault of the Truss government but it certainly made the situation much worse.

Fig 1: Bank of England Base Rate At End of Year

Source: BoE



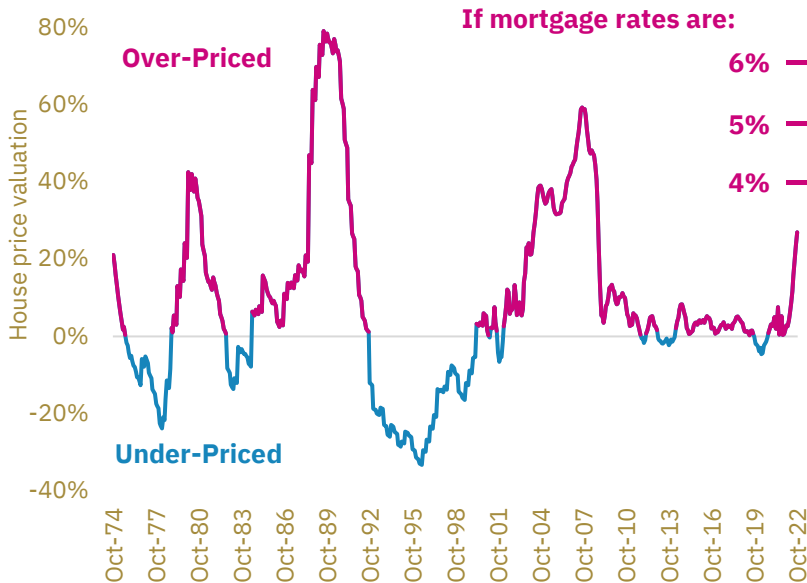
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The Housing Market Before Truss

2022 started as 2021 had ended: with a housing market boom. House prices continued their upwards trajectory thanks to record low mortgage rates and a shortage of homes available for sale. The recovery in the availability and fall in cost of higher loan-to-value mortgages also contributed to the boom as first time buyers took advantage – though there are signs that many may not be true first time buyers (see [Chart of the Week](#)). However, there were dark clouds growing with concerns about increasing interest rates and the cost of living crisis – especially affecting renters and low income households. Those dark clouds turned into a storm in February when Russia invaded Ukraine, adding further pressure to household and business finances thanks to rising energy costs. Despite these pressures, the immediate effects on the housing market were limited as near record low mortgage rates (see Fig 5) helped propel house prices to new record highs amidst a lack of homes available to buy.

Fig 2: Actual Prices Compared to Modelled Prices

Source: ONS, Bank of England - UK



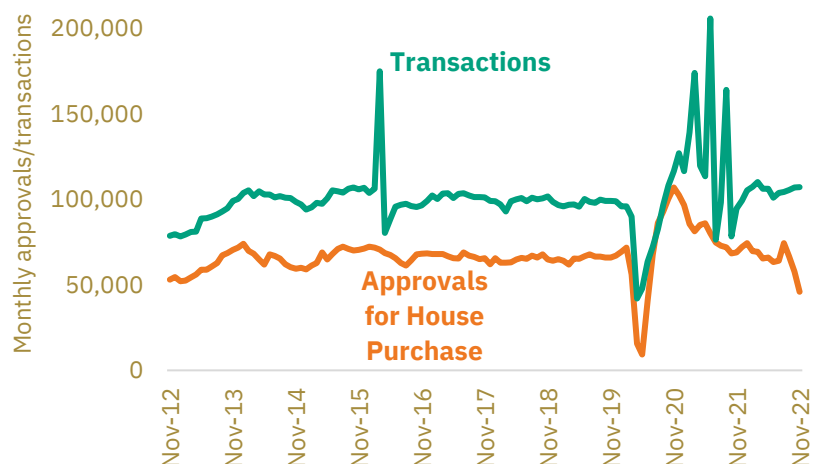
With house prices hitting new record highs, it was tempting to call it a housing bubble – and one that is now bursting. However, while house prices may have risen rapidly in recent years, they have done so in line with wages and falling mortgage rates. Fig 2 compares the ONS house price with a calculated house price based on wages and mortgage rates (and a couple of fixed ratios on repayments and loan-to-values). When the line is below 0%, actual house prices are lower than the modelled price – a relatively rare occurrence in the UK. When the line is above 0%, actual house prices are higher than what the model suggests. Uniquely for the UK market, the line has been near zero for the last decade – suggesting homes are priced appropriately given mortgage rates and wages. It was only when rates started rising towards 2% in April/May that prices quickly moved into over-priced territory.

By summer, the rise in mortgage rates was ringing alarm bells. It might not be a housing market bubble but it was an interest rate bubble and was starting to burst – with the housing market highly exposed (e.g. Fig 1 in June [market commentary](#)). April saw warnings about the risk of a recession, worries about the lockdowns in China, and some downgrades to forecasts for house prices in 2023. But the housing market continued powering on with house prices still reporting double-digit annual growth and activity levels holding around their pre-pandemic average (Fig 3). By June, it was clear that higher mortgage rates were beginning to hit housing markets across the globe. Average quoted UK mortgage rates at 75% loan-to-value ratios were at their highest rate since 2013 but in the US average 30 year fixed rates hit their highest rate since November 2008 according to Freddie Mac. Meanwhile there were falling home sales in Canada and New Zealand reported falling house prices.

By July the cost of living crisis and rising mortgage rates had reached a point that led us to [suggest](#) the autumn would mark the turning point for the market. However, the housing market continued to boom as buyers rushed to lock in their low mortgage rate offers before they expired. On the 1st of September, we [wrote](#) “this is getting scary” as energy costs soared, quoted mortgage rates hit 4%, and policy mistakes increased the likelihood of housing market stagnation, if not an outright crash. Finally, after a long leadership campaign over the summer, Liz Truss was appointed Prime Minister on the 6th of September. There were warning signs but at this point it was still not clear just how terrifying the next 49 days would be.

Fig 3: Housing Market Activity

Source: BoE, HMRC - UK



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The Housing Market During Truss

The start of Truss's short reign was not auspicious. The launch of her flagship energy policy was hampered by poor communication around the details of the "£2,500" household price cap and the parliamentary debate on the 8th of September was interrupted by news of the Queen, who passed away later that day. Parliament was then suspended until the 21st of September for a period of mourning that delayed further debate. On the 23rd of September, the chancellor Kwasi Kwarteng announced his "mini-budget" growth plan. It was welcomed by right-wing commentators and think-tanks but many others took issue with it, highlighting the unfunded tax cuts and lack of OBR forecast among other concerns. There was an immediate negative response from financial markets.

The impact of the "mini-budget" on financial markets was severe. The pound fell against the dollar, hitting an all-time low on the 26th of September. Meanwhile interest rates shot up. Financial market expectations for Bank of England Base Rate in one year's time peaked at 6.38% on the 27th of September (Fig 4). On the 28th of September, the Bank of England had to intervene and temporarily buy UK government bonds as some pension funds were at serious risk of collapse.

Given the chaos and uncertainty, mortgage lenders reacted by withdrawing products from the market as they were unable to price them. By the 29th of September, Moneyfacts [reports](#) the number of available mortgage products was 2,340, a 40% fall from the 3,961 products available on the morning of the "mini-budget". On the 30th of September, Truss committed to publishing an OBR forecast on the 23rd of November, alongside the chancellor's economic plans.

The mortgages that were still available rocketed in price. By the 3rd of October, Moneyfacts was reporting (via the [BBC](#)) that average fixed rate mortgages were approaching 6%. It was also becoming clear that Truss didn't realise the cost of fixed rate mortgages (the majority of the current market) were normally priced off financial market rates – swaps – rather than Bank Rate (as had usually been the case when most mortgages were variable rate). Mortgage rates continued rising through the month, with Moneyfacts reporting a peak of around 6.5% on the 20th of October. Meanwhile, Bank of England data (Fig 5) covering the whole of October shows average quoted mortgage rates hit 6% for two-year fixes and 5.6% for five-year fixes – their highest rates since 2008.

Fig 4: Financial Market Expectations for Base Rate

Source: Bank of England

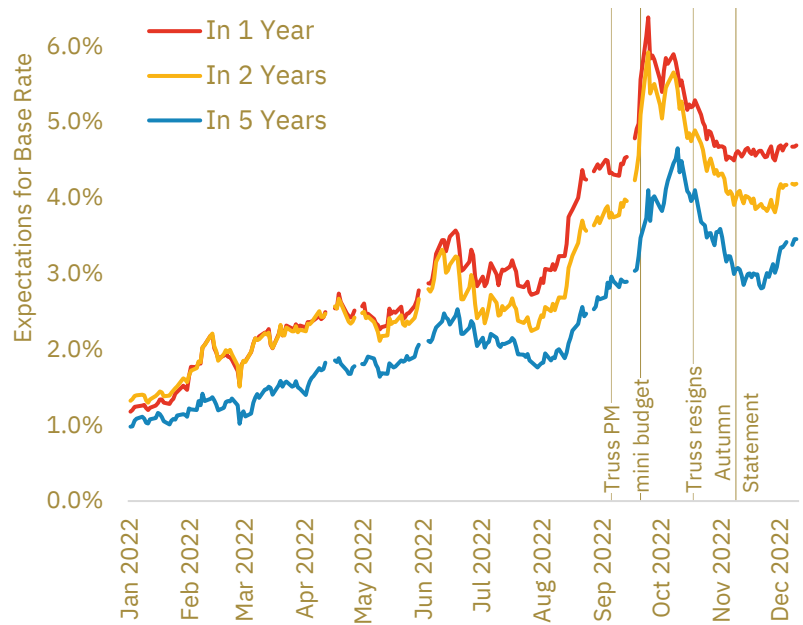
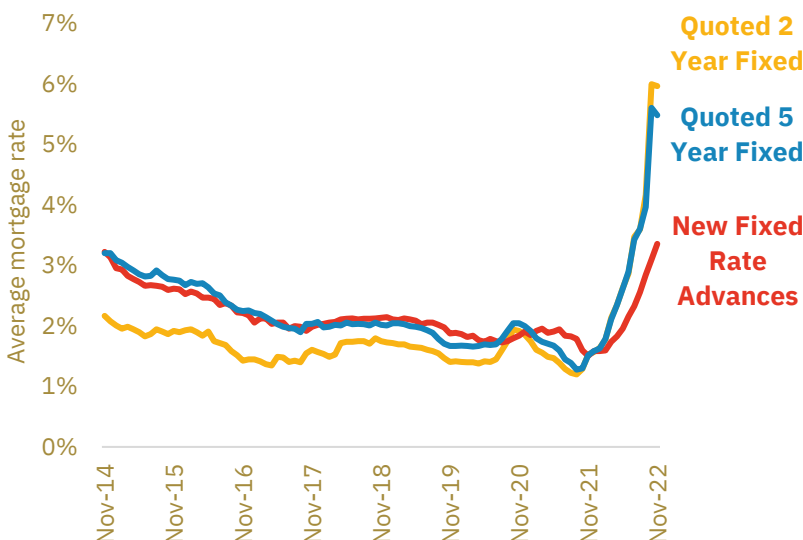


Fig 5: Average Mortgage Rates

Source: BoE *quoted rates at 75% loan-to-value - UK



The 3rd of October also saw some signs that the government was backing down. Kwarteng withdrew the abolition of the 45p tax rate and announced plans to bring forward the new fiscal statement and OBR forecast. The date for this was later confirmed as Halloween but headline writers would be denied the opportunity to make the most of it with ghoulish headlines.

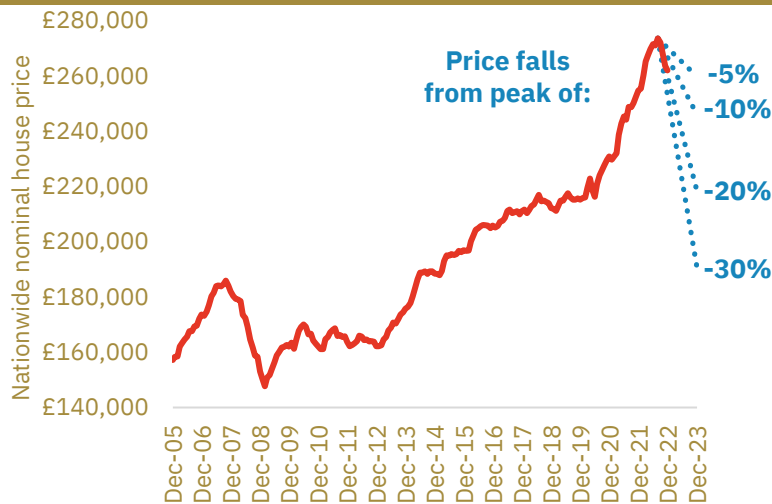
On the 14th of October, Kwarteng was summoned back from Washington DC and dismissed. He was replaced by Jeremy Hunt. This marked the end of the "Trussonomics" experiment with Hunt reversing the majority of the tax cuts on the 17th of October. Truss then announced her resignation on the 20th of October. Mortgage rates have fallen since then but the fallout from this period is still ongoing and some may be permanent.

The Housing Market After Truss

The challenges facing the UK's housing market didn't start with Liz Truss and they haven't ended now she's been replaced by Rishi Sunak. Quoted mortgage rates were already at scary levels (4%) at the end of the summer and the housing market looked set to at least slow in the autumn, even before the "mini-budget" fallout. However, the trauma of the Truss period has made the situation worse and Bank of England research clearly highlights (Chart 2.9) a significant domestic effect on long-term interest rates since August – what some have called the "moron premium". Mortgage rates may have fallen from their peak in late October but are still higher than prior to the Truss turmoil – there are now rates available below 5% but they are only available for high quality borrowers with big deposits. These higher mortgage rates were already affecting activity and prices in the final months of 2022.

Fig 6: UK House Prices & Potential Scenarios

Source: Nationwide and BuilPlace calculations



The final two months of 2022 saw sales activity slow and house prices start to fall. Zoopla had already reported (PDF) sales agreed were 28% lower in their December release and this week Bank of England data (Fig 3) showed mortgage approvals for house purchase were 30% lower than their pre-pandemic average in November. Meanwhile, the Nationwide house price index has already fallen 4% since its peak in August.

It is still highly uncertain what will happen to the housing market in 2023. It is quite possible that we are already in the early stages of a housing market downturn and these recent trends continue in the coming months. And with current mortgage rates, we could quite easily see a 20% price fall from peak – a fall that only takes prices back to around where they were at the start of the pandemic in early 2020 (Fig 6).

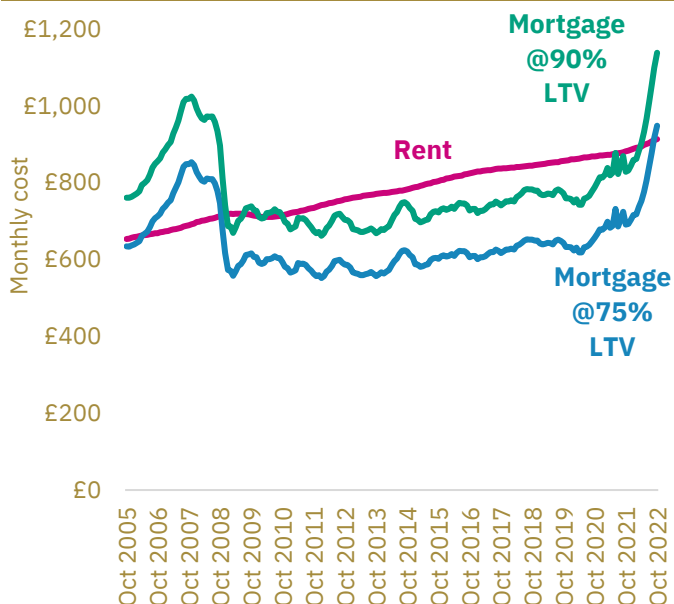
However, a large fall in house prices will require some degree of forced or at least motivated sales. Mortgage lenders will be under considerable pressure (internal and external) to avoid repossessions - temporarily shifting borrowers onto interest only payments looks the best option for help. In the absence of forced sales, a stagnant housing market is probably the more likely outcome, with low transactions and falls in new supply. Ultimately, what happens this year depends on mortgage rates – how high do they stay and for how long. The danger is that the combination of higher mortgage rates (4%+) and the cost of living crisis lead to a combined hit on consumer spending that further worsens the prospects for the economy. A consumer-led recession could then lead to rising unemployment and create the conditions usually required for a large fall in house prices later this year or next.

Renting Versus Buying

Homeownership is the preferred housing tenure across the UK for a number of reasons. Over the last decade it has also tended to be cheaper to pay a mortgage than rent the same property when comparing headline costs (Fig 7) and ignoring others such as repairs and opportunity costs (which we suspect most households also do when considering their housing options). With the shift to higher mortgage rates, the situation in 2022 reversed and renting is now theoretically cheaper – though the exact balance will depend on local market rental yields. Unfortunately, while this might suggest those excluded from home-ownership are in a better position, the actual state of the private rental market is shocking. A lack of stock available to rent amidst very high levels of tenant demand have pushed newly agreed rents to record highs while the quality of housing in the sector is appalling and security of tenure is poor. There are some tentative signs rental inflation is easing but the state of the mortgage market will probably lead to further demand pressure in the private rental market and increase the already desperate need for reform.

Fig 7: Cost of Renting Versus Buying

Source: ONS, BoE, BuilPlace calculations

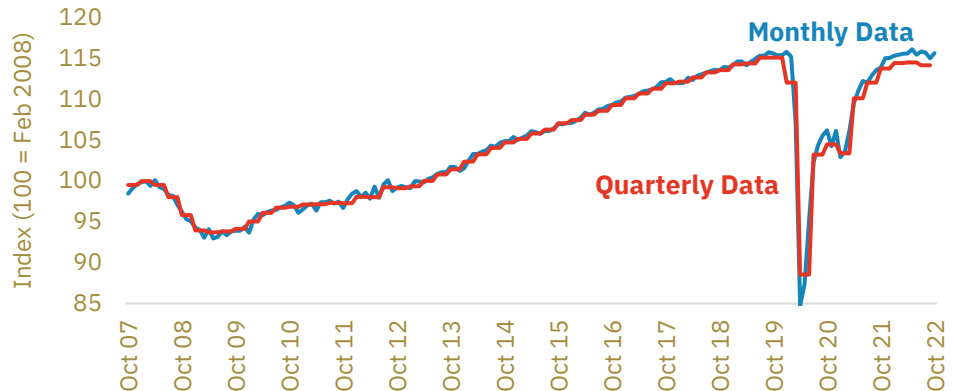


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Market At A Glance

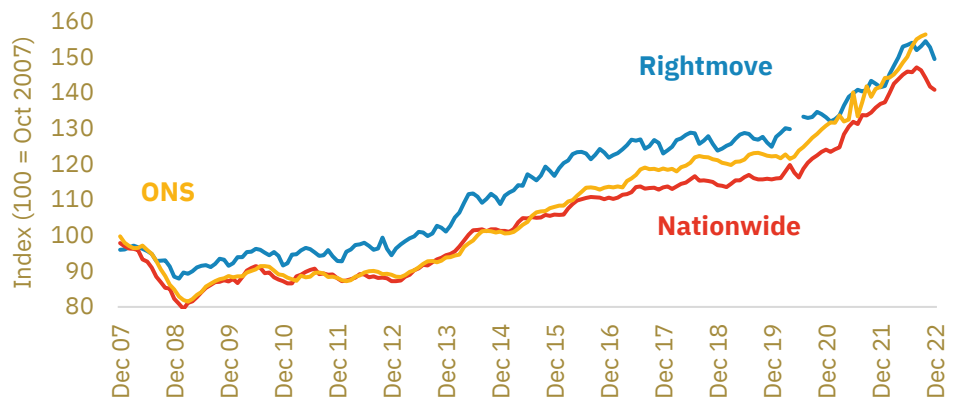
Economy - UK

The ONS monthly estimates reported GDP was 1.5% higher in October 2022 than the same month in 2021. This left monthly GDP 0.2% below the pre-pandemic peak recorded in January 2020. However, this data will inevitably be revised in coming months and years.



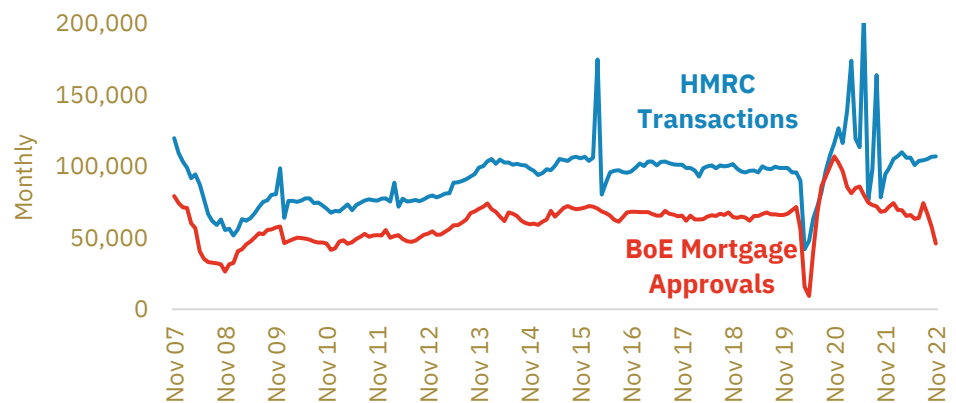
House Prices - UK

Rightmove reported a 5.6% annual rise in asking house prices in December 2022 while Nationwide reported a 2.8% annual rise in their mortgage approval based index in the same period. Meanwhile, the ONS reported 12.6% annual growth in its sales agreed index for the year to October 2022.



Transactions - UK

HMRC provisionally reported 107,200 residential transactions in November. This was 8.1% higher than the same month in 2019. Meanwhile, the Bank of England reported mortgage approvals for house purchase were 30.2% lower in November 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 212,600 completions in the year to Q3 2022 while there were 246,200 new build Energy Performance Certificates in the year to Q3 2022 – a leading indicator for net housing supply.

