Market Commentary

Residential Analysts

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United Kingdom – June 2024

- **Inflation Beaten But Weaker Sentiment**
- **Land, Bricks, & Money**

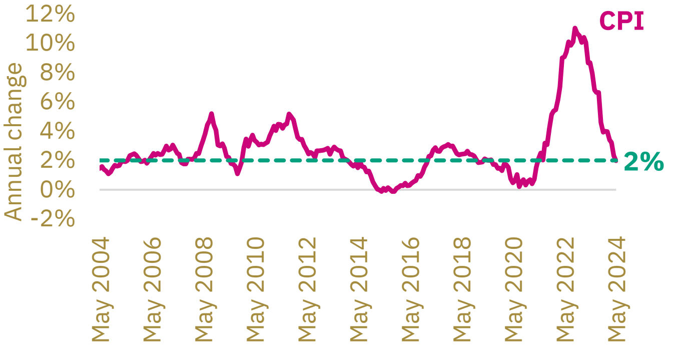
Inflation has fallen back below the 2% target but interest rates are still high and housing market sentiment appears to have weakened. Increasing new supply requires a focus on not just land but also bricks & money.

Inflation Beaten But Weaker Sentiment

Last month may have seen inflation fall back below the Bank of England's target but it also saw a weakening of sentiment in the housing market. ONS data for last month shows that inflation had fallen back down to below 2% in May for the first time in just over three years, with prices rising over 20% during the period (6.5% p.a.). Despite this, there has been no movement on base rate, still at 15 year high of 5.25%, and market expectations for future rates are still relatively high. As a result, while we've seen mortgage rates fall from their highs last autumn, average rates are still well above 4% and the housing market remains relatively subdued.

Fig 1: Consumer Price Inflation

Source: ONS



Alongside this, the amount of stock on the market continues to rise, with Zoopla reporting (PDF) "almost a fifth more homes for sale than a year ago". However, the Nationwide index shows house prices were up 3.3% in the first half of the year and, based on previous trends, this suggests a similar figure at the year end. Ultimately, it all still depends on where mortgage rates end up settling and whether we continue to avoid any severe economic fallout from the interest rate shock of the last couple of years.

Land, Bricks, & Money

It appears likely that we will have a Labour government in power when most of you read this and housing looks set to take centre stage in coming months. There's been plenty of attention on land with a focus on planning reform but much less has been said about the other required components of building homes: construction capacity including labour and materials (i.e. bricks) and the money required to develop and buy the homes.

On land: rolling back some of the recent changes to the planning system should help – with Anglia Square providing a useful case study. However, increasing the number of planning permissions will not increase new home delivery on its own. We also need the capacity to build and finance them: bricks & money.

On bricks: the construction industry is in a very poor state with companies going into administration regularly and that has a knock-on impact for housebuilding. For example, Wokingham BC is onto its third contractor for some flats, just three months after appointing the last one. Build costs are easing but industry margins are tight and labour availability – especially given the ageing population - is a concern. Meanwhile, other housebuilders will be watching Vistry's shift into a partnership model closely to see whether they can retain a higher margin or get dragged down to the construction industry's lower returns.

On money: its cost and availability is key driver of effective demand. Unfortunately, the higher interest rate environment and end of Help-to-Buy equity loan have reduced demand from both homeowners and investors. The impacts of this and the changing economic environment are wide ranging, for example Berkeley Group announced they will retain homes in their own rental portfolio for the first time since the financial crisis (PDF), Lendlease have announced their intention to sell their UK operation and focus on Australia (PDF), and L&G announced they are merging LGIM and L&G Capital while looking to sell the housebuilder Cala. Housebuilders have attempted their own replacement of Help-to-Buy in Deposit Unlock and will contribute to buyers' mortgage payments but have been happier to reduce output rather than prices – with selling homes to single-family build-to-rent investors an increasingly popular route to market for developers of all sizes. Meanwhile, some smaller developers have gone bust and their developments are for-sale unfinished (PDF) but the administration of one relatively large company in the north of England doesn't appear to have stopped one of its directors from popping up on the website of a newly launched development company. Development finance appears to be relatively available although at a price as everyone wants to be a debt funder in the current interest rate environment. Good news for those developers who need post completion funding for an "extended sales and marketing period".

In summary, any sustainable policy approach to new homes needs to improve land supply - with more strategic planning and less development control – but also needs to consider the capacity to fund, build, and buy them.

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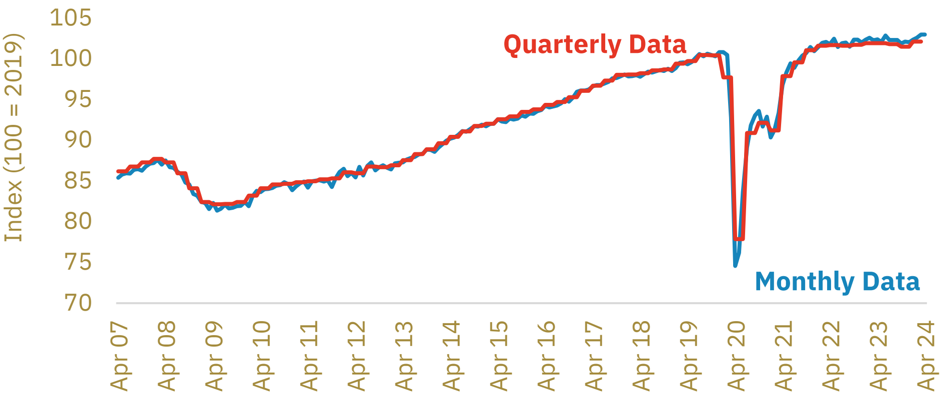
Market At A Glance

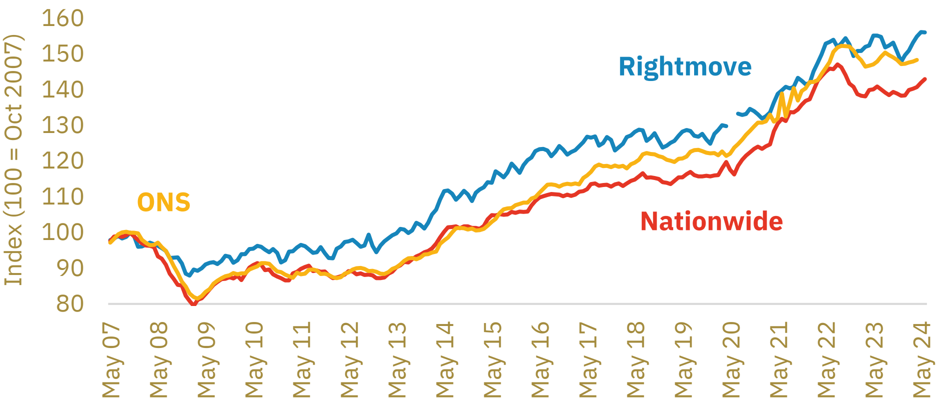
Economy – UK

The ONS estimated monthly GDP rose 0.6% in the year to April 2024. Monthly GDP was 2.1% above the pre-pandemic peak recorded in January 2020. However, this monthly data will continue to be revised in the future.



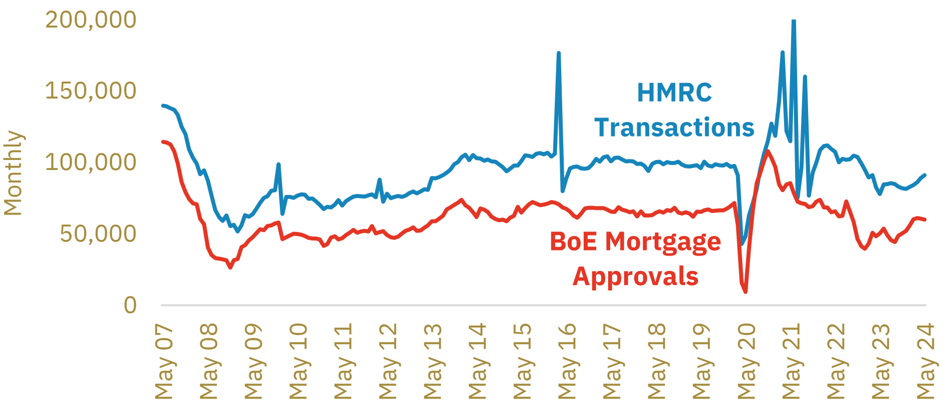
House Prices – UK

Rightmove reported a 0.6% annual rise in asking house prices in June 2024 while Nationwide reported a 1.5% annual rise in their mortgage approval-based index over the same period. Meanwhile, the ONS reported a 1.1% annual rise in its sales agreed index for the year to April 2024.



Transactions – UK

HMRC provisionally reported 91,300 residential transactions in May. This was just 5% lower than the same month in 2019. Meanwhile, the Bank of England reported mortgage approvals for house purchase were 8% lower in May 2024 than the same month in 2019.



New Supply – England

The latest net additions data for 2022/23 reported 234,400 net new homes in England with 212,600 new build completions. The latest quarterly house-building data suggests there were 187,000 completions in the year to Q1 2024 while there were 232,500 new build Energy Performance Certificates in the year to Q1 2024 – a leading indicator for net housing supply.