SPOTLIGHT
*Savills Research*

# Mainstream Residential Property Forecasts

## Back to the future

Over the hot, hot summer of 2022, a certain generation was keen to remind us that this was not the first time we had been forced to draw the curtains in the daytime and sleep naked out of necessity, not choice. "Not as bad as '76", they would say, while the pedants would tell us that technically we had less rainfall over the summer of 1995.

Much like the weather, we tend to judge the risks to the housing market by reference to previous downturns. And so, as we have seen inflation soar, costs of debt rise and turmoil in the mortgage markets, so the questions have kept coming: "Is it a repeat of the early 1990s?" "What are the parallels with the credit crunch?" "How old were your parents in the 1970s?"

We researchers do look back to history in our attempts to figure out what is in store for the housing market (feel free to check out our work from earlier this year on the history of the housing market from 1952 to 2022).

We look for parallels, but also for differences. In doing so, we try to build a picture of the drivers that will influence the market and what that will mean for prices and transactions. It is far from an exact science, not least because the economic assumptions behind our thinking are so liable to change. But we can give you a considered view of what we think is most likely to happen.

### A challenging economic backdrop

We begin with the outlook for the economy. We have based our housing market outlook on economic forecasts from Oxford Economics. Here, the working assumption is that the economy contracts in 2023 but that unemployment peaks far lower than in previous recessions. That contains the risk of unemployment-driven repossessions, which were a critical component of the market in the early 1990s.

What, then, of inflation and interest rates?

At the time of writing, economists are taking a more benign view of interest rates than the money markets. Our forecasts are based on the assumption that Bank base rate will hit 4.0% by early 2023 and remain there until mid-2024, before being gradually reduced once the beast of inflation has been tamed.

That suggests five-year mortgage rates, upwards of 5.5% in the middle of October, are fully priced. But it would also suggest that variable rate mortgages, including the standard variable rates (SVR) borrowers will fall back on at the end of their current mortgage's fixed term if they can't remortgage competitively, will rise further over the course of 2023.

**Figure 1** Underlying economic forecast assumptions

| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|---|
| Bank base rate (end of year) | 3.75% | 4.00% | 3.50% | 2.50% | 1.75% | 1.75% |
| Real GDP growth | 4.5% | -0.5% | 1.8% | 2.7% | 2.1% | 1.6% |
| Unemployment rate | 3.9% | 4.8% | 4.3% | 3.9% | 3.8% | 3.8% |

**Source:** Oxford Economics 28th October 2022

### Existing borrowers' woes

There is no doubt that borrowers coming to the end of their mortgage's fixed term will face a sharp rise in costs over the coming 18 months. But the extensive use of fixed rate mortgages recently means that many will avoid the worst increases in costs of debt, and that the impact will be less of a cliff edge than in previous periods of rising rates.

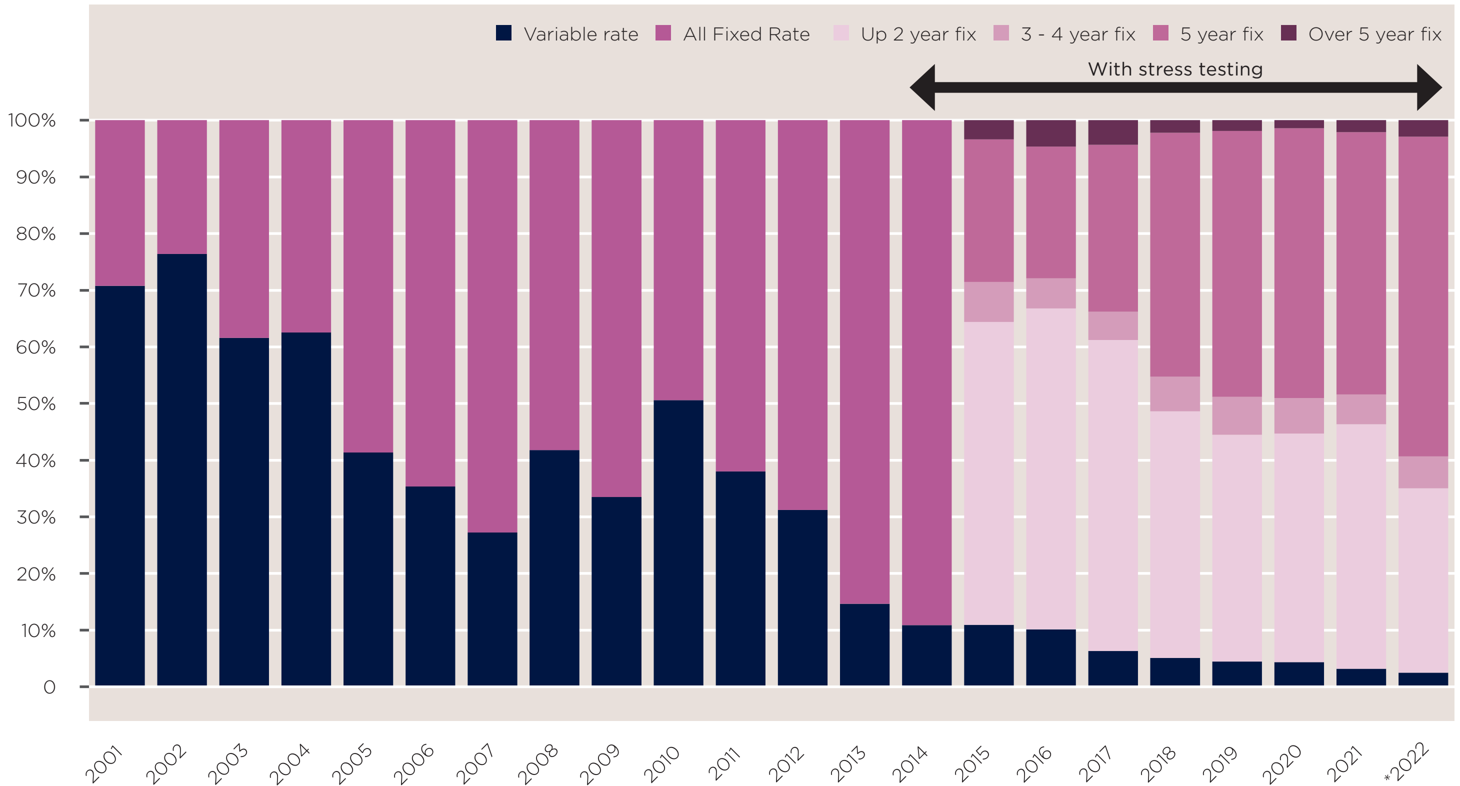
The robust mortgage regulations introduced in 2014 will also mitigate risks to some degree. These rules stress-tested borrowers' ability to afford the prevailing SVR plus three percent (unless they had fixed for a five years or more).

When this mortgage regulation was introduced, many considered it draconian. With the benefit of hindsight, it looks positively visionary.

Nonetheless, many mortgaged homeowners will find their finances uncomfortably stretched. This may cause some to dip temporarily into savings or to seek support from family. Those borrowers without this safety net will be looking to see what support comes from lenders to help them through these difficult times.

**"The robust mortgage regulations introduced in 2014 will mitigate risks to some degree. When this mortgage regulation was introduced, many considered it draconian. With the benefit of hindsight, it looks positively visionary"**
Lucian Cook, Head of Residential Research

**Figure 2** Borrowers have less immediate exposure to interest rate rises




*First 7 months of 2022 only

**Source:** UK Finance

## Lender forbearance

Banks and building societies will be eager to avoid the mistakes of the 1990s that lead to widespread repossessions. So, we would expect them to show a degree of forbearance: perhaps extending mortgage repayment terms or offering capital repayment holidays to allow borrowers to meet their mortgage interest commitments (until interest rates ease back).

Overall, this is likely to mean that we see a trickle of additional stock coming to the market from those under financial pressure, not a deluge.

That said, most prospective buyers of that stock that will have less buying power, given they will face higher mortgage costs.

## Measuring affordability

To put these affordability pressures into context we've looked at a simple comparative measure: the mortgage payments on the average home as a proportion of the average household income.

As discussed above, since 2014 lenders were required to stress test borrowers' affordability at their SVR plus three percentage points, unless they had locked into a fixed rate for at least five years. In a move that raised eyebrows in some quarters, the BoE did away with that requirement in August. Instead, lenders must now follow the less stringent Responsible Lending Rules and more easily administered limits on lending at over 4.5 times income.

If the benefit of hindsight makes the imposition of those regulations appear visionary, the decision to drop them just before a spike in mortgage costs looks impeccably timed, given the dramatic impact which their retention would have had mortgage affordability.

## Affordability in Q3 2022

Our analysis shows us that during September, when the average mortgage rate stood at 4.2%, monthly mortgage payments had reached 26% of our theoretical buyer's income. That was already dramatically higher than the relatively benign 17% seen at the beginning of the pandemic. Accordingly, at this time, it had quickly moved into the realms of what we would consider "stretched affordability" (though below levels seen prior to the downturns of the early 1990s and 2007).

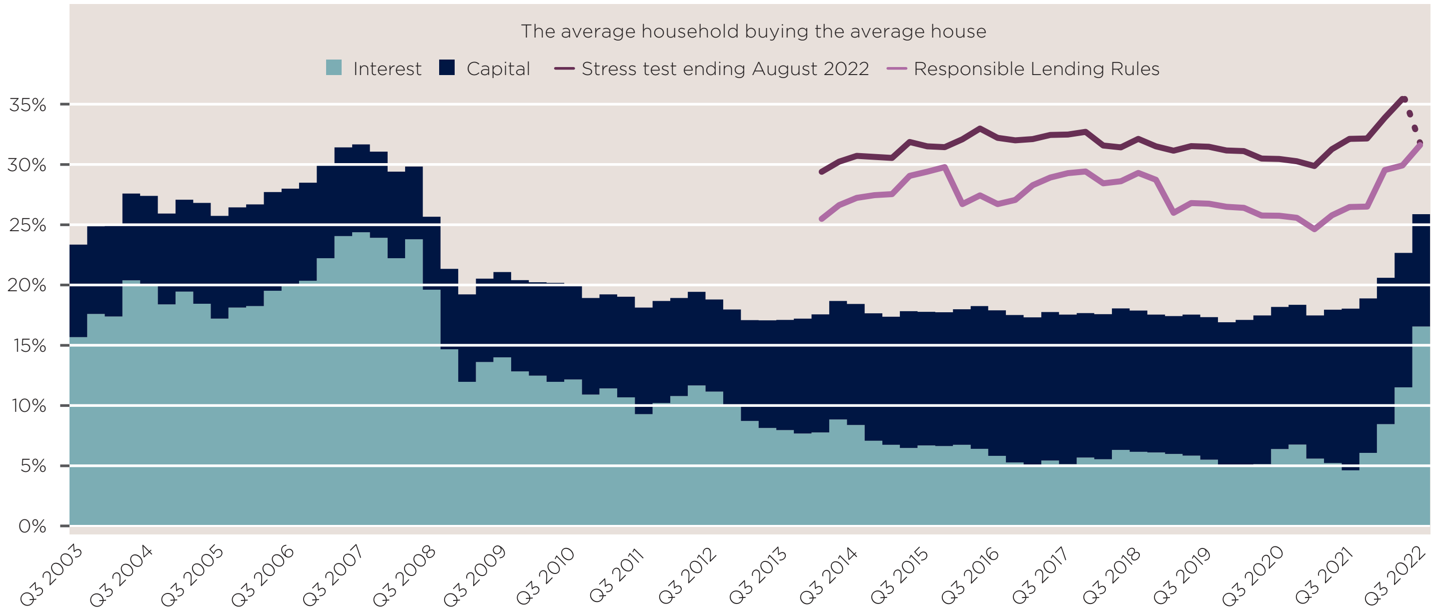
These additional mortgage costs were one of the key reasons we have already seen demand indicators, such as those in the RICS housing market survey, soften in the period leading up to the October. Put simply, buyers had become more wary about stretching themselves financially.

Though less stringent than before, the requirement for lenders to look at the impact on a borrower's finances of either

- A one percentage point increase in interest rates or
- A rise in line with market expectations

was increasingly looking like a constraint on the levels of mortgage debt they would be able to secure.

**Figure 3** Rising interest rates have eroded the affordability cushion




**Source:** UK Finance

## Turmoil in the mortgage markets

By the end of September, it had become clear that further increases in mortgage rates could rapidly restrict how much debt buyers could secure comfortably. The mortgage market disruption we saw in the wake of the mini budget soon brought this into focus as lenders withdrew 40% of mortgage products from the market and the average quoted rate for a 2-year fixed mortgage shot above 6.0%, according to MoneyFacts.

The short-term impact on both house prices and transactions depends on where rates for different mortgage products go from here and how long they remain elevated.

In this respect, it is worth remembering that what we have seen in the money markets over the Autumn of 2022, though not unprecedented, is certainly unusual. These mortgage rate hikes don't just reflect higher base rate expectations for 2022 and 2023, they reflect greater uncertainty regarding the UK government's ability to deliver financial stability.

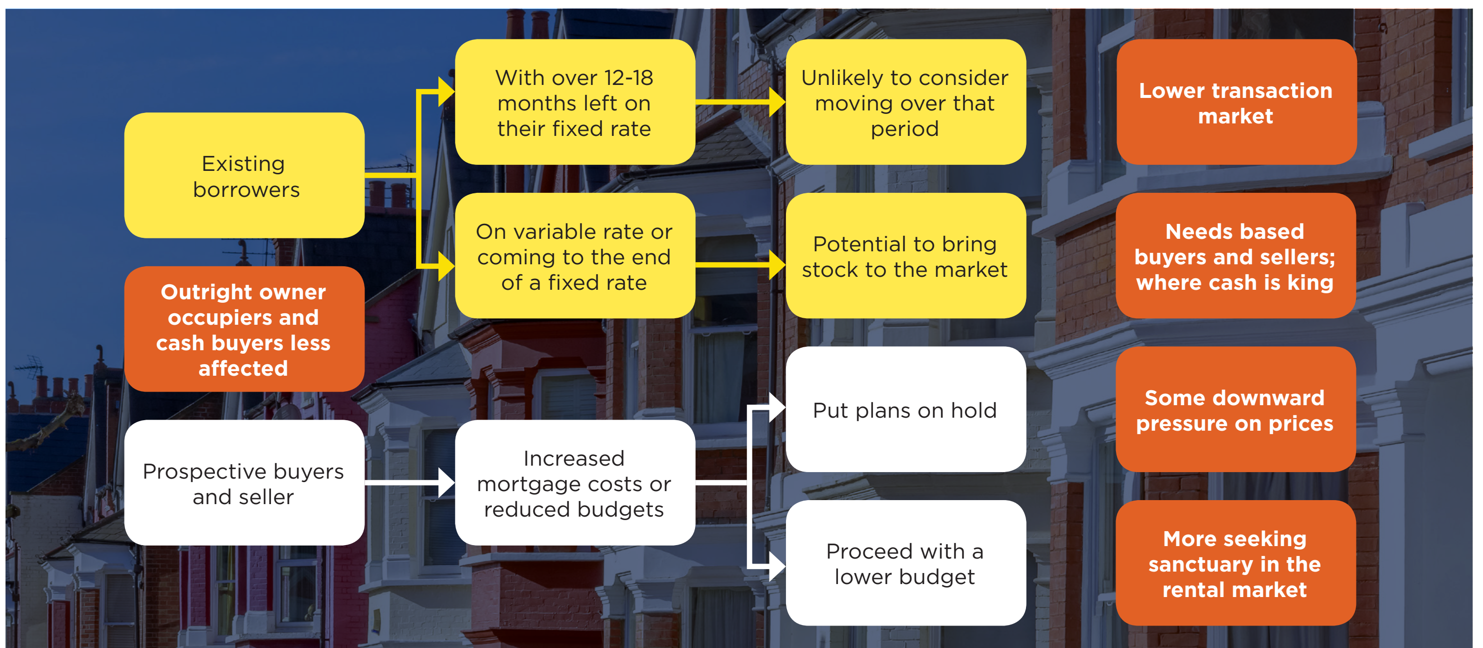
Through personnel changes and policy U-turns, the government has sought to address these concerns. While this may take the edge off affordability pressures prospective buyers face over the next 18 months, those pressures will remain significant.

## Double-digit price falls

Based on Oxford Economics' forecasts, we would expect to see lenders' margins for both variable and fixed rate products gradually ease back from current highs. But, given the prospective path of the Bank base rate, we expect to see mortgage rates elevated though 2023 and well into 2024. Mortgage affordability, already stretched in Autumn 2022, will be stretched even further over the remainder of this year and next by historical standards.

That points towards double-digit house price falls in 2023, in a year when discretionary movers sit on their hands and both first-time buyers and buy to let investors curtail their activity given the specific affordability pressures they face.

**Figure 4** Drivers of price falls in 2023




**Source:** Savills Research

## Looking longer term

Just as the prospects for mortgage rates are critical to our short-term view of the market, so too are they crucial to our view of where prices will end up at the end of our five-year forecast period.

**On the basis that:**

1. Mortgage markets settle down, with a marked reduction in lenders' margins over the next 12 months; and
2. Bank base rate gradually reduces from the middle of 2024 as inflation is tamed,

We would expect a marked improvement in mortgage affordability. Combined with nominal price falls of -10% in 2023 (-12.6% adjusted for inflation), that would gradually bring more buyers into the market and allow a return to modest house price growth from 2024 onwards, with a more pronounced rebound in 2026.

Even if Bank base rate returns to 1.75% by the end of our forecast period, we are unlikely to see the pace of recovery that we saw in the market from 2009 onwards. But, with an expectation that the economic woes are less entrenched than they were 30 or so years ago, neither is it likely to be as long in coming as in the early 1990s.

A reminder, if it were needed, that events of the past are, at best, a guide as to what can happen in the future.

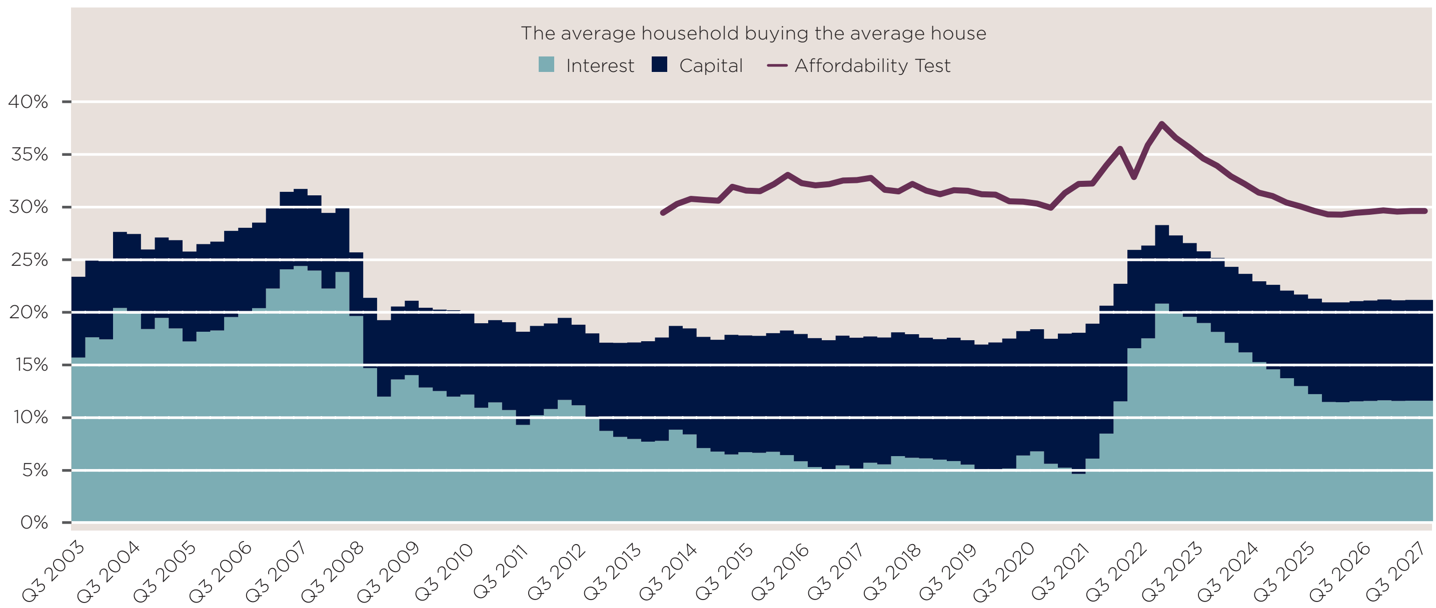
**Figure 5** UK mainstream house price forecasts

| | 2023 | 2024 | 2025 | 2026 | 2027 | 5-year |
|---|---|---|---|---|---|---|
| UK mainstream house prices | -10.0% | 1.0% | 3.5% | 7.0% | 5.5% | 6.2% |

**Note:** These forecasts apply to average values in the second hand market. New build values may not move at the same rate

**Source:** Savills Research

**Figure 6** Affordability over the longer term




**Source:** UK Finance

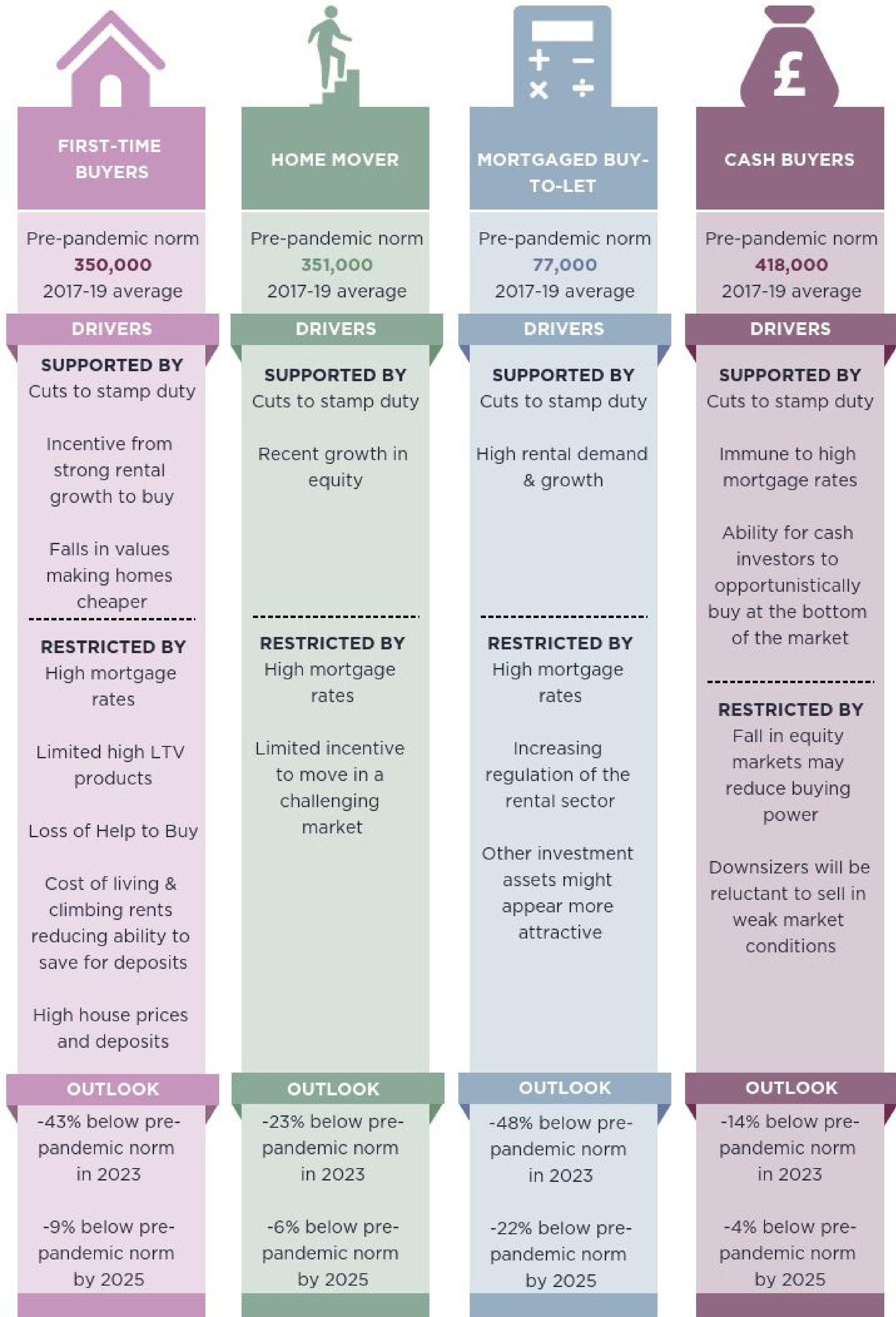
# A lower activity environment

There is close link between home values and transactions volumes. It's rare to see a dip in values without a corresponding fall in activity. Alongside a fall in value next year, we also expect a sharp fall in activity, with transactions only recovering back towards to pre pandemic levels from 2025 onwards.

n 2023 we expect limited mortgage product availability, along with high rates and stretched affordability to mean activity falls to a little under three quarters of the levels seen pre-pandemic. While activity will slow, we expect transactions to remain comfortably above the 740,000 sales seen when they last bottomed out after the Global Financial Crisis

Recovery will then vary according to buyer type, with cash-buyers and home movers the first to recover, followed by first time buyers and mortgaged buy-to-let investors. Looking longer term, we expect activity to plateau at around 1.1m transactions a year. This is slightly lower than the pre-Covid figure of about 1.2m, due to the higher underlying interest rate environment, with buyers weighted towards more affluent households even after a correction in values.

**Figure 7** Key market drivers for different buyer types




**Source:** Savills Research

**Figure 8** Forecast residential transaction volumes by buyer type

| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|---|
| Total transactions | **1,060,000** | **870,000** | **1,000,000** | **1,110,000** | **1,110,000** | **1,110,000** |
| First Time Buyers | 310,000 | 200,000 | 250,000 | 320,000 | 320,000 | 320,000 |
| Home Movers | 290,000 | 270,000 | 300,000 | 330,000 | 330,000 | 330,000 |
| Mortgaged Buy-to-Let | 90,000 | 40,000 | 50,000 | 60,000 | 60,000 | 60,000 |
| Cash Buyers | 420,000 | 360,000 | 400,000 | 400,000 | 400,000 | 400,000 |

**Source:** Savills Research

# Divergence in mortgage affordability will drive regional differences in price growth

Buyers in London and the South East are typically more affluent than the UK average, and yet they still need to borrow more relative to their income and need a bigger deposit in order to buy.

This means we expect higher interest rates to hit house prices in these areas harder in 2023, with more affordable parts of the country seeing smaller, but still material, price falls.

That same affordability issue will still weigh on growth in 2024. While we expect mortgage rates to come down as margins begin to compress, they will still be high by recent standards and put pressure on growth in the first half of 2024, particularly in the areas where affordability is most stretched. Once the base rate begins to come down in the second half of that year, we expect to see growth return to the market with the strongest part of the recovery in 2026. We envisage it will be seen earlier and more strongly in the more affordable markets of the North.

Before the pandemic and its economic disruption, our analysis suggests that - from a geographical perspective at least - we were in the late stages of a typical housing market cycle. As the housing markets stabilise in the second half of this 5-year window, we expect these cyclical factors to continue to take precedence over the regional distribution of economic growth. However, we're forecasting that regional house price growth will converge around the UK average at the end of our forecast period, raising the prosect that London will be again be in a position to deliver the strongest house price growth as we enter the next phase of the market cycle from 2027 onwards.

**Figure 9** Regional house price forecasts for the mainstream housing market

| | 2023 | 2024 | 2025 | 2026 | 2027 | 5 years to 2027 |
|---|---|---|---|---|---|---|
| UK | -10.0% | 1.0% | 3.5% | 7.0% | 5.5% | 6.2% |
| North West | -8.5% | 2.5% | 4.5% | 7.5% | 6.0% | 11.7% |
| Yorkshire and The Humber | -8.5% | 2.5% | 4.5% | 7.5% | 6.0% | 11.7% |
| North East | -8.5% | 2.5% | 4.5% | 7.5% | 6.0% | 11.7% |
| Wales | -8.5% | 2.0% | 4.5% | 7.5% | 6.0% | 11.1% |
| Scotland | -9.0% | 2.0% | 4.0% | 7.5% | 5.5% | 9.5% |
| East Midlands | -9.0% | 1.5% | 4.0% | 7.5% | 5.5% | 8.9% |
| West Midlands | -9.0% | 1.5% | 4.0% | 7.5% | 5.5% | 8.9% |
| South West | -10.0% | 1.0% | 3.5% | 7.0% | 5.5% | 6.2% |
| South East | -11.0% | 0.0% | 3.0% | 6.5% | 5.5% | 3.0% |
| East of England | -11.0% | 0.0% | 3.0% | 6.5% | 5.5% | 3.0% |
| London | -12.5% | -1.0% | 2.0% | 6.0% | 5.0% | -1.7% |

**Note:** These forecasts apply to average prices in the second hand market. New build values may not move at the same rate.

**Source:** Savills Research

Read our UK prime and mainstream residential property forecasts at savills.co.uk/propertyforecasts

**Savills Research**

We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.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