UK Valuation Dashboard

September 2022

Weakening economic outlook set to increasingly weigh on property markets going forward

ECONOMICS

Economic Summary

The Bank of England's battle to curb inflation has taken on greater urgency in recent weeks, with accelerating consumer price growth prompting the MPC to press on with a 50 basis point rate hike in August. This leaves the key policy rate at 1.75%, having increased from 0.1% last December. More importantly, the pace of tightening has been ramped up relative to the sequence of four consecutive 25bp rate rises beforehand. As the Bank now forecasts inflation will peak at over 13% during the final quarter of this year, further tightening seems a near certainty over the coming months. Meanwhile, the UK economy (in the Bank's view) is expected to fall into recession at the end of 2022, with a slowdown in consumer spending seen as a catalyst for the downturn. Alongside this, unemployment is projected to rise going into next year (from a rate of 3.8% currently to as high as 5.8% come the end of 2025). As such, the gloomy prognosis for the UK economy, alongside higher borrowing costs, is expected to increasingly weigh on activity across property markets going forward.

Commercial Property Market

Commentary

After a strong start to the year, signs are emerging that the mood music is becoming more cautious across the UK commercial property market. Indeed, the latest RICS UK Commercial Property Monitor results depict a noteworthy shift in respondents' views on the current stage of the property cycle. 53% of contributors now sense the market has entered a downturn phase, a sharp rise compared to just 23% taking such a view back in the Q1 survey. Alongside this, measures of demand growth eased across both the occupier and investment sides of the market, with the retail and office sectors seeing momentum drain from what previously had seemed to be signs of recovery. Looking at CBRE data, headline capital values have increased by an exceptionally strong 17% over the past year, albeit this annual pace of growth has eased from a peak of 19% back in May and looks likely to cool much further by year-end. With respect to rental growth, the latest figures available show this still accelerating in annual terms at the all-property level (reaching a record high of 4.9% in June). However, given the recent easing in rental growth expecations, this may slow towards the end of 2022.

Chart 1) Rent Expectations

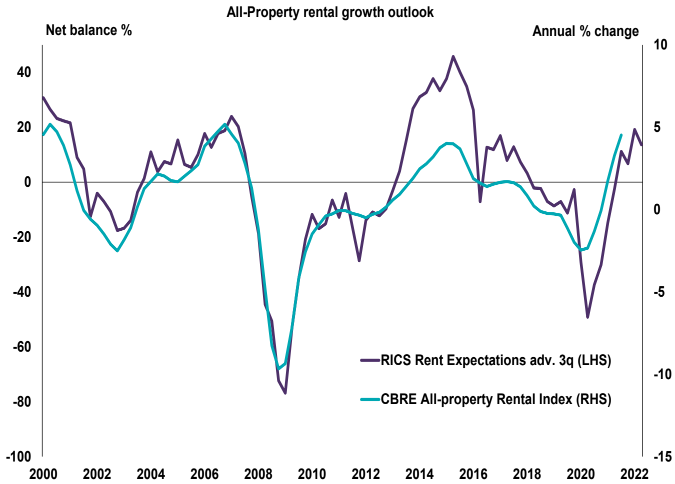

Chart 1 looks at the annual rate of growth in the CBRE rental index (all-property level) alongside the RICS Rental Expectations data. When the forward looking survey data is advanced on by three quarters, it gives the indication that rental growth is close to peaking, with a moderation likely in the coming quarters (albeit this should remain quite firmly positive over the forecast horizon).

Chart 2) Investment Enquiries

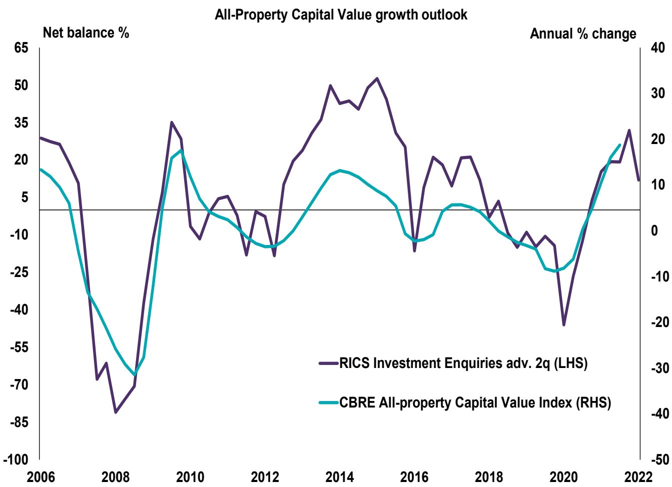

Chart 2 tracks the RICS Investment Enquiries series against the CBRE capital value index, with the former pushed forward by two quarters. On the basis of the relatively abrupt slowing in the investor demand gauge, it appears as if capital value growth will cool sharply from here. That said, given values are up by 17%, the annual growth rate may still be close to double digit territory come the end of the year.

Chart 3) Office Capital Values

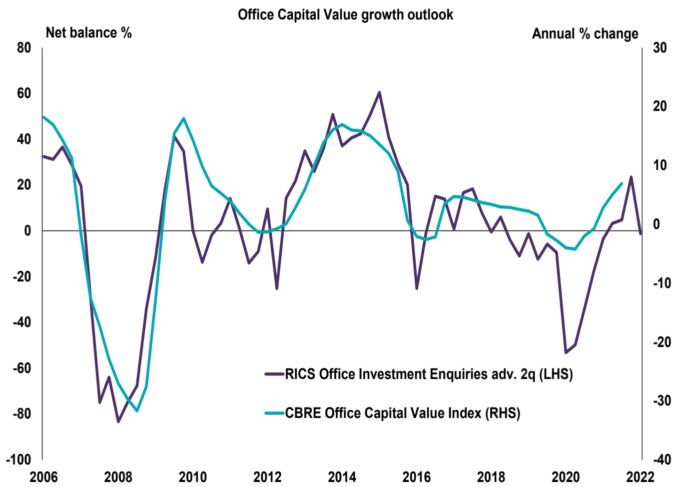

Chart 3 maps the RICS investment enquiries measure across the office sector alongside and the relevant capital value index produced by CBRE. With the investment enquiries data slipping into broadly flat territory, this suggests the recent acceleration in office capital value growth may have run it's course (the survey data now points to the y-o-y growth rate potentially slowing from 7% to around zero).

Residential Property Market

Commentary

The impact of recent interest rate rises now appears to be filtering through into the residential market, with measures of new buyer activity and mortgage lending softening over the past quarter. Given monetary policy tightening seems far from over, while consumers' disposable incomes are set to take a significant hit from cost of living pressures, the outlook for housing sales volumes appears somewhat subdued over the coming months. Alongside this, although house price inflation has lost a little momentum up to this point, the annual pace of growth remains elevated when placed in a historical context (11% on the Nationwide measure). Judging from the feedback to the latest RICS Residential Survey, the lack of stock available at present continues to underpin the market, with prices set to continue to rise (albeit a slightly moderated pace) over the coming six months. Of course, if the economy were to slip into a deep recession, forcing unemployment to rise more sharply than anticipated, this would take a greater toll on both activity and price growth further ahead.

Chart 1) House prices

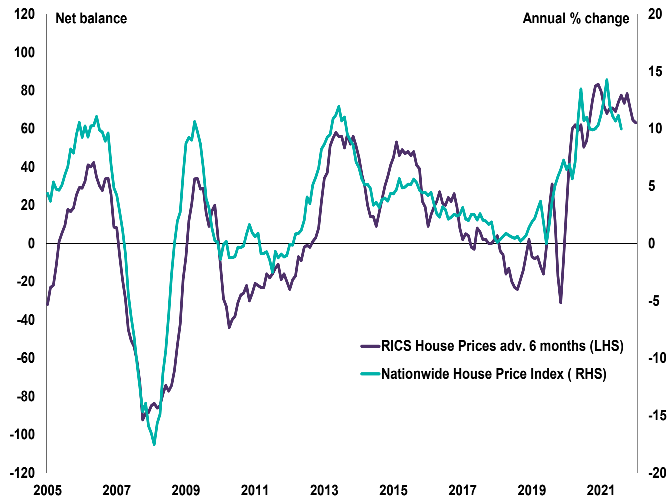

Chart 1 plots the RICS Price net balance alongside the Nationwide Index. The sentiment data from the survey provides a lead of six months and has been pushed forward accordingly. From this, it suggests that, although house price growth may fade further (having eased from 14% to 10% yoy between March and August), the annual rate of change seems set to remain well above the 5% mark in the coming months.

Chart 2) Regional prices

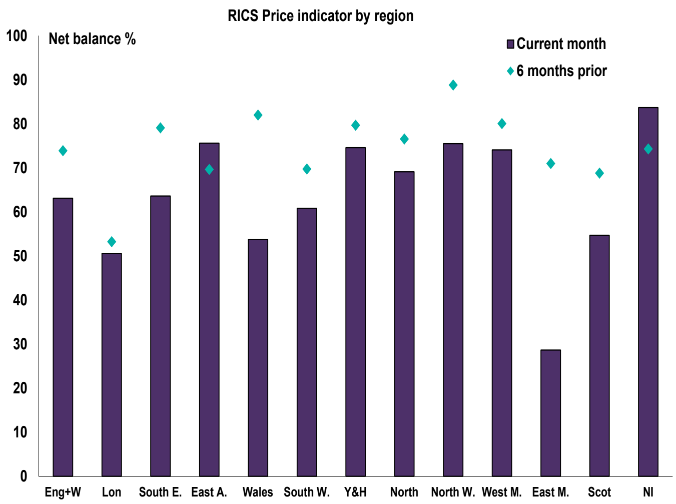

Chart 2 displays the disaggregated price balance data at the regional/country level. In virtually all instances, price growth has lost some momentum compared with six months ago. Nevertheless, the feedback across all areas remains consistent with a still solid degree of upward movement in prices for the time being.

Chart 3) Sales volumes

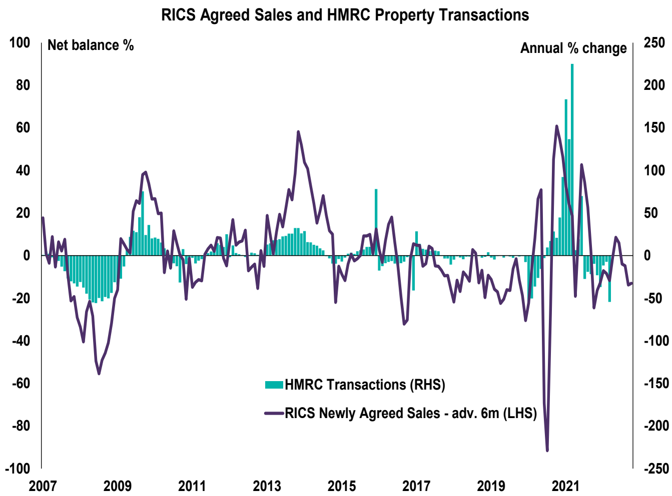

Chart 3 tracks the Agreed Sales net balance data from the RICS survey against the annual change in the number of residential transactions reported by HMRC (with the RICS series again pushed on by six months). With the survey data on sales falling a little deeper into negative territory of late, it looks as if transaction volumes will remain quite heavily down on a year on year comparison through to the end of the 2023.

Real estate indicators

	Latest reading	2022 RICS Economics forecast (end of year)	Commentary
All-property Index (annual growth rate)			
Capital values *Source: CBRE*	+17%	+8%	All-property capital value growth has now begun to moderate, having peaked at 19% a couple of months ago. This rate (currently 17%) looks likely to slow quite swiftly from here, partly due to base effects from last year but also linked to rising interest rates and slowing investment.
Rents *Source: CBRE*	+4.9%	+4.5%	Headline rental growth reached 4.9% yoy in July, marking an all-time high for the CBRE series. Although a similar pace of growth is likely to be maintained in the immediate future, rental growth expectations point to momentum fading from 2023.
Offices			
Capital values *Source: CBRE*	+7.1%	+2%	Office values have risen by around 7% over the past year but the weakening survey feedback around investment into the sector suggests growth may slow significantly over the next six months.
Rents *Source: CBRE*	+1.5%	+1%	Office rental growth clocked in at 1.5% yoy in July, with the index continuing to inch above the pre-Covid high. That said, the outlook now appears more subdued, with impetus likely to fade from Q4.
Industrial			
Capital values *Source: CBRE*	+31.1%	+15%	Industrial capital value growth has now begun to cool, with the annual rate of increase easing to 31% from 38% just two months ago. Of course, this remains extremely buoyant when viewed in a historical context, but the pace of growth is set to fade further through the end of 2022.
Rents *Source: CBRE*	+12.1%	+11%	Rents across the industrial sector have risen by a record 12% over the past year. This pace may be broadly maintained in the near term before softening in 2023.
Retail			
Capital values *Source: CBRE*	+14.6%	+8%	Retail capital value growth accelerated markedly up until May, as the annual rate hit 16%. This has begun to weaken now though, with survey evidence pointing to a significant slowing ahead.
Rents *Source: CBRE*	+0.5%	Zero	Rental growth recently turned positive across the retail sector for the first time since 2018. However, the deteriorating outlook for consumer spending is set to weigh on this area going forward.
Hotels			
Price index *Source: Costar*	+5%	+10%	Costar are currently forecasting a 10% recovery in hotel values between 2021 and 2022.
Rents *Source: RICS GCPM*	No data	+2%	RICS members still anticipate hotel rents recovering at a modest rate going forward.
Residential			
House price index *Source: Land registry*	+7.3%	+5%	House price inflation has eased only gradually up to now, with the main house price indices still showing annual gains of between 7-12%. While price growth seems set to moderate further through to the end of the year, survey data suggests this is unlikely to be abrupt.
Rents *Source: Rightmove*	+11.8%	+8%	Rental growth has continued to accelerate sharply over recent months, with the annual rate of increase reaching close to 12% according to Rightmove data. Rents are set to continue to rise firmly in the near term, even if the headline rate of growth begins to moderate to a certain extent.

Supply and demand

	Latest reading	12-months ago	Commentary
Offices			
Vacancy rate *Source: Costar*	6.9%	6.3%	Vacancy rates continue to edge higher across the office sector, as they have done in each quarter since the start of the pandemic. Although demand from occupiers to take-up office space was rising through the early part of the year, net absorption remained negative as firms continued to release space onto the market. The challenging macro outlook ahead suggests availability may rise further from here.
Occupier demand *Source: RICS GCPM*	+7% net balance	-3% net balance	The RICS office occupier demand indicator had reached a near seven-year high in Q1, but the latest quarterly figures show a noticeable slowing in demand growth. Indeed, the Q2 net balance of +7% is now indicative of only a marginally positive trend.
Investment enquiries *Source: RICS GCPM*	-1% net balance	-4% net balance	Investment demand growth ground to a halt across the office sector in Q2, as higher borrowing costs and a deteriorating economic backdrop seemingly took their toll.
Industrial			
Vacancy rate *Source: Costar*	3.2%	3%	Industrial vacancy rates continue to hover close to all-time lows despite the marginal uptick seen in the Costar data over Q2. This small rise is attributable to the pick-up in new space delivered to the market over recent quarters.
Occupier demand *Source: RICS GCPM*	+49% net balance	+63% net balance	Tenant demand for industrials remains firm, even if the RICS metric is not quite as elevated when compared to this time last year. Looking ahead, the market does face headwinds from falling consumer spending which may lead to a further cooling in demand.
Investment enquiries *Source: RICS GCPM*	+42% net balance	+64% net balance	Industrials remain the stand out category in terms of investor appetite across the traditional sectors. Nevertheless, investment inflows are also set to be dampened on account of the difficult macro climate.
Retail			
Vacancy rate *Source: BRC*	14%	14.5%	Retail vacancy rates have now edged down in each of the last three quarters according to the BRC. Even so, rates remain a full 2% above pre-pandemic levels with shopping centres still a particular challenge.
Occupier demand *Source: RICS GCPM*	-14% net balance	-25% net balance	The RICS Occupier Demand indicator fell back into negative territory across the retail sector during Q2, in part reflecting a pull-back in consumer spending amid the cost-of-living crisis.
Investment enquiries *Source: RICS GCPM*	-13% net balance	-28% net balance	Investment demand also slipped back into the negative zone in the latest survey results as the retail sector appears to be the most immediately impacted by the softer economic backdrop.

Further reading:

[RICS UK Economy and Property Update]

[RICS UK Commercial Property Market Survey]

[RICS UK Construction and Infastructure Survey]

[RICS UK Residential Market Survey]

Net balance data:

- Net balance = Proportion of respondents reporting a rise in prices minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%).

RICS Economics forecasts are formulated using forward looking indicators from the UK Commercial Property Market Survey. This includes both twelve month point estimates and net balance data.

Delivering confidence

We are RICS. Everything we do is designed to effect positive change in the built and natural environments. Through our respected global standards, leading professional progression and our trusted data and insight, we promote and enforce the highest professional standards in the development and management of land, real estate, construction and infrastructure. Our work with others provides a foundation for confident markets, pioneers better places to live and work and is a force for positive social impact.

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