# UK Valuation Dashboard

June 2023

## UK economy avoids recession for now, but headwinds remain significant

ECONOMICS

### Economic Summary

The UK economy posted a slender 0.1% expansion during Q1, leaving total output still 0.5% below its pre-Covid level. Although the latest figures suggest momentum remains both subdued and fragile, the UK has so far defied concerns that intense inflationary pressures and a tighter lending climate could pull the economy into outright recession. That said, with the Monetary Policy Committee voting to increase interest rates for a twelfth meeting in succession during May (lifting Bank rate to 4.5%), higher borrowing costs will remain a significant near-term headwind. As for inflation, although the pace of consumer price growth has now peaked, the past few months have seen a smaller than expected easing in the headline CPI rate. Moreover, there was a surprise pick-up in services inflation from 6.6% to 6.9% during April. This is of particular importance as the MPC looks closely at services inflation to gauge the strength of domestically generated price pressures. As such, this increases the likelihood that the MPC will feel compelled to raise interest rates again at their next meeting, albeit another round of labour market and inflation data will be available to assess before then. Against this backdrop, UK residential and commercial property markets continue to exhibit relatively weak trends in terms of headline buyer activity, even if sales volumes have recovered somewhat from the lows hit towards the end of last year.

# Commercial Property Investment Market

## Commentary

Despite picking up slightly in Q1, investment activity across the UK commercial property market remains subdued when viewed in a longer term context. Indeed, CoStar figures show the twelve-month rolling sum of volumes stands at just over £33bn, comfortably below the average of £40bn seen since 2009. Amidst this weaker backdrop, yields have continued to edge higher in recent months, rising to 6.1% in terms of the all-sector average. That said, following the sharp upwards adjustment in the wake of the 'mini-budget' last year, the rise in property yields over the first quarter of 2023 has come on a much shallower trajectory. Alongside this, the latest CBRE data shows headline capital values recovered marginally in each of the past two months, albeit this comes after a cumulative 20% fall between July 2022 and February 2023. Within this, the downward trend in values has abated for both retail and industrial assets in recent months, although office values continue to slip according to the latest data.

Chart 1) Investment enquiries and capital values

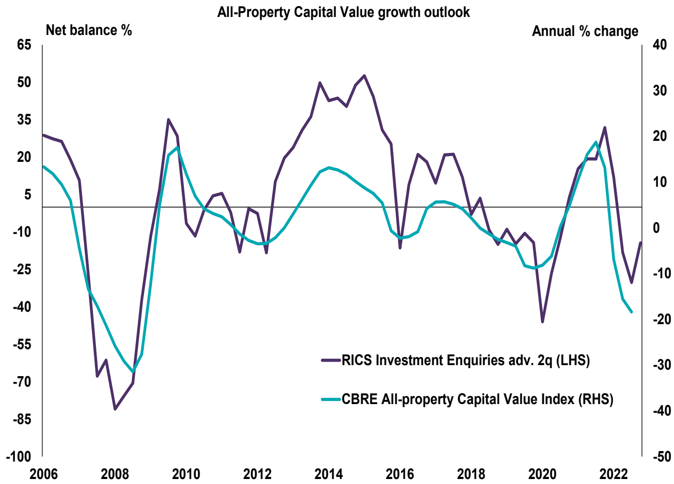



Chart 1 tracks the RICS Investment Enquiries measure (with a two-quarter lead) against the annual change in the CBRE all-sector capital value index. Given the slight move towards neutral territory in the RICS survey data, it suggests capital values may be close to bottoming out in this cycle. Consequently, the annual rate of decline (currently -18%) seems set to turn less negative over the next two quarters.

Chart 2) Industrial capital values

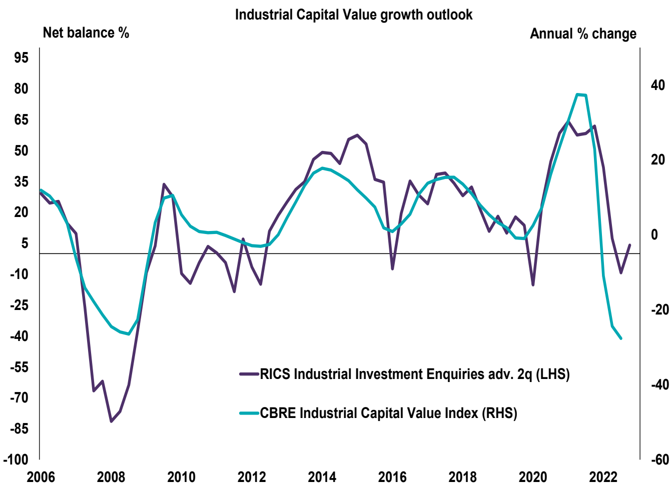
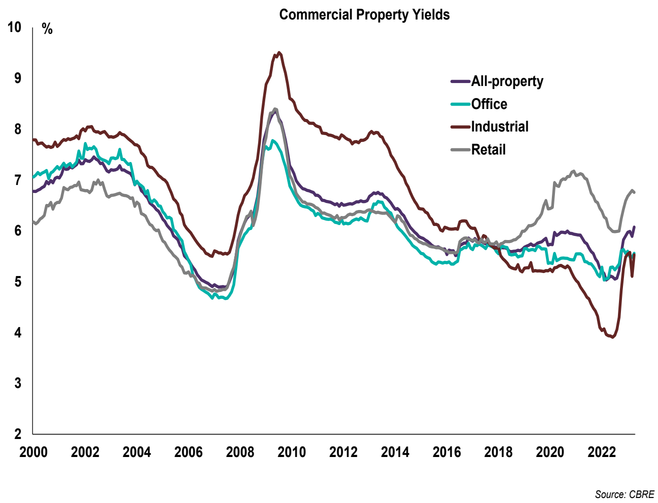



Chart 2 looks specifically at the industrial sector. With the RICS investment enquiries metric picking up for the first time in four quarters during Q1, it suggests the recent pull-back in industrial capital values may now have run its course (following a peak to trough fall of close to 30%).

Chart 3) Yields by sector




As shown in Chart 3, the industrial sector has seen the sharpest adjustment in yields since the middle of last year, rising from an all-time low of 3.9% to stand at 5.5% currently. Across offices, the rise in yields has been more modest, picking up from a recent low of 5.1% to reach 5.6% in April. As for the retail sector, yields have increased from 6% to 6.8% during the past nine months, albeit Q1 saw a largely stable trend.

# Commercial Property Occupier Market

## Commentary

In keeping with the generally resilient backdrop across the UK labour market up until now, commercial property occupancy trends have remained a little firmer than those on the investment side. For instance, the latest RICS survey feedback points to a stable picture for tenant demand at the headline level in Q1. That said, the aggregate backdrop masks divergent conditions at the sector level, with demand for both office and retail space still challenged by the ongoing structural shifts towards remote working and online shopping respectively. Drilling into the office sector specifically, there is also a noticeable divide between prime and secondary space, with high grade, energy efficient premises attracting significantly stronger take-up relative to lesser quality stock. Meanwhile, consistent with strong demand conditions away from some of the more traditional areas of the market, respondents foresee solid rental growth coming through across many of alternative sectors covered in the RICS monitor.

Chart 1) Rental growth expectations

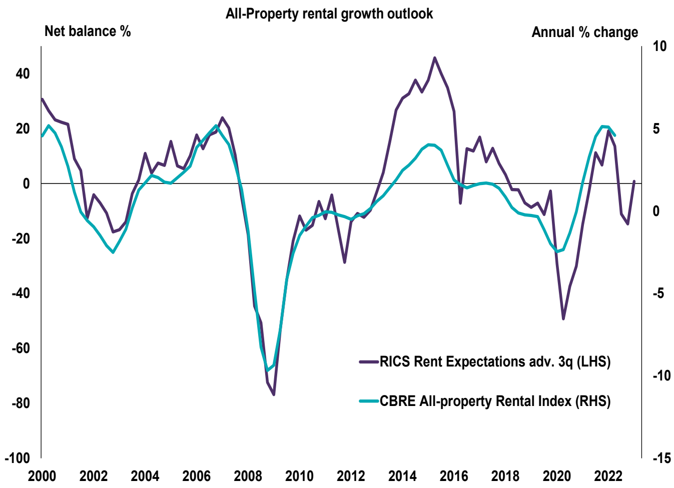



Chart 1 maps the annual growth rate in the CBRE rental index (all-property level) against the RICS Rental Expectations series. Advancing the forward-looking survey data on by three quarters points to headline rental growth easing from just under 4.5% currently to a rate closer to 2% by the end of the year.

Chart 2) Demand and supply conditions across mainstream sectors

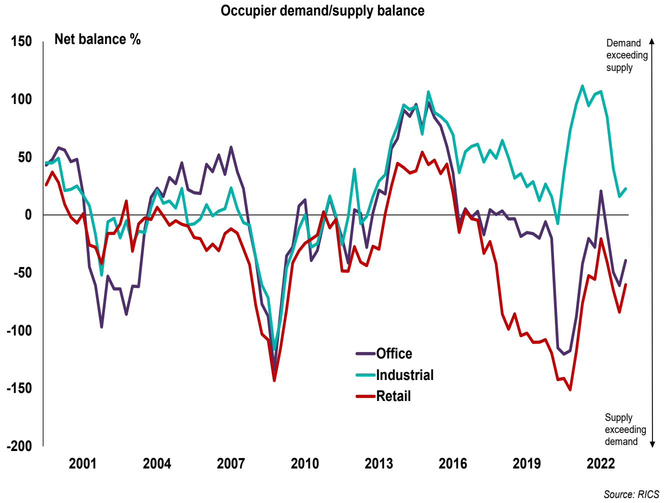



Chart 2 depicts changes in the balance between occupier demand and supply across the three traditional market segments (displaying the RICS tenant demand series minus availability). Whereas the results for the industrial sector continue to imply demand is outstripping supply (albeit to a smaller degree than in 2022), the reported rise in office and retail availability is still outweighing demand.

Chart 3) Twelve-month rental projections by sector

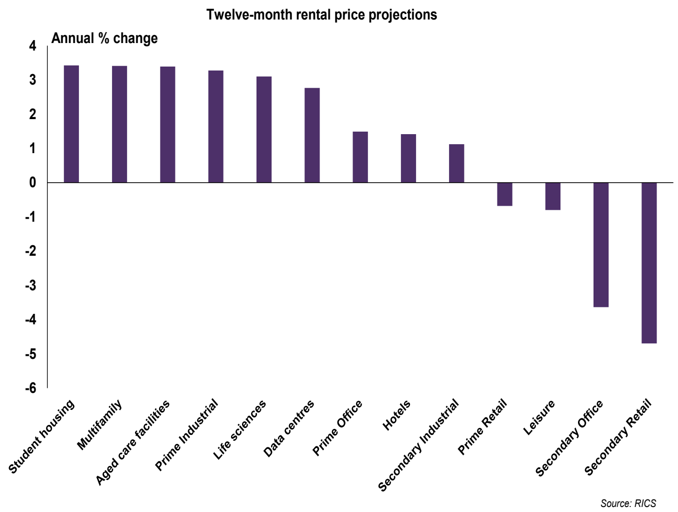


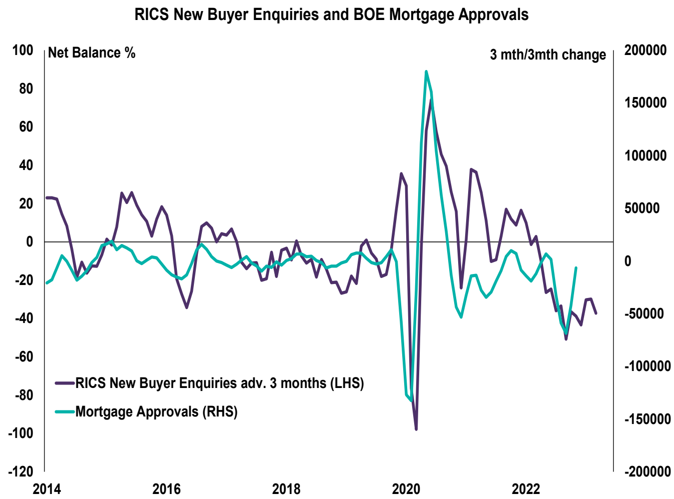

Chart 3 shows twelve-month rental growth projections disaggregated at the sector level. Student housing, multifamily, aged care facilities and prime industrial all display firmly positive expectations, with rents envisaged rising by around 3% in each instance. At the other end of the scale, sentiment remains deeply negative around the rental outlook for secondary office and retail space.

# Residential Property Market

## Commentary

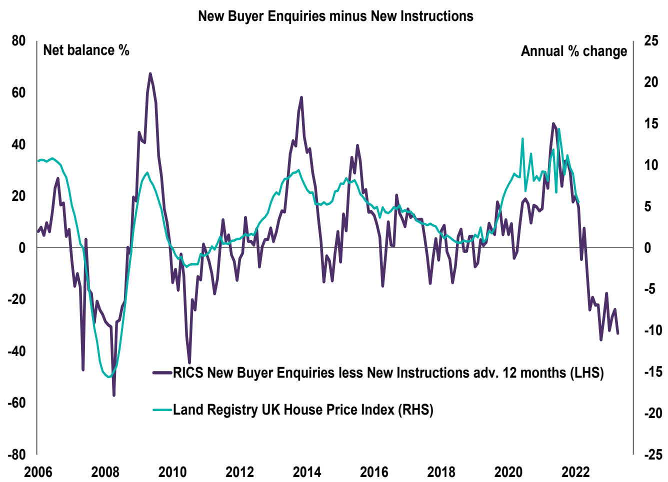
The latest newsflow around the UK housing market continues to depict a relatively weak backdrop in terms of sales activity. Although measures of mortgage approvals and completed transactions have recovered slightly in recent months, they remain firmly down on an annual comparison (-25% and -19% according to Bank of England and HMRC figures respectively). Looking ahead, the stabilisation in money markets of late suggests the easing in average quoted mortgage rates (from 5.5% in October to under 4.5% in April) has possibly come to an end. As such, home buyer demand is unlikely to receive support from a further moderation in mortgage rates from here, at least until there is a change in policy direction from the Bank of England. Meanwhile, the Nationwide House Price Index (gathered at a mortgage approval stage) has now posted declines in each of the last two quarters at the UK-wide level. This leaves the cumulative fall in house prices at -5.6%, although it is important to note that the pace of decline did moderate somewhat during Q1.

Chart 1) Mortgage approvals




The RICS New Buyer Enquiries data has historically provided a good steer on the near-term outlook for mortgage approvals (with a three month lead), as demonstrated in Chart 1. Given the renewed dip in the survey data on buyer demand, it suggests mortgage lending, having partially rebounded in recent months, will struggle to gain much momentum in the immediate future.

Chart 2) Outlook for national house prices




Combining the RICS data on new instructions and buyer enquiries provides a useful indication of recent changes in the supply/demand balance across the sales market. Chart 2 shows how this can then be used to gauge the outlook for house prices twelve months ahead. With the RICS metric treading water and stuck in negative territory of late, it points to the Land Registry national house price index (captured at the point of sale completion) remaining down in annual terms by between -5% and -10% through to the early part of next year.

Chart 3) Regional house price trends

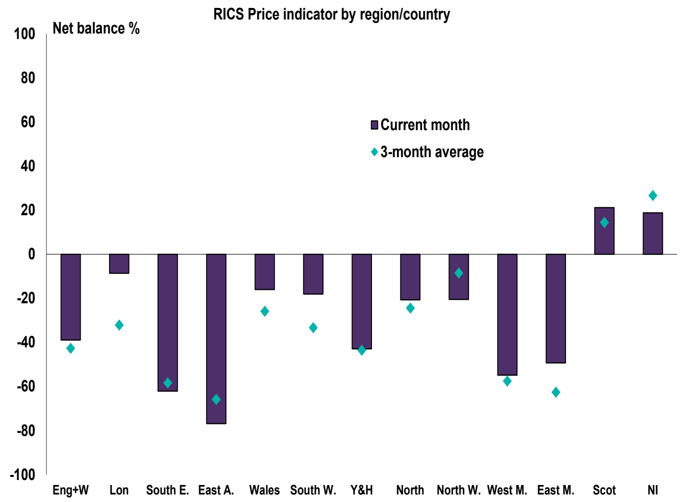



Chart 3 shows the RICS Price measure disaggregated by region/country. Most parts of the UK continue to see a downward trend in house prices, albiet the pace of decline (in net balance terms) has eased in several regions. Interestingly, a much more stable trend was cited in London house prices during April, although it may be premature to call an end to the recent pull-back in prices across the capital based on a single month's data.

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