UK Valuation Dashboard

March 2023

Monetary policy continues to tighten but the peak for interest rates may be close

ECONOMICS

Economic Summary

The latest 0.5% rate hike from the Bank of England marked the tenth consecutive meeting in which the MPC voted to tighten policy. This now leaves Bank Rate at 4% (a fourteen-year high), following a cumulative 3.9% rise in interest rates since the current tightening cycle began in December 2021. Going forward, aided by the recent fall in wholesale energy prices, headline inflation is expected to moderate significantly in the months ahead, leading many to believe the peak for interest rates is very close (if not already reached). That said, although inflation looks set to ease swiftly from its current double-digit rate, price growth is still seen remaining above the 2% target throughout the duration of 2023. As such, it seems this leaves little prospect for any loosening in monetary policy until at least 2024. Furthermore, the impact of the rise in borrowing costs over recent months has become increasingly visible across both the residential and commercial property markets, with buyer activity and prices falling noticeably of late.

Commercial Property Investment Market

Commentary

Commercial real estate investment activity dipped sharply towards the end of 2022, with the fallout across financial markets following the September mini-budget (alongside the more general tightening in credit conditions) taking their toll on investor appetite. CoStar figures show Q4 volumes slumped to £4.4bn, the lowest quarterly total (excluding the start of the pandemic) since 2009. Accompanying this, capital values have fallen back significantly in recent months, with the latest CBRE data showing a cumulative 19% fall in all-property values since June last year. Perhaps most striking is the reversal in industrial capital values, which have fallen sharply over the past six months, having risen by an extraordinary 56% between February 2020 and June 2022. Looking ahead, capital values are anticipated to fall further across all traditional CRE sectors over the near-term (with secondary assets seeing the sharpest falls), albeit the month to month pace of declines has already decelerated markedly at the start of 2023.

Chart 1) Investment enquiries and capital values

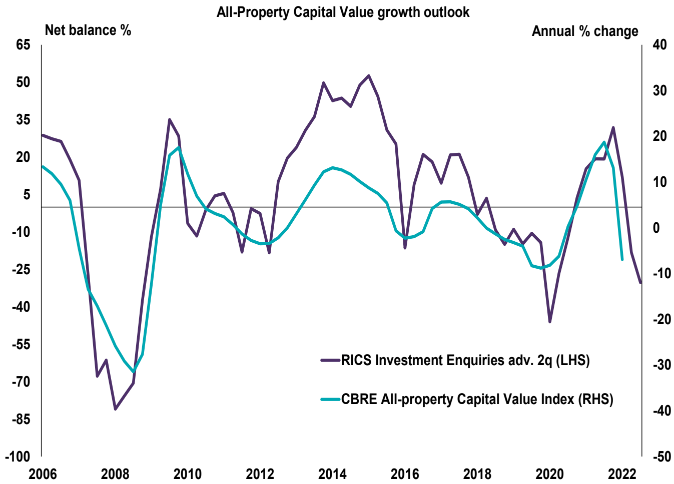

Chart 1 maps the RICS Investment Enquiries series (given a two-quarter lead) against the annual growth rate in the CBRE all-sector capital value index. With the RICS feedback on investor demand slipping further into negative territory in Q4, this is pointing to a continued fall in capital values through the first half of 2023. As such, the annual pace of decline looks likely to hit double digits in the coming quarters.

Chart 2) Industrial capital values

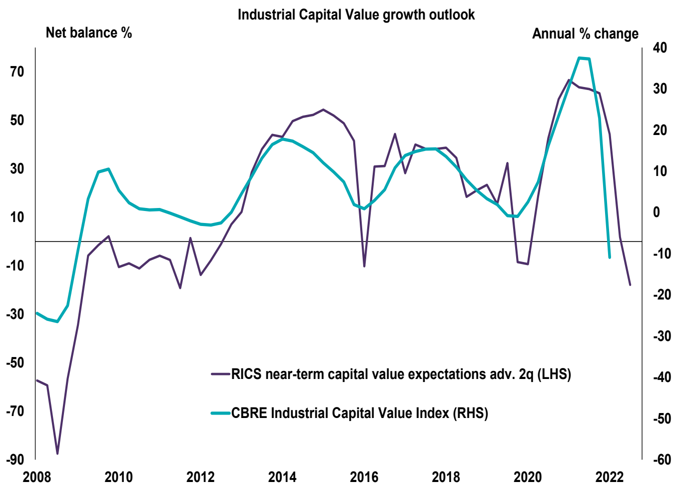

Chart 2 tracks RICS members' near-term capital value expectations for the industrial sector alongside the relevant CBRE data. The signal from advancing the RICS numbers forward by two quarters is that the annual change in industrial values is likely to slip deeper into negative territory in the early part of the year (potentially reaching close to -20% by the end of Q2).

Chart 3) Office capital values

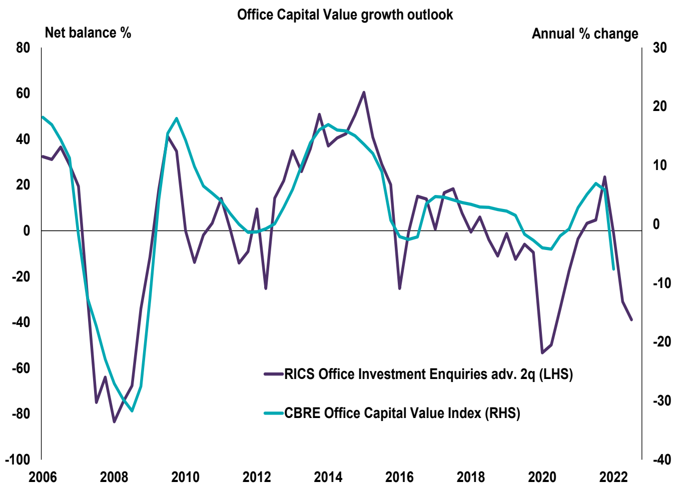

Chart 3 plots the RICS investment enquiries measure across the office sector alongside and the CBRE index. Given the sharp decline in investor demand during Q4 according to the survey results, there looks to be further downside for office values over the coming quarters. Indeed, by Q2 2023, it appears office values may be down somewhere between -15% and -20% on an annual comparison.

Commercial Property Occupier Market

Commentary

Although momentum is also fading on the occupier side of the UK commercial property market, conditions up until now appear somewhat more resilient in comparison to those on the investor side. In particular, tenant demand for industrial space continues to edge up, albeit the pace of growth looks to have cooled significantly compared with the early part of 2022. Meanwhile, vacancies remain on a downward trajectory across the industrial market, with this balance between supply and demand producing still positive rental growth expectations for the sector. Likewise, rents are also seen rising within some of the more alternative asset classes such as multifamily residential, data centres, student housing and aged care facilities. However, the same cannot be said for secondary office and retail rents, which both display firmly negative twelve-month projections as both availability and inducements rise in the face of weakening demand from tenants. Prime office rents meanwhile display a more resilient outlook relative to their secondary counterparts, with respondents to the RICS survey expecting a marginally positive trend for higher-quality office space over the coming twelve-months.

Chart 1) Rental growth expectations

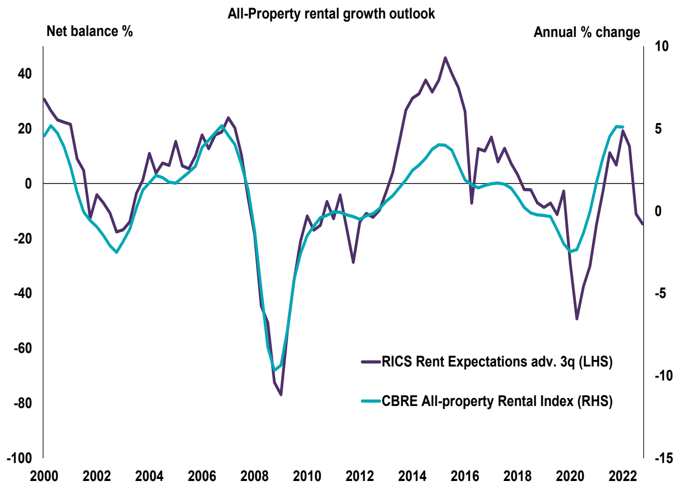

Chart 1 looks at the annual rate of growth in the CBRE rental index (all-property level) alongside the RICS Rental Expectations data. Advancing the forward-looking survey data on by three quarters gives the indication that rental growth has now peaked (currently at 5% yoy), and is likely to drift towards a much flatter annual rate of change by Q3 2023.

Chart 2) Industrial near-term rental outlook

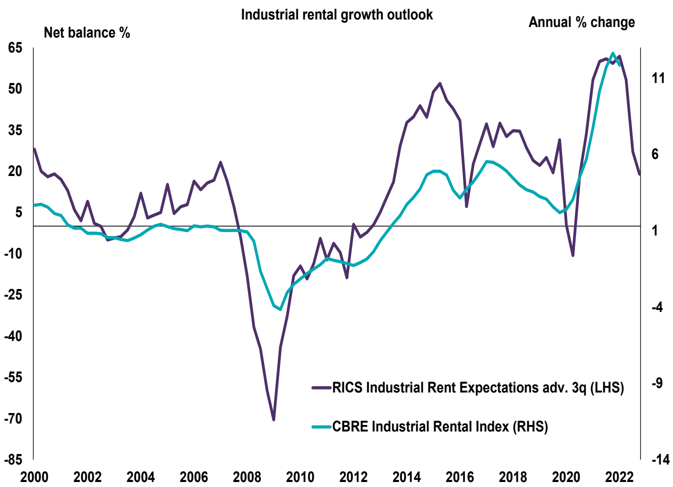

Chart 2 looks specifically at the industrial sector, where rental growth appears set to moderate (from a recent record high annual growth rate of around 13%) to something closer to 5% in three-quarters time. Even so, with a net balance of +19% of RICS survey participants expecting industrial rents to increase, the outlook remains comfortably positive.

Chart 3) Twelve-month rental expectations by sector

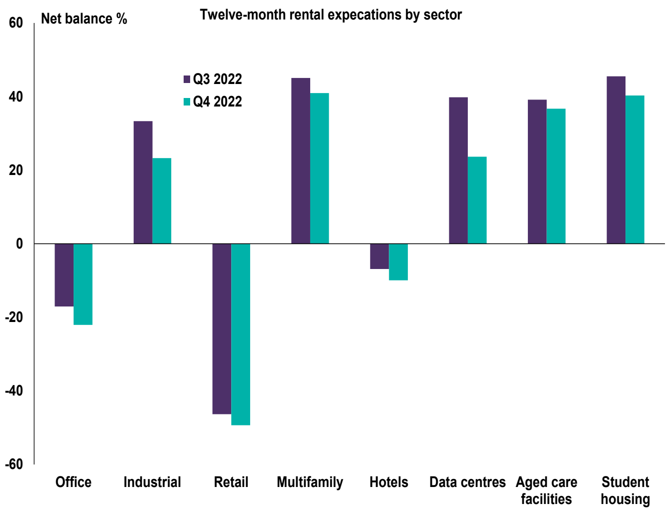

Chart 3 shows the sector level breakdown of twelve-month rental growth expectations from the RICS survey. The outlook for headline office and retail rents is quite firmly negative for the year ahead, with expectations being revised down slightly between Q3 and Q4. Conversely, respondents foresee solid rental growth coming through across many alternative sectors over the next twelve months.

Residential Property Market

Commentary

With average quoted mortgage rates standing at close to 5% currently (compared to around 2% twelve months ago), affordability has become incredibly stretched across the UK housing market. As such, new buyer activity has been dampened significantly, evidenced by the RICS survey data on new buyer enquiries, as well as Bank of England figures on mortgage approvals, pointing to hefty month-to-month declines of late. Alongside this drop in activity, house prices have also started to slip as the market adjusts to the higher interest rate environment. Indeed, the Nationwide house price index has fallen by 3.2% since September, while forward-looking survey feedback suggests prices are likely to continue to drift lower over the first half of 2023. Beyond this, the future direction of mortgage rates will be crucial in determining where both price and activity levels settle. On that front, the recent fall in wholesale energy prices has led to an easing in market based interest rate expectations, albeit rates are anticipated to remain much higher than those seen in early 2022 for the foreseeable.

Chart 1) Sales volumes

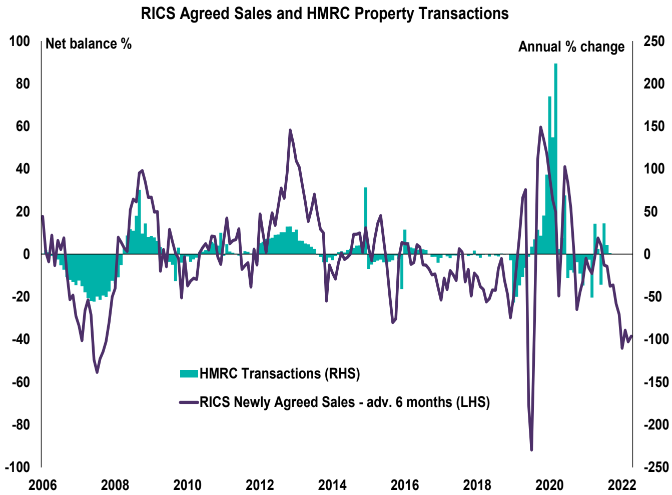

Chart 1 tracks the RICS Agreed Sales net balance data against the annual change in the number of residential transactions recorded by HMRC (with the RICS series pushed on by six months). Having averaged around 105k transactions per month through 2022, sales volumes look set to post substantial year-on-year declines through H1 2023 (likely averaging closer to 60-80k per month).

Chart 2) House prices

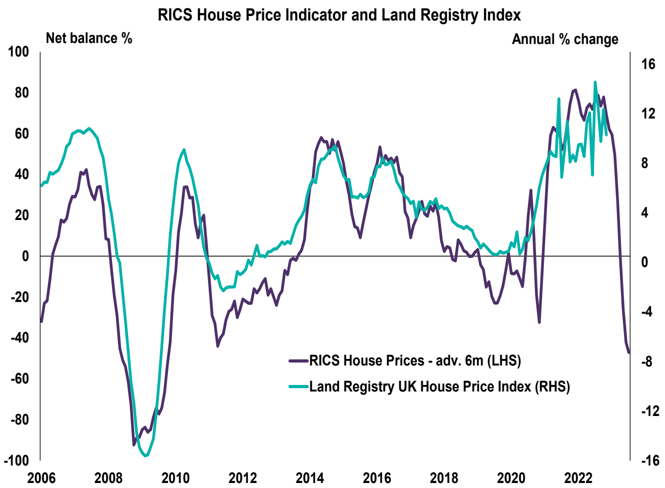

Chart 2 plots the headline RICS Price indicator (with a six-month lead) alongside the official Land Registry House Price Index. The recent sharp decline in the survey feedback points to the annual change in house prices turning negative over the coming months (prices are up by +10.4% yoy on the latest estimate), potential reaching around -8% by the midpoint of the year.

Chart 3) Regional house prices

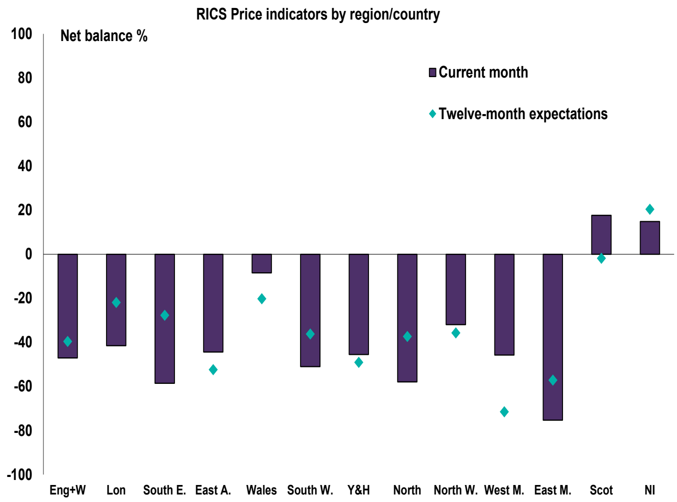

Chart 3 shows the RICS Price metrics disaggregated by region/country. With the exception of Northern Ireland and Scotland, the survey feedback is signalling a downturn in prices across all parts of the UK. What's more, prices are expected to continue to decline over the next twelve months across virtually all parts of the UK.

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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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