hometrack

Research and Insight
October 2022

UK House Price Index

+8.1%

Current UK house price growth

-33%

Hit to new buyer demand in wake of mini budget

48%

Proportion of buyers using cash or small mortgages to buy homes

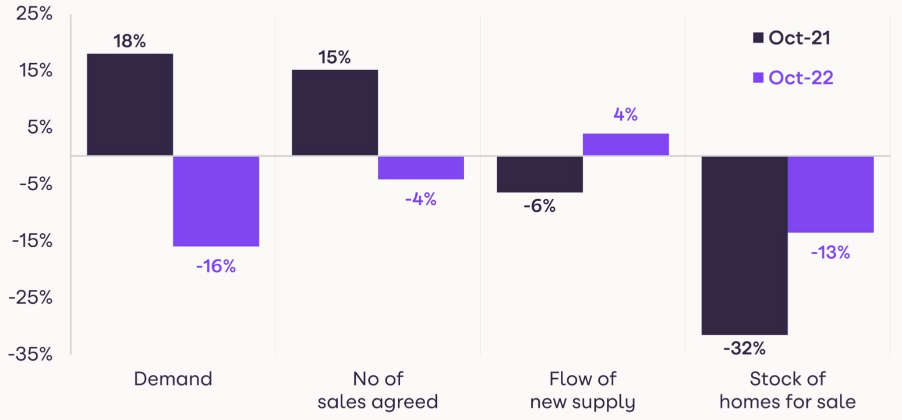
Executive summary

- Spike in 2 and 5 year fixed mortgage rates hits demand, down a third since mini budget
- Sales still being agreed at slower rate, from cash buyers and those with cheap loans - pipeline of nearly 293,000 sales in progress
- No signs of any impact on pricing expected in Q4
- Outlook for 2023 depends largely on trajectory for mortgage rates
- Sustained 6% mortgage rates would lead to double-digit price falls eroding 'paper' gains over pandemic but few negative equity cases
- More likely outcome is a fall in mortgage rates towards 4% and a modest decline in house prices of up to 5% over 2023 with 1m sales
- Robust labour market and scarcity of supply will support pricing but markets in southern England to feel the greatest impact

"Sustained 6% mortgage rates would lead to double digit price falls. If mortgage rates fall back in the next quarter, the outlook for 2023 will be very different.".

Richard Donnell
Research Director

Demand and new sales dip below the 5 year average



Source: Zoopla Research

% change - 4 weeks to 23 October & equivalent period in 2021 vs 5 year average

+17%

Jump in new mortgage approvals over August as buyers race to secure cheap finance

Political turmoil compounds rise in borrowing costs

The political and economic turmoil over the last few weeks has resulted in average mortgage rates spiking above 6% with ongoing uncertainty over the outlook for the UK's public finances and economy. The health of the housing market is inextricably linked to the health of the economy and, in particular, the cost of borrowing.

There are two aspects to consider looking ahead. First, is how the final months of the year will conclude. Second, the outlook for 2023 in the face of higher mortgage rates.

Uncertainty squeezes out new buyers

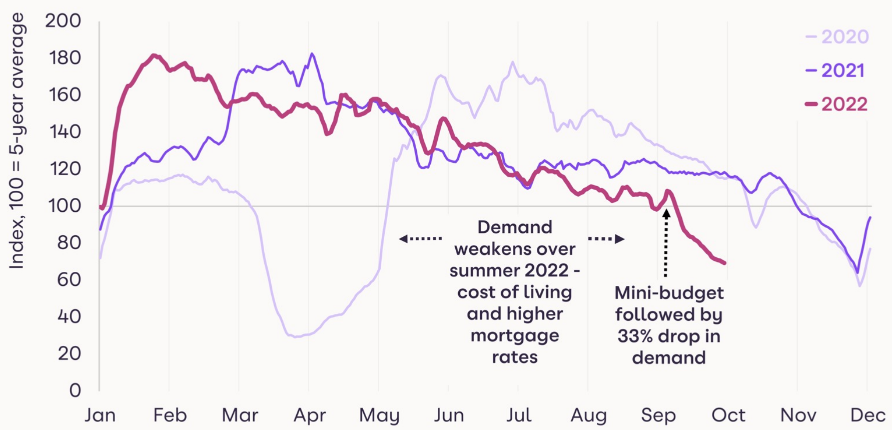
The sudden increase in mortgage rates represents the largest interest rate shock for new buyers since the late 1980s. The immediate impact has been on households without mortgages arranged at cheaper rates, most of whom are sitting on the side-lines.

This explains why our measure of new buyer demand fell by a third since the mini budget. It is similar to what typically happens in late November ahead of the Christmas slowdown. The drop in buyer interest has been spread uniformly across all markets. However, those with cheap loans secured, as well as cash buyers, are continuing to make offers and agree sales, albeit at a slower rate than this time last year, down 25% on a year ago.

Dwindling pool of buyers with cheap mortgages

Pent-up demand to move remains. Households rushed to secure low-cost mortgages over summer as rates started to rise. Bank of England data for mortgage approvals showed an unseasonal jump in mortgage approvals in August, up 17% over the month. This demonstrates an underlying desire to move among a proportion of households, driven by pandemic and other factors.

New buyer demand drops in the wake of the mini-budget



Source: Zoopla Research

Rolling 7 day average, residential estate agency only

Large pipeline of sales remains

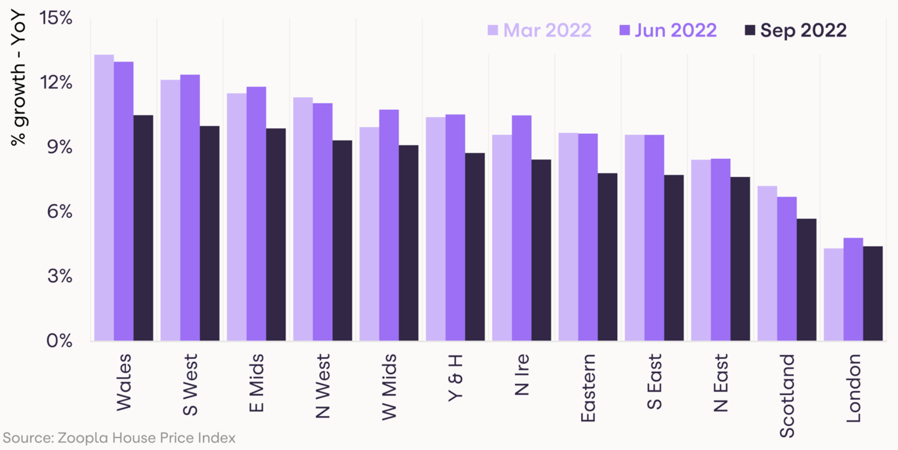
The shock to demand comes at the end of another strong year with c.293,000 sales in the pipeline, most of which we expect to complete. Fall-throughs are increasing, mainly a result of a lack of affordable finance but we are still on track for nearly 1.3m sales in 2022.

Too early to see any pricing impact in Q4

We don't expect to see any pricing impact to materialise until the first quarter of 2023. Typically, it takes several months for pricing to adjust in the face of weaker demand. There has been a short-lived surge in the number of homes coming to the market, although the number of homes for sale remains below average, supporting pricing. At the same time, c.7% of homes for sale have seen the asking price reduced by >5% - a increase on recent months but still below 2018 levels.

Our latest price index shows average house prices increasing by 8.1% over the last year. This is due to the strength of demand and sales agreed over the last 6 months, which continue to push prices higher in the face of an ongoing shortage of homes for sale. The annual rate of growth is starting to slow across all areas, and this will accelerate further into Q1 2023.

House price growth starting to slow across all areas



Source: Zoopla House Price Index

Mortgage rates trends will decide 2023 outlook

The outlook for transactions and pricing in 2023 is sensitive to the economic climate. It will also be impacted by how much buying power - due to higher borrowing costs - feeds into achieved prices.

The most important part of this equation is how long mortgage rates for new buyers stay over 6% and how quickly they might fall back to 5%, a level we see as a tipping point for house prices. Should mortgage rates fall back quickly in the next quarter, the outlook for next year will be very different compared to the prospect of mortgage rates remaining at or above 6% for the next 12 months.

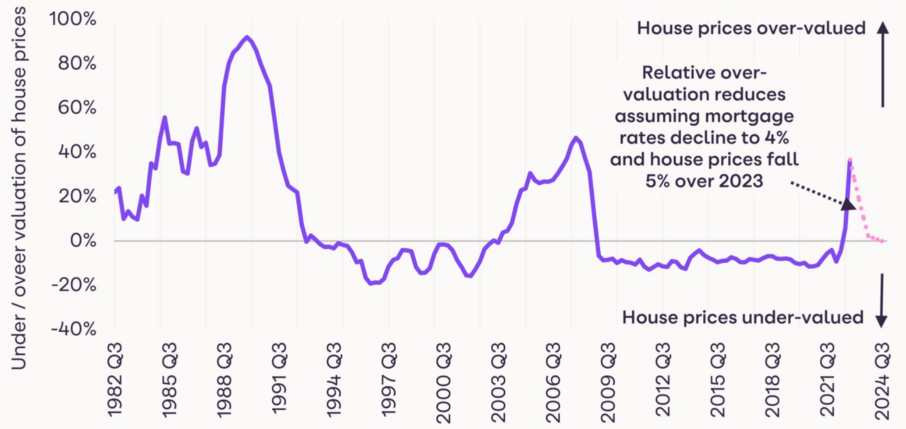
Spike in mortgage rates make housing unaffordable

We run several models to assess the impact of changes to the fundamentals that drive house prices. One of them tracks the relative over- or under-valuation of housing against a 'sustainable house price' benchmark. This model shows prolonged periods of house price over valuation in the late 1980s and in the run up to 2007. This has not been the case in the last decade with prices rising in line with market fundamentals. However, mortgage rates jumping to 6% creates a sizable over-valuation compared to our sustainable price benchmark.

The scale of historic over-valuations in prices does not translate into subsequent real-world price reductions, as mortgage rates adjust and borrowers can adjust how they fund purchases. The scale of housing downturns is also influenced by what happens in the preceding 1-3 years. Relaxations in lending criteria for new borrowers and/or tax changes can lead to a prolonged build-up of an over-valuation in prices. This compounds the size of subsequent decline in prices and sales. This was the case in the late 1980s and run up to 2007.

This has not been evident in recent years, due to much tighter control of new lending where most new borrowers are subject to affordability 'stress testing' to prove they can afford 6-7% mortgage rates. However, tighter lending criteria impacts the buying power for new borrowers. Lenders will now be testing affordability at up to 8% mortgage rates, squeezing buying power further.

Short term over-valuation of house prices due to unfold over 2023



Source: Zoopla Research

Difference between actual & sustainable house price modelled based on long run disposal incomes, mortgage rates and loan to

How will the hit to buying power play out in 2023?

There are several routes this over-valuation could unfold. A rapid reversal in mortgage rates would have the greatest impact. It could be accelerated further by a modest decline in prices. Mortgage rates moving back towards 4% by the end of 2023 with a 5% fall in prices would reverse most of the current over-valuation by the end of 2023. At present, we believe this is the most likely outcome accompanied by a decline in sales volumes over the year to 1m.

Mortgage rates to fall in 2023 and ease some pressure

Events are moving fast in the world of politics and financial markets. On balance, we believe that mortgage rates will start to decline before the start of 2023 and this will continue into next year.

There are signs that money markets are already adjusting to a changing political outlook where stability in the UK's public finances is an imperative. The big unknown remains how much further central banks need to move on interest rates to bring inflation under control. A recent speech from the Bank of England suggested markets were over-estimating how much higher interest rates will rise. Time will tell.

What is clear is that mortgage rates are not going to return to the ultra-low levels of recent years. Home buyers need to realise that mortgage rates of 4 to 5% are set to become the norm moving ahead.

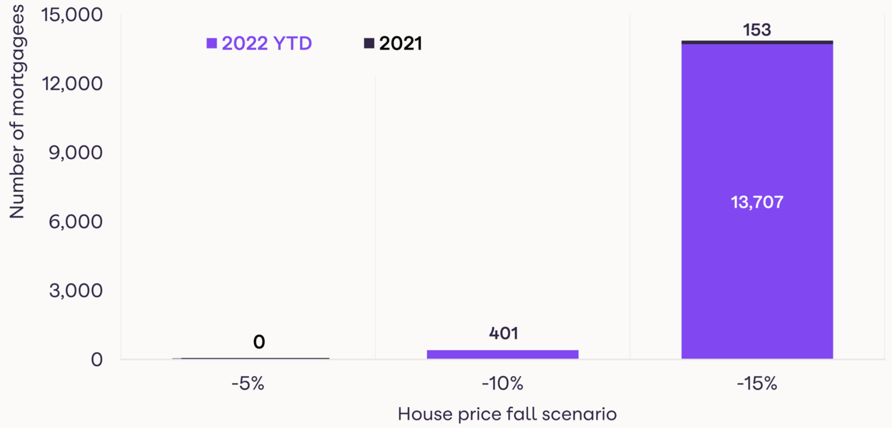
Mortgage rates stuck at 6% would lead to price falls

While we believe it is less likely, were mortgage rates to stay above 6% for the majority of 2023 then UK house prices would need to fall back to reflect the hit to the purchasing power of those using mortgages. There is a large equity buffer to absorb lower prices and a 10% decline in average prices would wipe out a sizable proportion of the paper gains over the pandemic (more so in markets with lower price gains).

Low exposure to negative equity from 10% price falls

Levels of negative equity would remain minimal, certainly by historic standards. A nationwide 10% fall in house prices would result in a small handful of negative equity cases from purchases with high loan to value mortgages made in 2022. This highlights how the housing market has been increasingly driven by buyers using equity more than borrowers reliant on high loan-to-value mortgages.

Mortgagees at a risk of negative equity by year of mortgage



Source: Zoopla Research estimate using BoE data

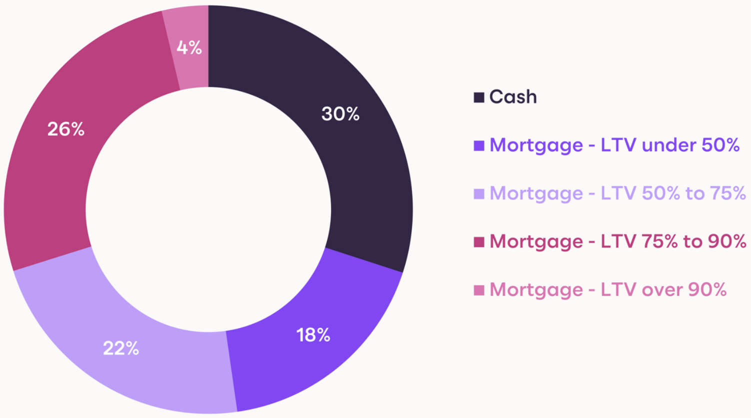
National view by purchase year. 2022 YTD is January to August

Half of sales are cash or small-sized mortgages

Mortgage availability and cost are important for many buyers. However, half of all sales are paid for by cash or using a mortgage that is small relative to the value of the property (<50%). These buyers will see less of a hit to buying power than those using larger loans.

Healthy levels of market activity do require a balance of buyers and normal levels of transactions cannot be sustained with some groups excluded from the market or buying in much lower numbers. First-time buyers and those looking to trade up using a much bigger loan will feel the shock of higher borrowing costs more than others. This will also impact more buyers in the south-east of England where house prices are highest, which drives a greater sensitivity to mortgage costs.

Home purchases by cash buyer and size of mortgage



Source: Zoopla Research estimates using BoE

LTV = loan to value

Outlook

The spike in mortgage rates has delivered a quick reality check for home buyers. Many are continuing with agreed purchases but others did not expect to be buying with mortgage rates 3x higher than at the start of the year and are sitting it out for the rest of 2022.

The broader motivations to move home will remain into next year supported by pandemic-driven factors and cost of living pressures. For many households it will come down to what they can get for their home and what this value unlocks for their next move. Price reductions will come out of equity for most households but it can take time for everyone who wants to move to accept pricing adjustments. We expect the adjustment process will be quicker than normal given the step-change in the outlook and the scale of recent price gains.

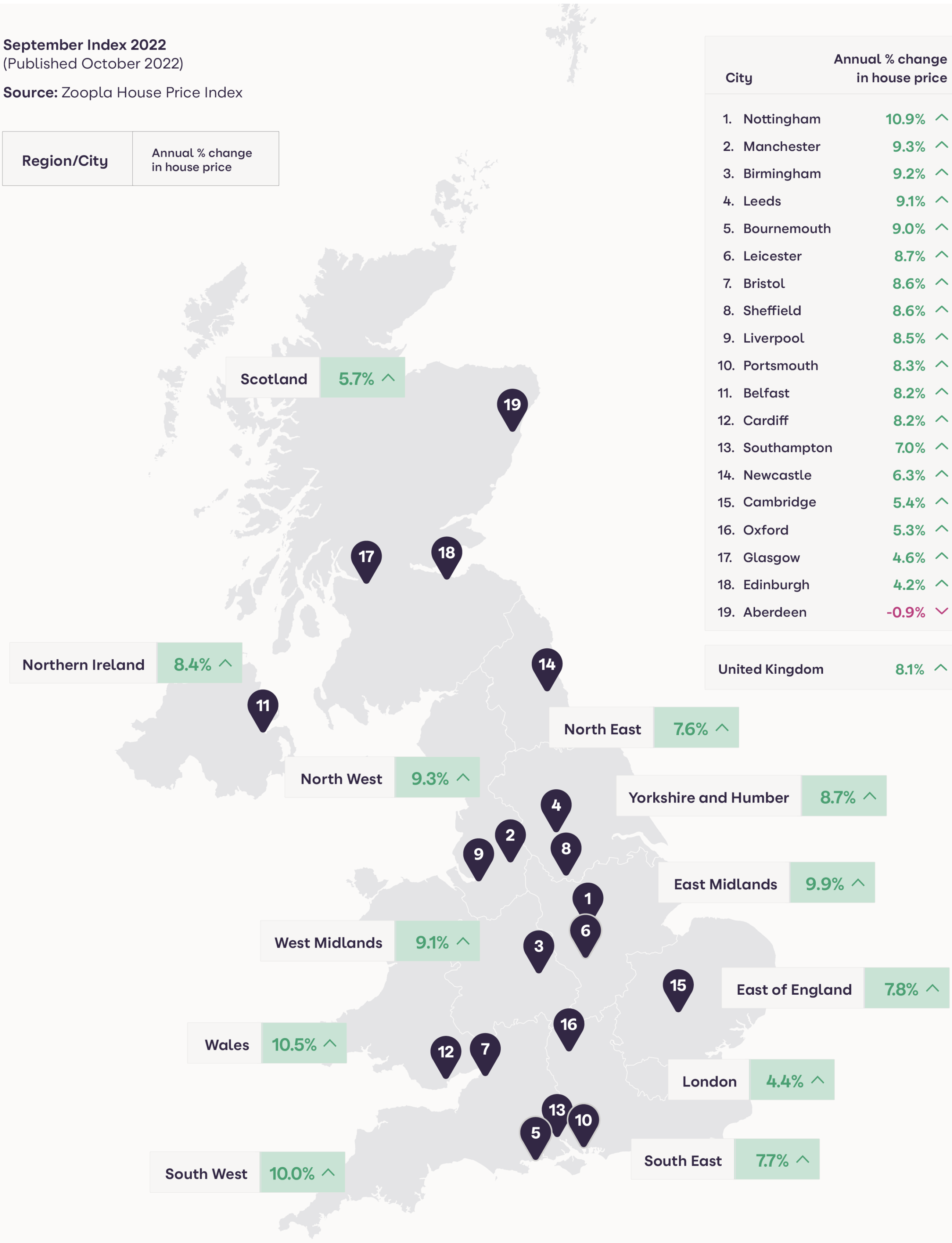
While the focus is on mortgage rates, the labour market remains robust and wages continue to increase, albeit failing to keep pace with the rising cost of living. The proposed cut to National Insurance and support for energy bills will offset some of the pressures on incomes. The housing market in 2023 looks set to be one of re-adjustment as we return to normal levels of mortgage rates.

House Price Index – Country, region and city summary

Note: The Zoopla house price index is a repeat sales-based price index, using sold prices, mortgage valuations and data for agreed sales. The index uses more input data than any other and is designed to accurately track the change in pricing for UK housing.

September Index 2022
(Published October 2022)

Source: Zoopla House Price Index



City	Annual % change in house price
1. Nottingham	10.9%
2. Manchester	9.3%
3. Birmingham	9.2%
4. Leeds	9.1%
5. Bournemouth	9.0%
6. Leicester	8.7%
7. Bristol	8.6%
8. Sheffield	8.6%
9. Liverpool	8.5%
10. Portsmouth	8.3%
11. Belfast	8.2%
12. Cardiff	8.2%
13. Southampton	7.0%
14. Newcastle	6.3%
15. Cambridge	5.4%
16. Oxford	5.3%
17. Glasgow	4.6%
18. Edinburgh	4.2%
19. Aberdeen	-0.9%
United Kingdom	8.1%

Zoopla House Price Index, city summary, September 2022

Source: Zoopla House Price Index. Sparklines show last 12 months trend in annual and monthly growth rates - red bars are a negative value - each series has its own axis settings providing a more granular view on price development.

	Average price	%yoy Sep-22	%yoy Sep-21	Monthly trend	Annual trend
UK	**£259,100**	**8.1%**	**7.1%**		
20 city index	**£294,800**	**6.5%**	**5.8%**		
Nottingham	£198,100	10.9%	8.5%		
Manchester	£217,000	9.3%	9.2%		
Birmingham	£203,400	9.2%	6.8%		
Leeds	£206,300	9.1%	7.6%		
Bournemouth	£346,600	9.0%	8.5%		
Leicester	£224,600	8.7%	8.5%		
Sheffield	£170,000	8.6%	8.5%		
Bristol	£333,600	8.6%	7.4%		
Liverpool	£153,200	8.5%	11.4%		
Portsmouth	£284,400	8.3%	7.8%		
Cardiff	£254,400	8.2%	7.2%		
Belfast	£167,800	8.2%	8.7%		
Southampton	£261,600	7.0%	6.3%		
Newcastle	£147,700	6.3%	6.3%		
Cambridge	£467,400	5.4%	5.1%		
Oxford	£451,100	5.3%	4.6%		
Glasgow	£140,500	4.6%	7.2%		
London	£525,900	4.4%	2.5%		
Edinburgh	£264,400	4.2%	4.0%		
Aberdeen	£142,300	-0.9%	-0.1%		

Source: Zoopla House Price Index. Sparklines show last 12 months trend in annual and monthly growth rates – red bars are a negative value – each series has its own axis settings providing a more granular view on price development.

Contacts

If you have any questions about our research please do get in touch

Richard Donnell
Director of Research & Insight
richard.donnell@zoopla.co.uk

Theo Brewer
Director of Innovation
theo.brewer@hometrack.com

Recent publications

Sign up for all the latest research from Zoopla at advantage.zpg.co.uk