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future trends '23

Our research of trends that will define the specialist finance and property markets in 2023

DECEMBER 2022

As 2022 draws to a close, it's fair to say there has been a myriad of economic and political challenges the specialist finance and property markets have grappled with.

Three prime ministers, four chancellors, the aftermath of a global pandemic, a cost-of-living crisis, and a war in Europe – all these factors have caused inflation to hit a 41-year high of 11.1%, creating a cost-of-living crisis that has caused the biggest decline in living standards for over 50 years.

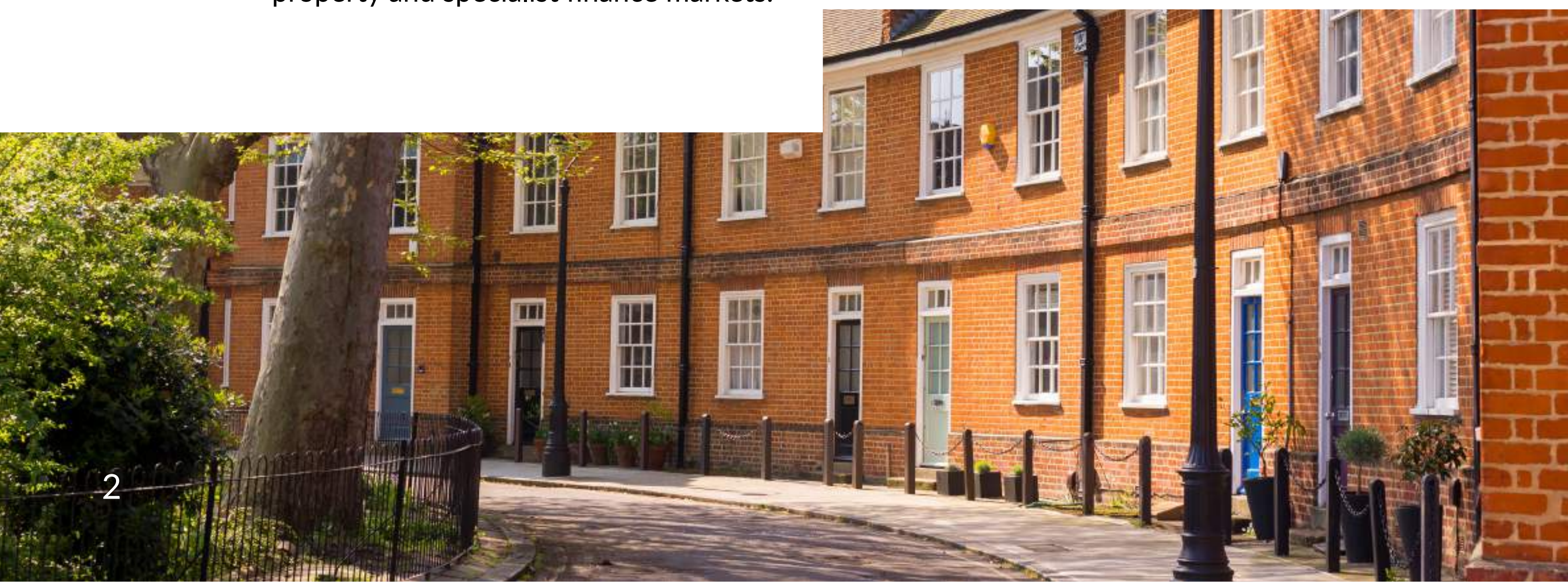
Simultaneously, the Bank of England, in its perennial battle against inflation, has been forced to hike interest rates by 2.75% since December 2021. As a result, mortgage rates have risen dramatically, making mortgages unaffordable for many.

Despite this, the market has remained robust, considering the significant obstacles to success that have been placed in front of it.

According to **Halifax**, for example, the annual rate of price growth currently sits at 4.7%. Meanwhile, the average property was valued at £275,000 in December 2021, but the most recent data suggests that the average house price exceeded £285,000 this year, and continues to sit well above pre-pandemic levels.

But ultimately, as 2022 has shown, we can't take anything for granted. These challenges will continue to impact the market in 2023. As always, there will be some key trends that will define the property and specialist finance markets.

Here's what we think will be most important:



A Period of Cooling Off

Admittedly, it would be remiss to suggest the current economic climate is not going to contribute to a cooling off in the property market. Certainly, interest rates have an important bearing on performance, but more general issues like the cost-of-living crisis, growth, and the general state of the economy must also be taken into consideration. As such, the first trend to look out for in 2023 is a period of slow growth or decline for house prices.

It is clear that the whole of Europe – including the UK – sits on the precipice of a recession, caused largely by the energy crisis created by the war in Ukraine. This, in combination with higher interest rates and the end of the government's Help to Buy scheme, will put pressure on how much people can borrow, or afford to offer for a house purchase. This could reduce demand as a result - during the 2007 recession for example, prices fell by 12%.

In 2023, however, we predict the downturn will be less severe than in 2007. Certainly, with fewer buyers in the market, and reduced demand, prices will fall. According to the Office of Budget Responsibility (OBR), they'll dip by 9%. That said, Knight Frank argues they'll only decline by 5%, so any predictions should be taken with a pinch of salt to an extent.

Since March 2020, for example, when prices dropped to their lowest level since 2011, the market made a miraculous recovery. This was despite a global pandemic and the cost-of-living crisis. Admittedly, the government stepped in to support the market during this period – particularly with the stamp duty holiday – but similar measures have been announced this year and should help to stabilise the market in the short term.

Also, it's worth noting that because of the price growth seen in the last two years, even a 9% drop in prices would keep the average house price above pre-pandemic levels. And, as the economy rebounds following the recession, we could see a renewed flurry of activity in the property market.

On the subject of demand, however, we must also mention the effect that the lack of supply of homes in the UK is having on the market. By the mid-2020s, the target was for the UK to be building 300,000 new homes a year to keep supply in line with demand. However, figures suggest we're only building around 200,000 a year, while Rishi Sunak is set to drop the housebuilding targets altogether. This lack of supply could limit the extent to which the market can reignite activity and grow post-recession, exacerbating the challenges facing the industry for a few years to come.

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Optimism for Mortgage Rates

Admittedly, house prices have already started to slow since Liz Truss's disastrous mini-budget. According to Knight Frank, the main culprit behind the start of this slowdown is rising mortgage rates, which superseded 6% for two-year fixed mortgages in recent weeks. With costs rising everywhere, the market is still enjoying significant activity, but buyers are being more cautious about where they get their mortgages from. Indeed, taking a step back to shop around could save hundreds of pounds a month, but this has applied some pressure to growth.

So too, has the threat of higher interest rates, which has been signalled by the Bank of England in recent weeks. Once the base rate rises, high street lenders often do the same. These increases are passed on to customers in the form of higher monthly mortgage payments.

Despite this, we think that there are reasons to be optimistic when it comes to mortgage rates in 2023. Indeed, since Sunak became Prime Minister, the markets have relaxed to an extent. Many lenders have opted to remove the 'Truss premium' from their products. As such, from the current highs of 6%, we expect mortgage rates to fall to around 5% by 2023.

However, that is not to say that they won't fall further. For instance, if the base rate were to peak at around 4.5% in the first few months of 2023 (lower than the currently forecasted 6%), we could see lenders reduce their rates further. Certainly, if inflation is subdued by the end of 2023, we could see base rate pressures ease, allowing mortgage rates to edge back down as well.

Having already discussed prices, if mortgage rates do come down, then we should see market activity ramp up as the cost of borrowing drops. In particular, if there are prospective buyers who were looking to enter the market towards the end of 2022, but are waiting to see if mortgage rates come down, demand could build up in 2023, supporting prices further.

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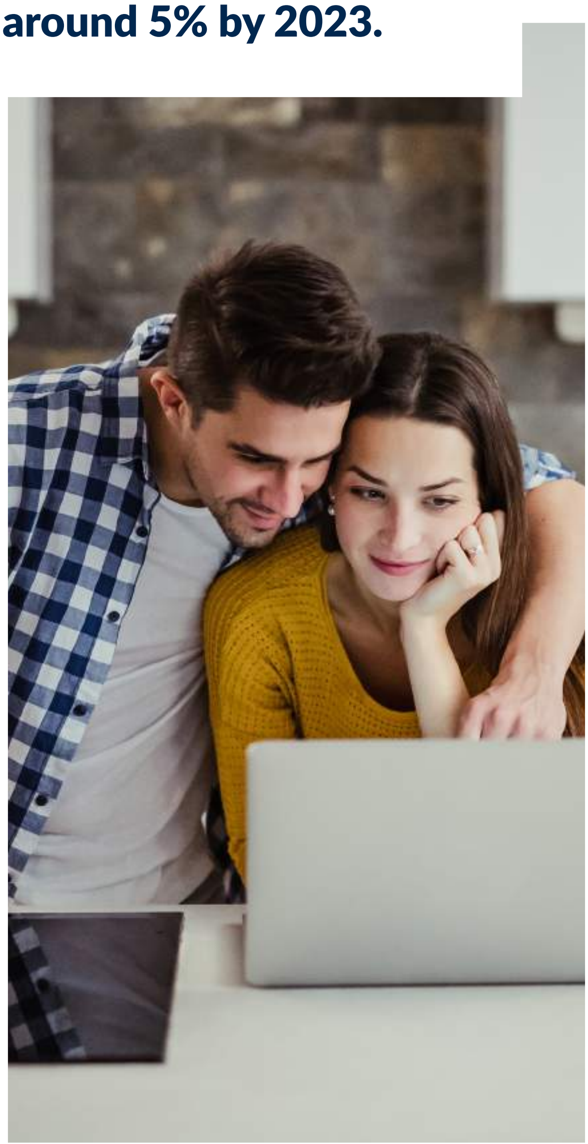

Cash and Foreign Buyers Will Remain Active

Currently, the housing market is particularly attractive to cash buyers. With some homeowners and landlords opting to sell their homes due to rising mortgage rates, cash buyers picking up properties have increased in number in recent months. As such, this trend could continue into 2023 as prices cool and rates stay high.

Additionally, the run on the pound to a 37-year low against the dollar after the mini budget in September made property investments in the UK a lot cheaper for overseas investors – particularly from the US. The pound has recovered somewhat since then, and overseas investors still have to pay a 2% stamp duty surcharge, but the discount that the weakness of the pound brings will outweigh the extra tax burden.

We saw a similar run on the pound in 2016 following the Brexit referendum, and 14% of the world's commercial real estate investments back then occurred in Britain. As such, we could see foreign investors capitalising on favourable exchange rates in 2023.

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Rental Prices Will Continue to Rise in the Buy-To Let Sector

Despite a plateau in house prices, rental prices could continue to rise in 2023. This will bring some welcome relief to buy-to-let investors and landlords. To a greater extent than sale prices, rental prices are driven by the balance between demand and supply.

Savills say there were 26% fewer homes available to rent in Q3 2022 than there were pre-pandemic, so supply is scarce. Meanwhile, rental demand could increase as prospective buyers opt to rent while they hold off on their purchases and wait for mortgage rates to come down. In fact, the number of people looking to rent a home is 142% higher than it was half a decade ago, and this trend could continue in 2023.

According to a recent study by the Royal Institution of Chartered Surveyors (RICS), this discord between supply and demand could result in as much as a 15% increase in rental prices in 2023.

26%

fewer homes available to rent in Q3 2022 than there were pre-pandemic.

15%

increase in rental prices in 2023 could be caused as a result of discord between supply and demand.

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Some Sectors Will Outperform the Rest of the Market

Despite the OBR predicting a 9% dip, there are some sectors of the market that could outperform in 2023. For instance, Knight Frank predicts that prices for prime central London (PCL) properties will only fall by 3% in 2023, before plateauing in 2024. Due to the higher levels of affluence and housing equity, as well as the influx of overseas buyers, the PCL market could be more insulated than most next year.

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The Market Will 'Go Greener'

As we enter 2023, the private residential market edges one year closer to the implementation of the new Energy Performance Certificate (EPC) ratings changes in April 2025. These new regulations will require any property being let to new tenants to have an EPC rating of C or higher, with fines of up to £30,000 for non-compliance. In 2022, it is estimated that three in five (58%) homes across the UK have an EPC rating of D or lower – that is 12.6 million properties.

Investment will be needed across the country to improve the energy efficiency and sustainability of residential properties. On top of this, there is demand from tenants and buyers for greener homes, especially as energy bills rise. This could incentivise landlords to renovate their properties and make them more sustainable.

In fact, 42% of tenants now consider the energy efficiency of a property before renting, while 82% of buyers said they would be willing to pay more for an energy-efficient property. As such, a growing trend in 2023 could be the implementation of sustainable features to more homes in the UK as investors and landlords try to get ahead of oncoming regulations.

42%

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More Stability Under Sunak and Hunt

For now, it seems the appointments of Sunak and Hunt as Prime Minister and Chancellor respectively have settled the financial markets. Following the Autumn Statement - where little was announced to intervene with the property market - investors and landlords should take some comfort in the fact that the property market continues to be seen as the bedrock of the UK economy. Hunt's policies to balance the books will hopefully deliver stability in the longer term, while the stamp duty incentives may help the sector ride out the current economic turbulence.

Going into 2023 with a more stable government in place could encourage lenders to relax their mortgage rates. After all, rate hikes don't just reflect rising interest rates, but also the government's ability to manage the economy and deliver certainty.

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The view of our CEO

“With all the turbulence we have seen in recent months, it’s no wonder that we will see a slight dip in property prices heading into 2023. With inflation, interest rates, and the cost-of-living crisis in mind, specialist lenders will need to play a vital role in supporting the property market through the recession. This support can be manifested in a variety of ways.

Clear and proactive communication, for example, between lenders, brokers and borrowers will be crucial. If there is one thing that our clients value in the current climate, it’s clarity over our products and the impact that the economic climate might have on them.

At MFS, we underwrite our buy-to-let mortgages and bridging loans from day one, so we are clear with our clients from the outset. This ensures they won’t encounter any nasty surprises further down the line, allowing them to invest with confidence.

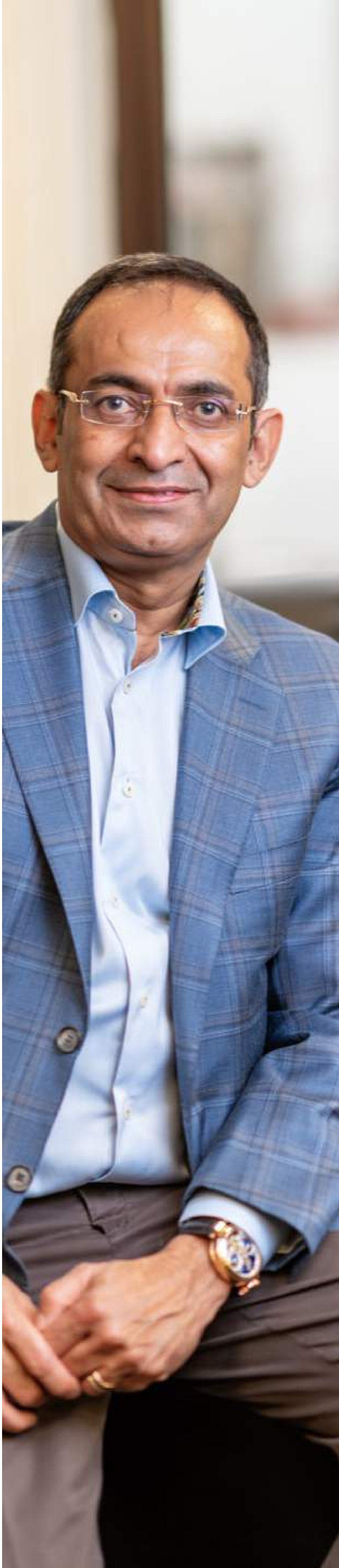
Flexibility and creativity will also help support the market. In the aftermath of the mini-budget, some lenders pulled products or refused to take on any new applications, creating a nightmare situation for borrowers and their brokers. As such, in 2023, lenders must be able to find a way around complex circumstances to help borrowers find financial solutions that best suit their needs, no matter how complex the case might be.

With the high street mortgage market in disarray, bridging loans could prove increasingly useful and popular options for landlords and investors looking to get a deal or project over the line. Our bridging loans enable borrowers to purchase a property, restructure a portfolio, or make renovations that will increase house value despite falling prices, so could be an ideal product for borrowers in the short- to medium-term.

We are working hard to provide these qualities as a lender. Although the months ahead will be challenging, there are still opportunities in the UK market. As such, we will be on hand to enable buyers, landlords and investors seize them by delivering the right financial products for their needs.”

*- **Paresh Raja, CEO,** Market Financial Solutions*

MFS are a bridging loan and buy-to-let mortgage provider, not financial advisors. Therefore, Investors are encouraged to always seek professional investment advice.

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