RETTIE RESEARCH REPORT
Winter market briefing

RETTIE

DECEMBER 2023

Braving the weather: The Scottish housing market in 2023

THE RETTIE 2024 FORECASTS: HEADLINES

- 2024 house price forecast at +1.5%
- 2024 transaction activity forecast at +4.3%
- Continued pressure expected on the private rented sector (PRS), with likely double-digit rise in average rents on new listings and continuing fall in supply levels, although this will be impacted by forthcoming Government legislation.

This time last year, the housing market and wider economy had been thrown into turmoil by the UK Government's Autumn Mini-Budget. Average mortgage rates jumped by almost 4 percentage points in 6 months and the mortgage payment on the average Scottish house purchase increased by almost 60% (from under £800pcm in most of 2022 to over £1,200pcm by November 2022).

A year on, while the cost of borrowing remains relatively high, the market has settled into a new reality. **Transactions** have remained relatively robust, although they look like ending close to 10% down on 2022 levels. **House prices** also remained relatively robust, not moving much in the country as a whole. As we outlined in our end of 2022 forecasts, this is much as we expected and a long way from the market collapse that some commentators anticipated.

Meanwhile, pressure on **the rental sector** is increasing, with an annual increase of 14% on newly advertised rents across Scotland, while supply continues to contract.

For 2024, Rettie are forecasting a rise in the average house price in Scotland by 1.5%* and a rise in sales transactions by over 4%* as the market adjusts to its new environment.

*Figures based on mid-range forecasts

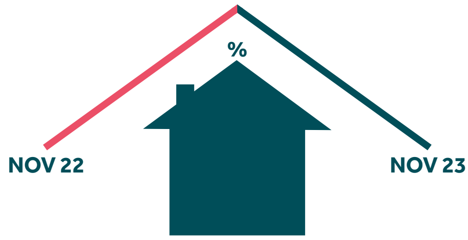
> *The housing market in 2023 is adjusting to higher interest rates. Demand has dropped back, but not excessively, and sales activity is stabilising and should recover in 2024, giving more buyers and sellers confidence to enter the market. As for the rental market, there is likely to be continued pressure on the private rented sector (PRS) as demand has not dampened in the way it has in the sales market.*

Dr John Boyle MRICS, Director of Research & Strategy

KEY FINDINGS

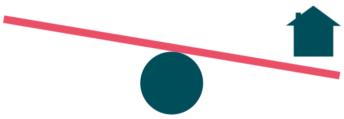
1. Prices relatively robust, activity down

As we forecast at the end of 2022, house prices have remained **relatively robust** over 2023 and are 1% up on last year's figures in the calendar year to October. Market activity has been more affected by economic conditions, with transactions **down around 9%** in the first 10 months of the year.



2. Mortgage costs dampen affordability

The main reason for the reduced sales market has been the **sharp increase in mortgage rates**. In 2020, the average Edinburgh mortgage payment was under £1,000pcm, before **peaking at £1,800pcm** in mid-2023, prior to a reduction in rates later in the year.



3. Signs of a stabilising market

There are positive signs pointing towards **a stabilising sales market** as we end 2023. While 2024 is still likely to be challenging, some improvement in activity is expected.

4. Rental market sees excess demand

The rental market remains in a condition of **significant excess demand**, pushing up advertised rents and reducing time to let. Scottish Government solutions to tackle rising rents with price caps may further reduce availability, leading to significant shortages in pressed markets.

5. Forecasts suggest modest rise in activity

Our new forecasts highlight **modestly rising activity levels in 2024**, although still likely to be behind the long-term average, with another year of flat or marginal price movements also anticipated in the year ahead.

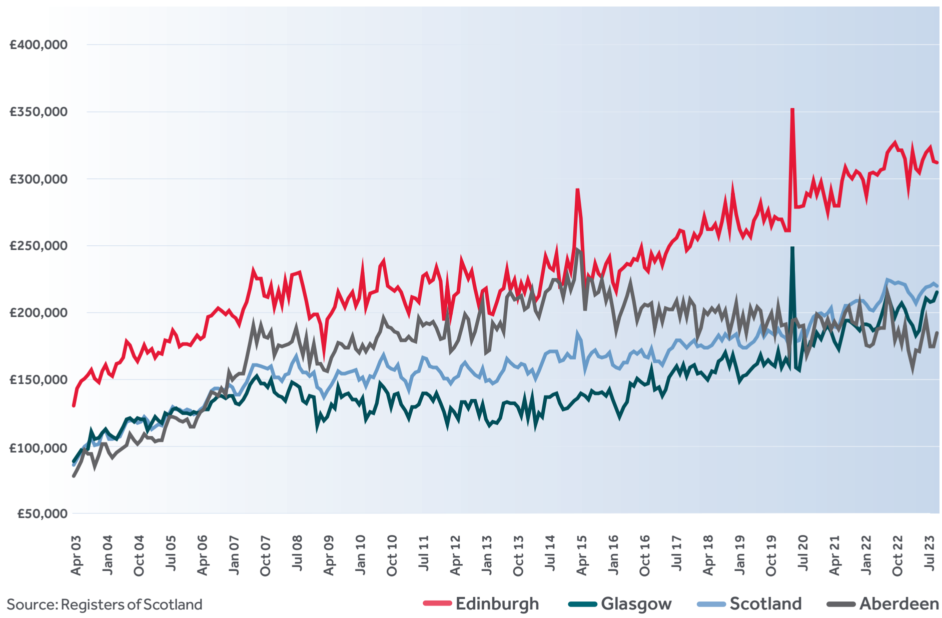
KEY FINDINGS EXPLORED

1. Prices relatively robust, activity down

PRICES REMAIN RELATIVELY ROBUST

With the increase in the cost of new mortgages, there has been a cooling effect on the sales market, albeit after a period of prolonged strong positive growth, especially in the wake of the pandemic. Despite this headwind, average prices have remained relatively robust in the past year.

Figure 1: Average House Prices Have Stabilised in 2023



Source: Registers of Scotland

The latest figures for October 2023 from Registers of Scotland have the average Scottish house price down 1.5% on the same month last year. However, **the average house price over Jan-Oct 2023 remains 1% up** when compared to the first 10 months of 2022.

TIGHTER SUPPLY SUPPORTING PRICES

As expected, **tighter supply has supported house prices**, especially in the more desirable locations and for family style housing. Some markets have, however, been hit harder. For example, the urban flatted market has been more challenged through the impacts of the rising mortgage rates on the affordability for younger households, who will tend to have less equity reserves.

The **new build** market has also been more severely impacted, with sales **down 15%** in the first 10 months of 2023. As well as the reduction in demand, the new build sector has also faced supply-side problems with rising construction costs and labour market and supply chain pressures. All of this has impacted on the viability of development in many areas, slowing delivery.

KEY FINDINGS EXPLORED

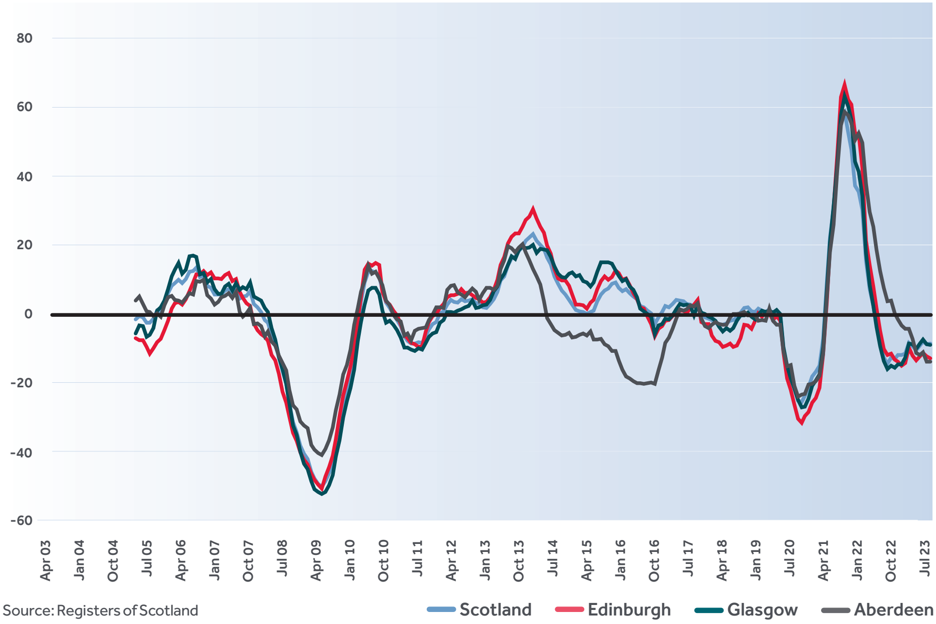
1. Prices relatively robust, activity down *continued*

TRANSACTIONS FALL BUT CRASH PREDICTIONS PROVE FALSE

Although transactions have dropped back, this was far from the crash that some commentators predicted. To put it in context, during the Global Financial Crisis (GFC) of 2007/9, transaction volumes plummeted by over 50% before transaction activity in Scotland settled at around 100,000 per annum from the mid-2010s. There was volatility around the pandemic, but we seem to be **gradually moving back to pre-pandemic patterns** despite the economic upheaval of the last year or so.

gradually moving back to PRE-PANDEMIC PATTERNS

Figure 2: Year-on-Year % Change in Sales Transactions in Scotland Shows Volatility with Economic Events but the Post GFC Long-term Average is Around 100k pa in Scotland



Source: Registers of Scotland

POSITIVE SIGNS EMERGING

With thoughts turning to Christmas, we are now seeing the market move into its seasonal slowdown, just as in previous years. However, as we enter this slowdown, there are **some positive signs that we can see emerging from different indicators**.

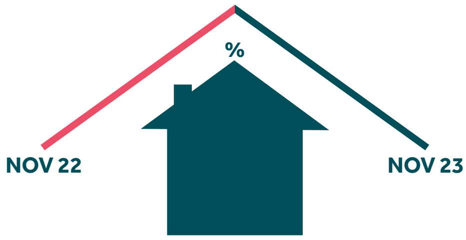
The October Residential Market Survey from the Royal Institute of Chartered Surveyors (RICS) shows future sales expectations (next 3 months) **turning positive** in Scotland after a period of negative market sentiment. The GKF Consumer Confidence Survey in October also provides some hope as, while it is at -30, this is an improvement on the -45 score at the start of the year.

There are also positive signs with **mortgage lending**, with 2-year fixed rates now back below 5%. In addition to this, interest rate SWAP rates, which can be an indicator of market expectations of bank rate and mortgage rates, have also been trending down in November. These **indicators point towards stabilising and improving market conditions** as we enter 2024, although the challenges of above target inflation, relatively high interest rates and a cost-of-living crisis remain for many.

2. Mortgage costs dampen affordability

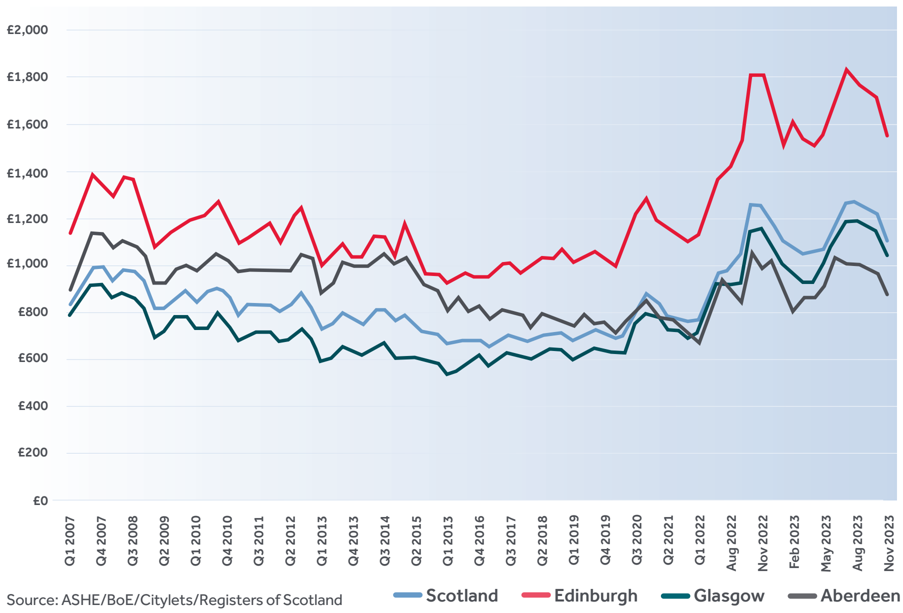
SHARP INCREASE IN RATES HAS HAD DAMPENING EFFECT

The main reason for the reduced sales market has been the **sharp increase in mortgage rates**, which has had a dampening effect on the housing market over the past year.



This is particularly understandable when you track the cost of the average mortgage payment. In 2020, the average mortgage payment (based on the average mortgage rate, average loan to income and loan to value on the average house price) in Edinburgh was **under £1,000pcm**, before **peaking at £1,800pcm** in mid-2023. With mortgage rates reducing, this figure has pulled back to nearer to £1,500pcm. If rates stabilise, or continue to fall, this will improve affordability and confidence in the market.

Figure 3: The Average Mortgage Payment on the Average House Price is Dropping Back after a Spike in 2022



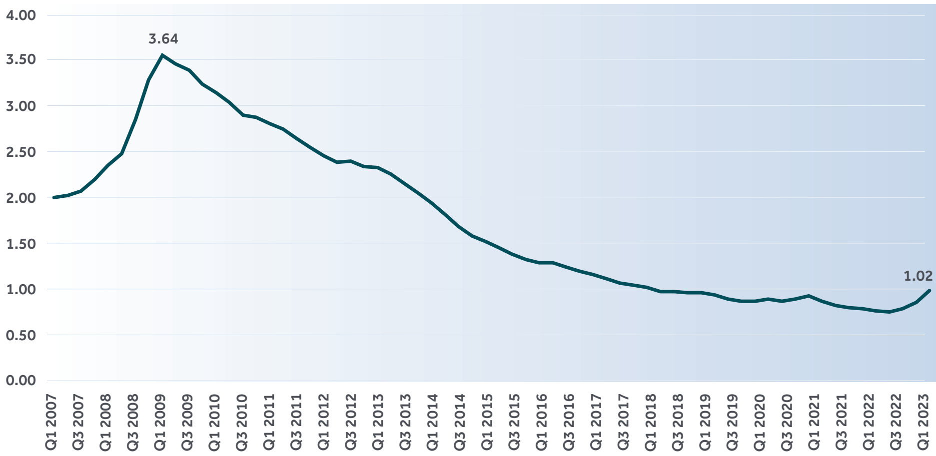
Source: ASHE/BoE/Citylets/Registers of Scotland

2. Mortgage costs dampen affordability *continued*

MITIGATION SEEMS TO BE WORKING

In terms of overall sector health, while there has been a small upturn in arrears, the steps lenders are taking to mitigate rate shocks seem to be working, with the arrears well below the level seen at the time of the Global Financial Crisis in 2008/9. This has **reduced the potential impact of distressed sales** in the market, which has also been **a stabilising factor**.

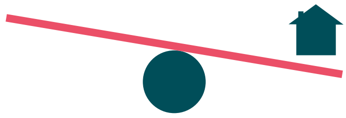
Figure 4: The Percentage of Borrowers in Mortgage Arrears has Remained Low in Scotland



Source: BoE

3. Signs of a stabilising market

SUPPLY AND DEMAND BACK IN BALANCE

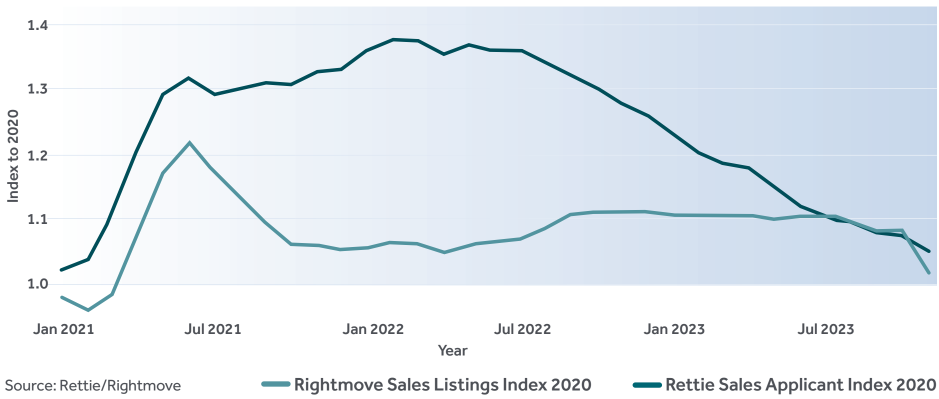


Analysis of **supply and demand indices** in the market over the past few years shows some revealing trends.

Across Scotland, both the number of properties coming to the market and the level of enquiries from buyers registering with Rettie saw a sharp increase in 2021, in the wake of the pandemic. The spike in demand remained elevated until Summer 2022 but began to slip from this point, undoubtedly accelerated by the UK Mini Budget and the accompanying sharp rise in interest rates. The index of Rightmove listings was, by contrast, relatively flat over much of 2021-23.

As demand levels have reduced, this has lessened the price pressures in the market. Demand levels are now returning to pre-pandemic levels and in line with supply pre-pandemic levels, hence the stabilisation in prices.

Figure 5: Scottish Supply vs Demand (Indexed to 2020) Is Now Back in Balance



Source: Rettie/Rightmove

EDINBURGH SHOWS INCREASED SUPPLY

In Edinburgh, unlike the wider Scottish market, supply **increased** from mid-2022 onwards. This has been driven by sellers looking to take advantage of strong sales values, as well as a proportion of landlord investors (both short – and longer-term tenancies) electing to exit the sector due to increasing costs and regulations while sales values are high.

By contrast, **Glasgow** has had a **more consistent** pattern, with less fluctuations in both supply and buyer demand. However, these trends do vary within cities depending on location and property type.

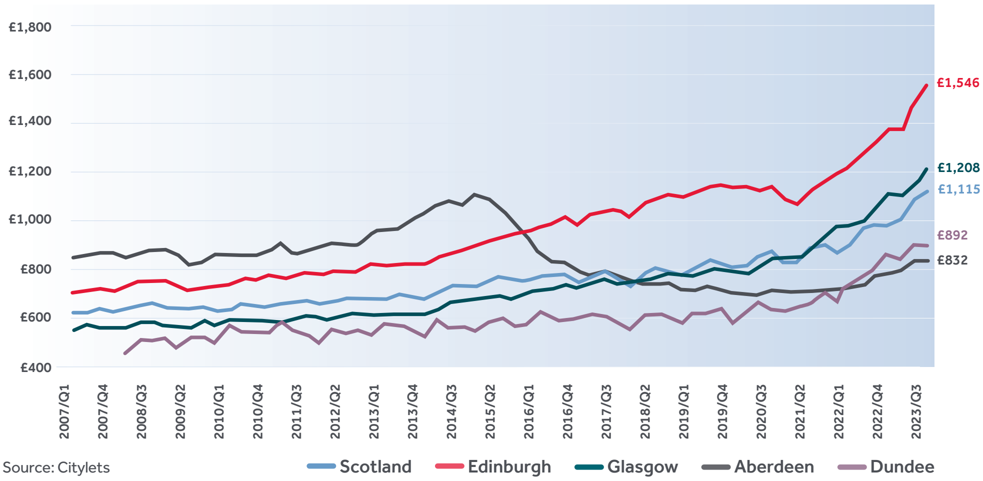
4. Rental market sees excess demand

AVERAGE ADVERTISED RENTS RISE SHARPLY

The rental market has been a hot topic in the past year as the average rent of newly listed properties across Scotland has **increased sharply**.

As of Q3 2023, Citylets is reporting the average advertised rent in Scotland at £1,115pcm, with rents of £1,208pcm in Glasgow and £1,546pcm in Edinburgh – figures which represent **annual increases of 14%, 16% and 17%** respectively. This is despite the introduction of rent freeze/cap measures by the Scottish Government from September 2022, which only applied to existing tenancies and not new tenancies.

Figure 6: Average Advertised Rents Have Risen Fast in Most Locations in 2022-23



Source: Citylets

The emergency legislation has probably exacerbated the size of the rent rises on new tenancies, as landlords have sought to compensate for caps within tenancies as well as the prospect of future tighter rent controls.

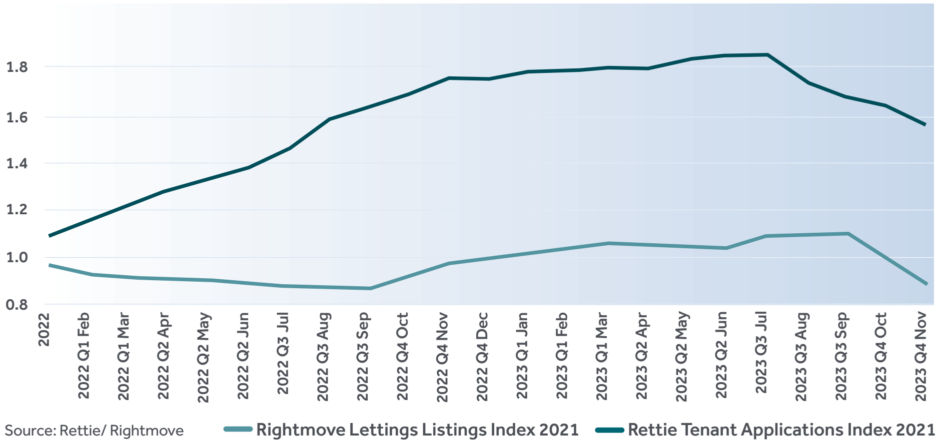
AVAILABILITY AT THE HEART OF AFFORDABILITY CRISIS

The pressure on the rental sector is the result of a number of factors. First, and most significantly, is supply. Analysis of new listings coming to the market shows that, over the past couple of years, **new supply has contracted by around 7%**.

At the same time, demand within the market has continued to rise. Indexing tenant applications received by Rettie and new rental listings to 2021 levels illustrates this imbalance clearly. The number of tenant applications received by Rettie is **around 1.6 times 2021 levels**, down from a peak of 1.8 earlier this year. By contrast, new listings are currently at 0.9 of 2021 levels.

4. Rental market sees excess demand *continued*

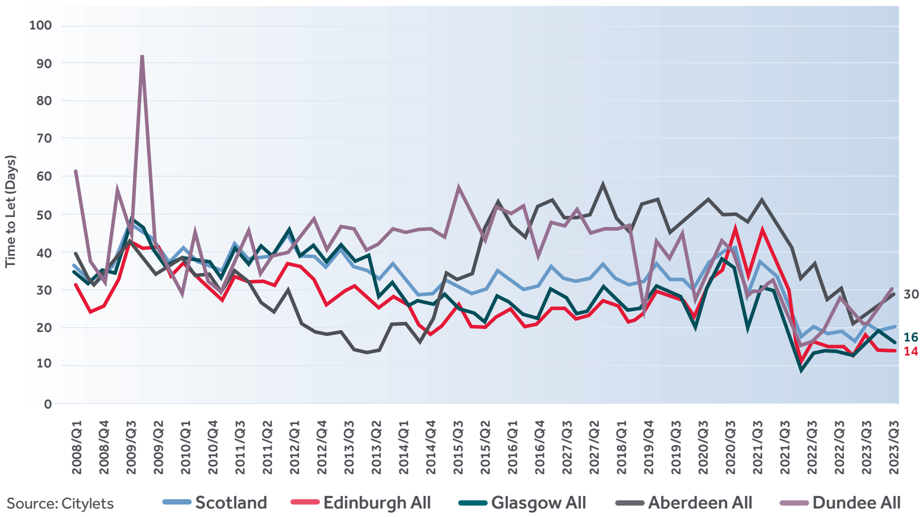
Figure 7: Index of Rettie Tenant Applications vs Rightmove New Rental Listings Shows the Demand/Supply Imbalance in the Rental Market



Source: Rettie/ Rightmove

The current imbalance is reflected not only in rising rents but also in the time it takes to let a property (TTL). Having historically averaged between 30 to 40 days, the average TTL in Scotland is now **down to 18 days**, with TTL in the **major cities even lower**.

Figure 8: Average Time to Let in Scotland and its Main Cities has Plunged in Recent Years



Source: Citylets

KEY FINDINGS EXPLORED

4. Rental market sees excess demand *continued*

EDINBURGH AND GLASGOW IN FOCUS

Average rents continue to grow

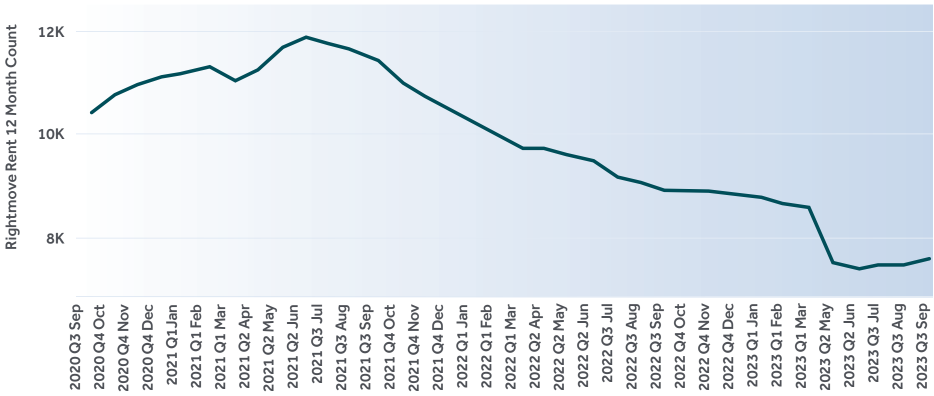
Average advertised rents in **Edinburgh** are now **over £1,500pcm,** having returned a double-digit Compound Annual Growth Rate (CAGR) over the past 3 years, with average new advertised rents **increasing by over a third** in this time. TTL has now dropped to **14 days** from a longer-term average of 20-30 days.

In **Glasgow**, average rents have **risen faster than in Edinburgh,** and are now **over £1,200pcm** having achieved 12% CAGR over the past 3 years.

New listings continue to fall

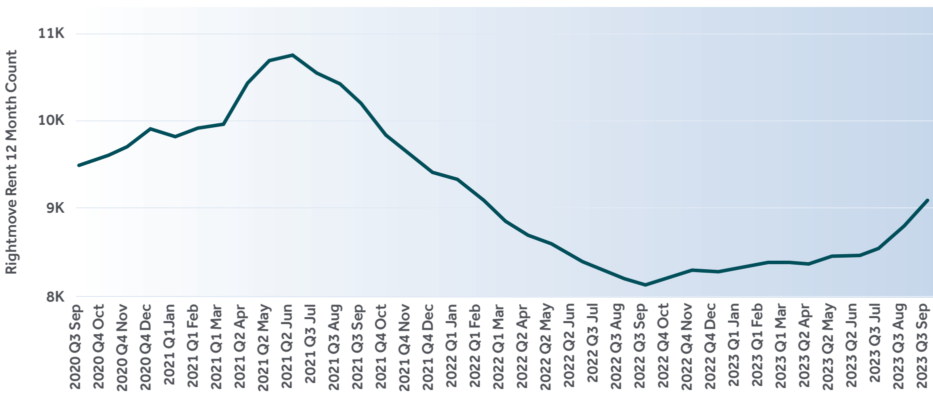
The downturn in supply has seen Edinburgh and Glasgow new rental listings fall precipitously in the last 2 years.

Figure 9: 12-Month Rolling Total of New Listings in Edinburgh (2023 YTD)



Source: Rightmove

Figure 10: 12-Month Rolling Total of New Listings in Glasgow (2023 YTD)



Source: Rightmove

4. Rental market sees excess demand *continued*

SHORT LETS

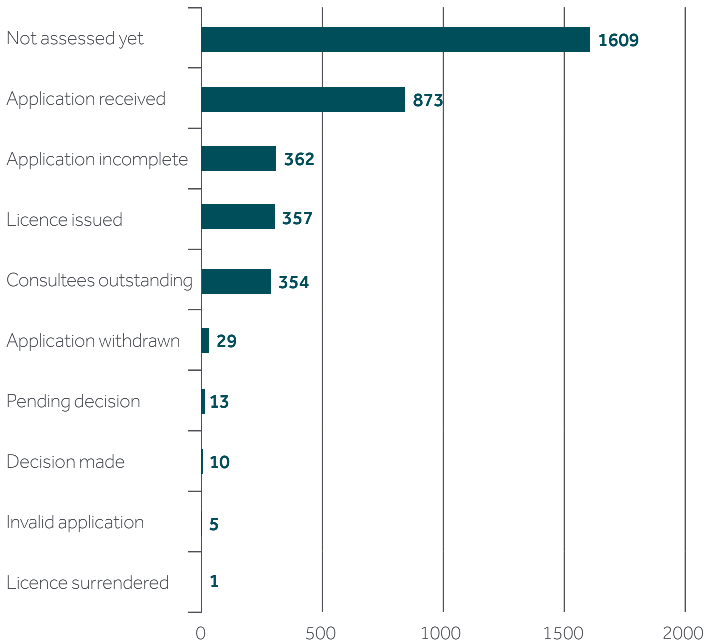
In Scotland, from 1 October 2022, licensing is mandatory for all short-term lets (STLs). New hosts must apply to the local authority before accepting bookings or receiving guests. Existing hosts needed to apply for a licence before 1 October 2023, although they can continue to operate while their license is considered. Local authorities can designate 'short-term let control areas' to manage high concentrations of STLs. Within control areas, such as Edinburgh, use of a dwelling house, which is not a host's principal home, as an STL will require planning permission.

Scotland's Court of Session recently ruled that some aspects of Edinburgh's policy, including a presumption against granting permission for STLs for whole properties within apartment buildings, was unlawful. Edinburgh Council said it would make changes to comply with the court ruling.

However, the Court has just ruled again against the Council, stating that the planning application actively discourages anyone from applying who does not have planning permission or an application in the pipeline, despite this not being required in every case. The judge also called the application process unfair and illogical in terms of potential outcomes.

To date, there have been 3,613 license applications submitted to the City of Edinburgh Council as of 27th November 2023, of which **only 357** licenses have been issued. Although many of these applications have still to be considered, there is considerable uncertainty about the future for the sector in the city and in other Scottish tourist areas, particularly given recent rulings.

Figure 11: Short Lets Applications by Status: Edinburgh as of 27th November 2023



3,613
Submitted Applications at 27th November

357
Licenses Issued at 27th November

10%
% Licenses Issued at 27th November

Source: City of Edinburgh Council

5. Forecasts suggest modest rise in activity

And now the £20bn question (the approximate value of the Scottish residential market sold annually). **What is the outlook for the market in 2024?**

While mortgage rates have been coming down, they will remain above historic levels for a time, maintaining a headwind for the market. This is likely to exert **continued downward pressure on the overall average price across Scotland**. In saying this, properties are still coming to market and there remains active demand, although not at the levels seen over 2021 to mid-2022.

In our central forecast, **we expect average prices to rise fractionally next year**, by around 1.5%, before moving back closer to the long-term trend (of around 4%) in subsequent years if the economy recovers as anticipated. It will take time for the whole market to adjust to higher interest rates, as people gradually come off fixed term deals, which will probably lead to average house price growth at reduced levels for a time.

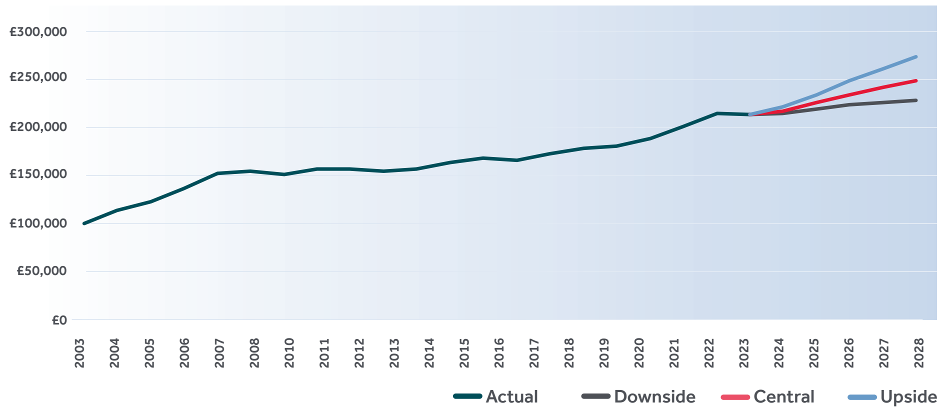
We also anticipate that **sales activity will stabilise and start to recover**. Transactions look like being around 94,000 for 2023 and we believe that they will be maintaining around the 100,000 level for the next few years. For buyers and sellers alike, this stabilisation in market conditions will give some confidence to enter the market.

This will vary across geographies and property types.

In terms of the rental market, with the cost of the average mortgage currently more than the average advertised rent, there is likely to be **continued pressure on the private rented sector** (PRS) as demand has not dampened in the way it has in the sales market.

In recent months, Rettie has been engaging with the private rented sector, the Build to Rent (BTR) sector and the Scottish Government to address the issues impacting the sector and trying to find workable solutions.

Figure 12: Rettie Average House Price Forecasts, 2023-27



5. Forecasts suggest modest rise in activity *continued*

Rettie & Co Average House Price Forecasts for Scotland

Year	Downside	Central	Upside
2023	-2.0%	0.0%	2.0%
2024	0.5%	1.5%	3.5%
2025	2.0%	4.0%	6.0%
2026	2.0%	4.0%	6.0%
2027	1.0%	3.0%	5.0%

Rettie & Co Transactions Forecasts for Scotland

Year	Downside	Central	Upside
2023	89,000	94,000	99,000
2024	93,000	98,000	105,000
2025	95,000	100,000	110,000
2026	95,000	100,000	110,000
2027	105,000	110,000	120,000

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