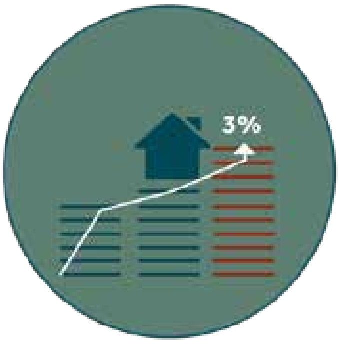
Rettie Research Report

RETTIE

Autumn Market Briefing September 2024

Like the weather, the Scottish housing market has been *unsettled*.

Our *forecasts.*



Rettie raises its 2024 house price forecast to 3% as interest rates drop back.

Our transactions forecast for 2024 remains at +4.3%.

Rent rises are cooling off but remain strong and this is likely to continue.

It hasn't been a balmy summer, but neither has it been a wash-out. The same can be said for the recent performance of the housing market both in Scotland and in the wider UK, which can best be described as 'a little tepid'.

This somewhat lukewarm performance is due to the fact that the market is continuing to adjust to the higher interest and mortgage rates that kicked in in Autumn 2022. However, things could be worse as a number of commentators forecast a sharp market retreat, but this didn't happen. Instead, the market stabilised in terms of average prices and transactions. One of the reasons for this is that rising mortgage rates only 'dripped' into the market as households came off their fixed mortgage deals gradually, rather than all at once.

Interest rates are now starting to fall, but this is expected to happen slowly. Unfortunately, having relatively high rates in place for a while longer will continue to act as a depressant on the housing market. What's more, when it does come, the market recovery is likely to be slow.

The rental sector, which has been growing very strongly in recent years, has showed some signs of cooling in the main cities. However, rent rises have remained above wage growth and inflation. This is a continuation of a trend that started in earnest in 2022, as a result of a demand/supply imbalance made worse by political interference.

"The Scottish housing market has sailed along at a pretty steady pace over the first part of 2024. There has been little change in the key market metrics, which is a reasonably good outcome considering the headwinds of higher interest rates and a fairly anaemic economy since 2022. The exception is the new build sales market, which has continued to come under pressure due to the additional supply-side pressures it is facing. The rental market remains relatively buoyant in terms of demand but there are concerns about the direction of Government legislation."

Dr John Boyle MRICS, Director of Research & Strategy

Key *findings*.

01. Sales market maintains stability

The sales market remains stable and industry sentiment is expecting some improvement in the coming months. However, interest rates will need to fall further to encourage significantly greater activity.

02. New build sales continue to fall

Transactions are again down year-on-year from the post-Covid rebound in late 2020 and 2021. Rising costs in the face of a stagnant sales market, along with increasing government regulations, are suppressing activity.

03. Mortgage affordability improves

Mortgage affordability is improving, although costs remain at high levels (when viewed historically). Overall, average mortgage costs are now dropping below average rental costs, incentivising people to purchase rather than to rent.

04. Tighter supply drives the cost of renting upwards

The number of new listings in the rental market continues to fall, clearly highlighting the demand/supply imbalance. Rent rises are cooling in the main cities. However, this is on the back of the substantial two-digit rent rises that have happened over the last two years – rises that have created affordability issues in the market.

Key findings *explored*.

01. **Sales market maintains stability**

On a 12-month rolling basis, average prices across Scotland have plateaued since late 2022. This followed two years of moderate rises (2021–22). Growth has stopped mainly due to rising mortgage rates.

Aberdeen is the exception to this general picture as the city has seen a slow decline in average prices since 2015, when the oil price collapsed. However, even in Aberdeen, prices now seem to have stabilised

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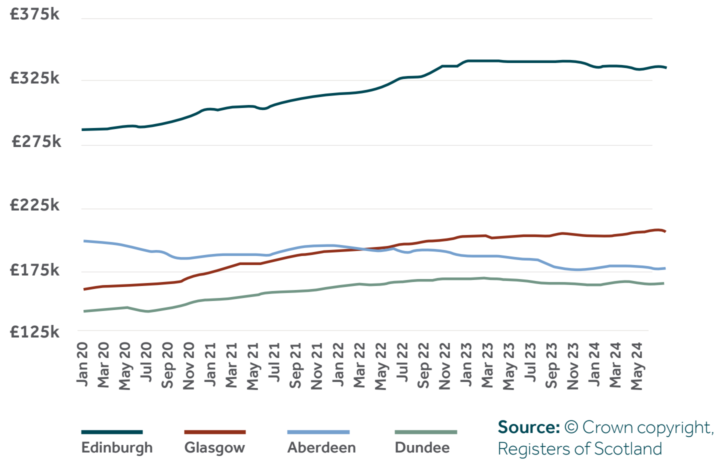
12 Month Rolling Average House Price.

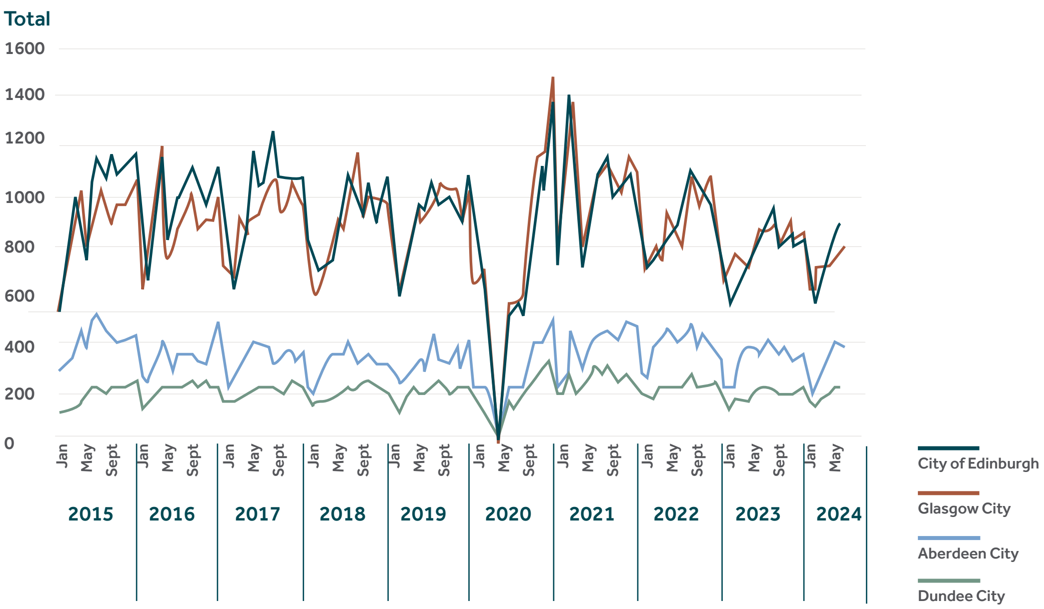


Source: © Crown copyright, Registers of Scotland

The number of house sales has followed a similar pattern across different parts of Scotland.

- In the years before the pandemic, there was a fairly steady seasonal pattern to sales, with the national market ticking along at around 100,000 annual transactions.
- The pandemic then caused a slump and a bounce-back.
- Since then there has been a return to pre-pandemic patterns, a lthough the most recent data shows that sales in Scotland's two main cities (Edinburgh and Glasgow) seem to be edging down below pre-pandemic volumes.

Transactions levels are now largely at pre-pandemic levels although trending a little lower in Edinburgh and Glasgow.



Source: © Crown copyright, Registers of Scotland

Key findings *explored*.

02. **New build sales continue to fall**

The new build market has endured a sustained period of challenging conditions. Demand has been suppressed by rising mortgage rates, while rising labour and material costs have slowed down delivery of new homes.

From late 2020 onwards, there has been a notable downward trend in new build sales.

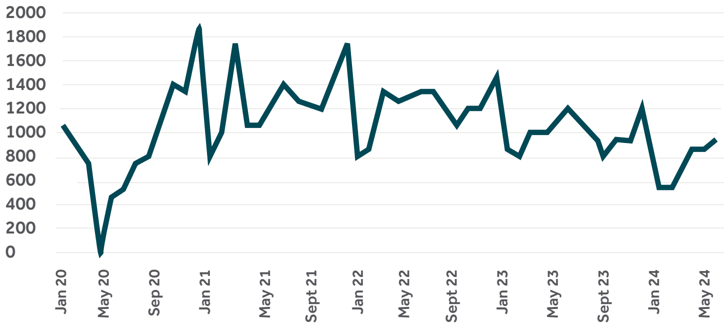
- **In the last year, new build sales volumes are down over 20% across Scotland.**
- **New build sales have only accounted for 11% of all Scottish sales in the last 12 months (this figure is normally around 15%).**

This is in contrast to the largely stable pattern in the overall sales market.

The average price of a new build in Scotland has continued to rise and is now around £324,000 (up 2.2% in H1 2024, compared with the same period last year). However, incentives are commonly being used at around 4–7% of gross sales prices. This means that, in net terms, new build prices are likely to be actually falling in most locations.

New build sales have been on a clear downward trend in the last two years.

New Build Transactions



Source: Rettie & Co.

Compounding the problems caused by current economic conditions, the new National Planning Framework (NPF4), introduced in February 2023, continues to cause uncertainty around the new build market. Worries were further heightened following the result of the landmark Mossend Appeal earlier this summer. This decision by the Court of Session has significant implications for developers wanting to bring forward land for housing on unallocated sites. Further information can be found here: Policy 16(f) of NPF4 – the Miller Homes Mossend appeal decision | Brodies LLP.

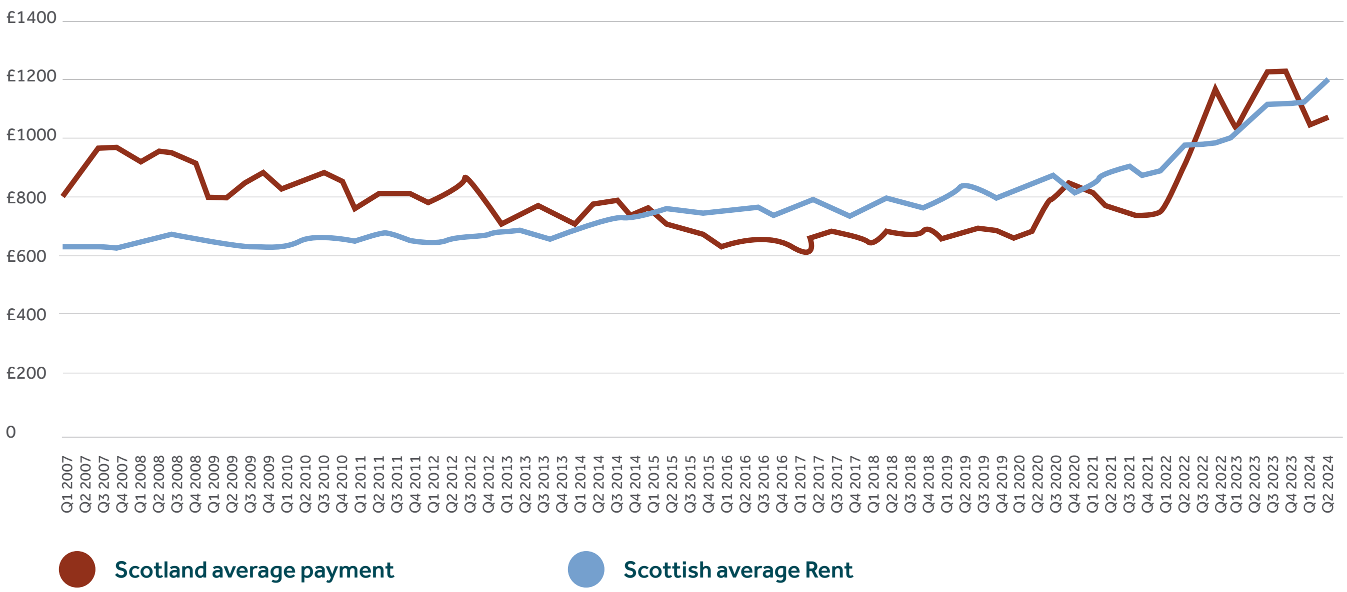
Key findings *explored*.

03. **Mortgage affordability improves**

For much of the 2015–22 period, house buying was more affordable than renting, with the cost of average mortgage payments (based on average 2-year fixed rate mortgage at 85% loan to value) below that of the average rents. Sharply rising mortgage costs from Autumn 2022 reversed this position. This provided greater incentives for many people, especially first-time buyers, to rent rather than buy.

Recently, average mortgage costs have dropped back again. They have now fallen below average rents, which have continued rising. This is providing a renewed incentive for first-time buyers to make the move into property. Given that first-time buyers are the lifeblood of the sales market, this reversal is encouraging.

Average mortgage costs have once again dropped back below average rents in Scotland



Source: Rettie & Co.

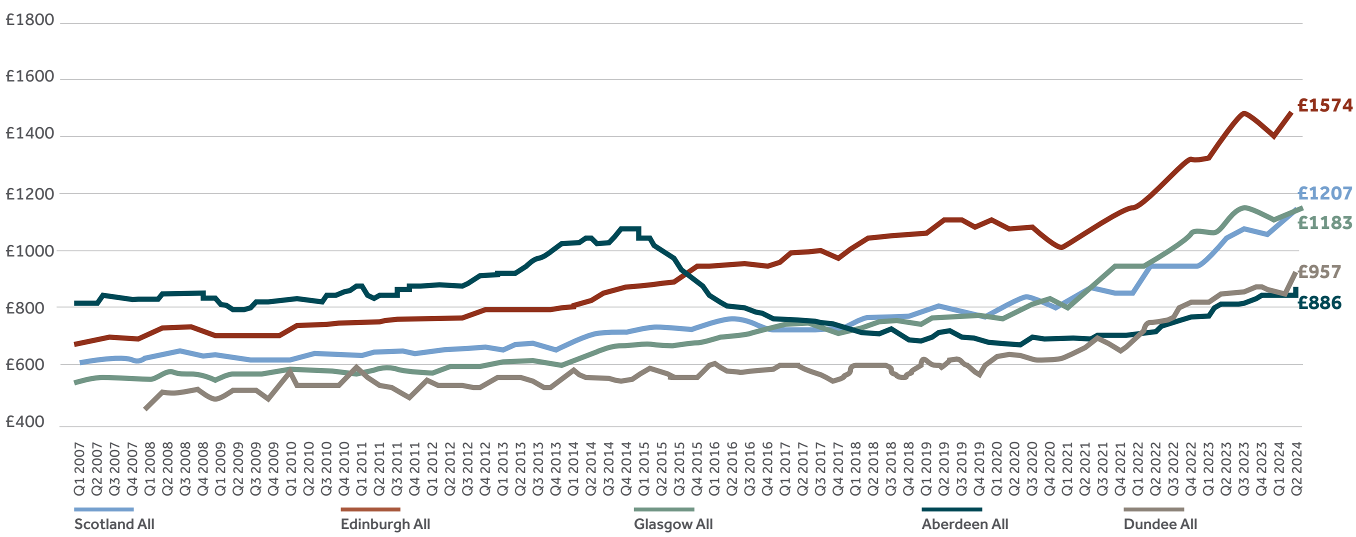
Key findings *explored*.

04. **Tighter supply drives the cost of renting upwards**

Average advertised rents (new rents between tenancies) in the private rented sector (PRS) have now cooled after a 2-year spurt. This spurt was caused by a growing demand/supply imbalance in the sector, and by the unintended consequence of the Scottish Government's rent freeze/cap that operated over this time. This cap froze rents within tenancies but not between them.

Average advertised rents level off after 2-year spurt

| **Source:** Citylets



Key findings *explored*.

04 continued.

It seems clear from the current evidence that rental availability has now dropped back drastically. As demand is on the rise, this has led to rent pressures. The Scottish Government's proposal to deal with this issue is to bring in a strict rent control regime (to be managed by local authorities). This proposal is contained in the new Housing Bill that is now working its way through Parliament. The government doesn't seem to recognise that this will, in all likelihood, have the unintended consequence of further squeezing supply and leaving many tenants unable to find a property to rent.

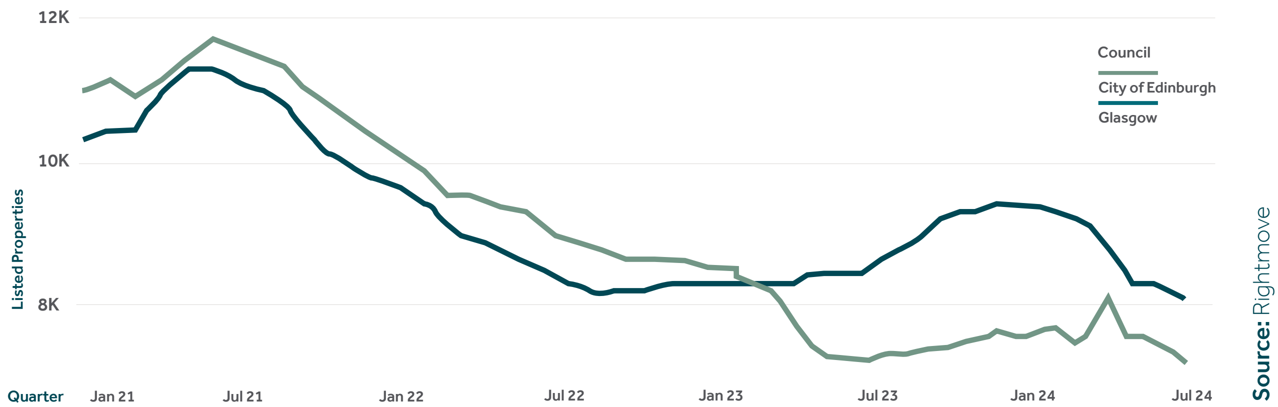
The Housing Bill has also deterred build-to-rent (BTR) investment, which is capable of producing significant levels of new supply. There has, unfortunately, been virtually no investment of this type in Scotland since the rent freeze was first announced in Autumn 2022.

Some of the BTR schemes that were in the pipeline have now been replaced by Purpose Built Student Accommodation (PBSA). This is another unintended consequence that sees the further removal of rental and affordable housing from the pipeline.

We hope that the Government will be significantly amending this Bill to deal with some of these downsides.

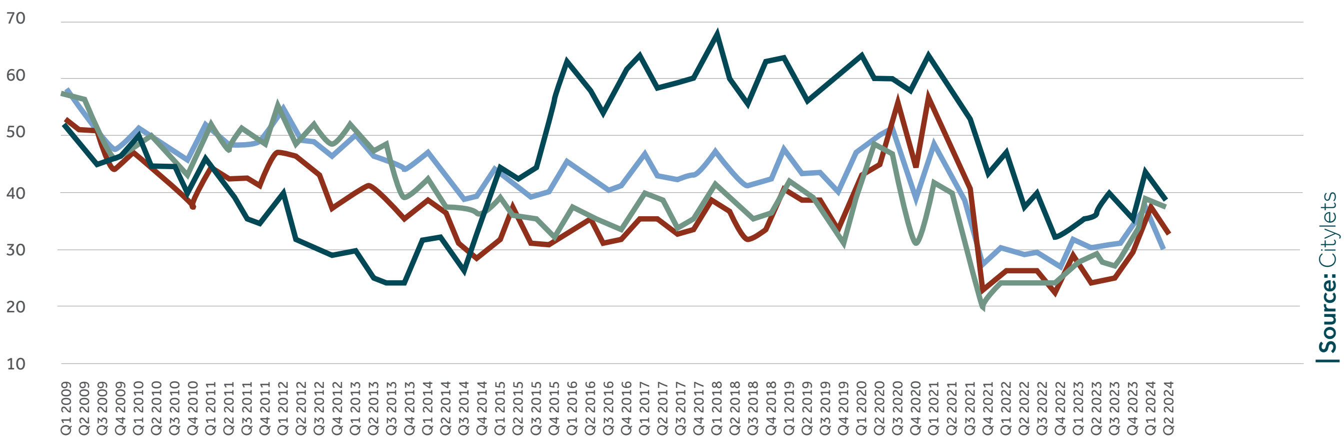
Our Lettings Team also report that the 6% Additional Dwelling Supplement (ADS) on second home purchases (including buy-to-let properties) is acting as a major barrier to new supply. This level of ADS is significantly higher than it is in the rest of the UK. It is inhibiting people from buying a property for investment purposes. These individuals include circumstantial landlords, who had planned to retain a property and buy a new home for themselves. They are now less likely to do so because of the costs involved.

Rental properties listed on the main portals have fallen back significantly in the last 3 years



The time taken to let a rental property in the PRS remains at historic lows. The Scottish average has stood at around 20 days for the last few years, when it was previously around 30 days. It should be noted that, in the main cities, time to let has risen slightly as market pressures have reduced a little.

Time to let remains low in an historical context



Market outlook and *forecasts*.

While mortgage rates are now reducing, they will remain above historic levels for a time, which will mean that the market will still face a headwind. This is likely to exert **continued downward pressure on the overall average price across Scotland**. This is despite the fact that demand remains active, although it is considerably weaker than it was in the period from 2021 to mid-2022.

One piece of good news is that the wider economy is improving better than anticipated in 2024. However, forecasts from the Bank of England suggest that the **rate of growth may slow again next year.**

In our central forecast, **we expect average prices to rise this year by around 3%.** This is slightly up on the forecast we made at the start of 2024. For 2025, we have revised down our forecast to 3%. This is due to the sluggish economic performance that is anticipated. In subsequent years, we think that growth will then move back closer to the long-term trend (of around 4%) – if the economy recovers as anticipated. However, it will take time for the whole market to adjust to higher interest rates, as people gradually come off fixed-term deals. This will probably suppress average house price growth for a time.

Sales activity is stabilising and starting to recover, albeit slowly. Transactions were around 93,000 in 2023 and we believe that this will increase modestly this year. We also think there will be a gradual movement towards a longer term trend of c.100,000 sales per year as economic recovery becomes more established. However, this will vary across geographies and property types. To give some context, Scotland achieved 154,000 sales in 2007 at the market peak, a level that we are unlikely ever to return to.

In terms of the rental market, we think that some of the **pressures on the PRS** will ease as demand dampens a little (due to the cost of the average mortgage falling below the average advertised rent). This is already being seen in the main cities, although sharper reductions in supply may increase pressures again, especially if the problems presented by the new Housing Bill are not addressed.

Scottish average house price forecasts

	Lower	Central	Upper
2024	2%	3%	4%
2025	2%	3%	4%
2026	3%	4%	5%
2027	3%	4%	5%
2028	3%	4%	5%

Scottish transactions forecasts

	Lower	Central	Upper
2024	94,000	98,000	102,000
2025	94,000	98,000	103,000
2026	96,000	100,000	103,000
2027	100,000	105,000	110,000
2028	100,000	105,000	110,000

"It has been a warm welcome from everyone at Rettie since joining in August, and great to work on this briefing with Dr John Boyle. I've brought with me my experience in advising landowners and developers in the development land market and I look forward to delivering detailed analysis for clients in the residential development and investment markets, at a time when comprehensive, and reliable, analysis could not be more valuable." **Murray Watson, Senior Researcher**

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