London's Economic & Housing Prospects

February 2023

OXFORD ECONOMICS

MITHERIDGE

Report commissioned by Mitheridge Capital Management

About Oxford Economics

Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college, to provide economic forecasting and modelling to UK companies and financial institutions expanding abroad. Since then, Oxford Economics has become one of the world's foremost independent global advisory firms, providing reports, forecasts and analytical tools on more than 200 countries, 250 industrial sectors and 7,000 cities and regions. Oxford Economics' best-in-class global economic and industry models and analytical tools give it an unparalleled ability to forecast external market trends and assess their economic, social and business impact.

The modelling and results presented here are based on information provided by third parties, upon which Oxford Economics has relied in producing its report and forecasts in good faith. Any subsequent revision or update of this data will affect the assessments and projections shown.

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About Mitheridge Capital Management

Mitheridge Capital Management LLP is a London-based alternative investment firm specialising in real estate. Founded in 2010, Mitheridge generates long-term value for its investors by finding innovative solutions to society's evolving needs. Through the collective experience of its management team and Advisory Group, it captures opportunities with a mixture of institutional discipline and creativity. The Mitheridge Group includes our wholly owned property development company and our charitable entity, the Mitheridge Foundation. Mitheridge is authorised and regulated by the Financial Conduct Authority.

Mitheridge has commissioned Oxford Economics to conduct independent research into the fundamental economic indicators for London and the impact on the housing market, as a follow-up to a report published in November 2021. This update sets out Oxford Economics' latest research, identifying and forecasting key drivers in relation to London's economy, current housing situation and future housing requirement.

Mitheridge maintains a high conviction in pursuing an investment strategy addressing the growing demand for homes in London and in its surrounding areas. The analysis hereafter provides a range of statistical data and comparisons to other major cities across the UK, Europe and globally, outlining the opportunities for creating more homes in London, where there is already a chronic level of undersupply.

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Key takeaways

- The recent economic and political turmoil, and likely recession in 2023, do not fundamentally change our view of the longer-term prospects for London's economy and the likely demand for housing.
- However, it is likely London will fall into recession this year, but we expect it to be less deep than in other UK regions. This is because London should benefit from relatively high levels of household wealth and less dependence on troubled industrial sectors.
- After 2023, we expect London to lead UK economic growth and outperform its major international competitors.
- The population impact of the pandemic was temporary and London's population will continue to grow, supported by strong net migration in the short to medium term, but natural change will be the major driver of growth, as it has been in the past 20 years or so.
- London house prices rose on average in 2022, but began to decline at the end of the year. This decline is expected to continue into 2023 and 2024. Affordability worsened in 2022, but the anticipated house price correction should alleviate this in the short term. We expect house price growth to return in 2025 and continue over the longer term.
- The recent annual supply of housing has increased relative to pre-pandemic levels. However, even accounting for recent improvements, the supply of new homes falls well short of both the London Plan 2021 target and the assessed level of housing need.
- Construction price inflation should ease this year and further in 2024, with lower rises in materials prices and earnings anticipated.

After

2023

London expected to lead UK economic growth and outperform its major international competitors

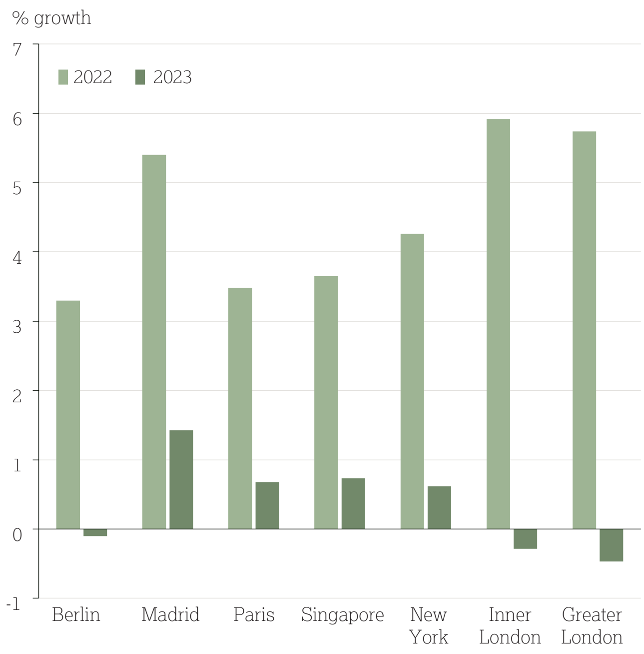
The economic context

In many respects 2022 was unusual, marked by strong economic growth on average over the year and a resilient labour market. But much of the growth was achieved in the first half of the year, as rocketing inflation and rising interest rates eroded household spending power in H2. Inflation peaked at over 11% in October, and the Bank of England increased interest rates in an attempt to curb rising prices.

We estimate that London's economy grew by almost 6% in 2022, higher than the UK average and other major international competitors. The labour market was remarkably resilient, with high levels of employment and unemployment rates at near record lows.

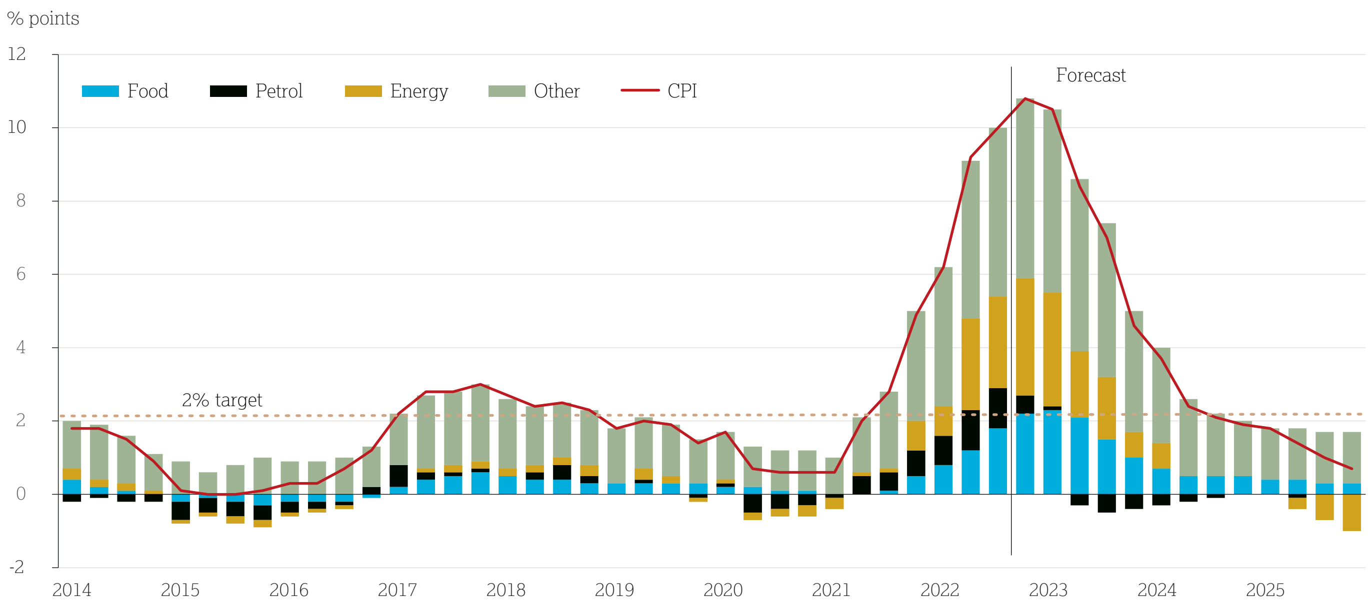
However against a backdrop of the slowing global and UK economy, business surveys and recent labour market data show evidence that activity in London slowed at the end of 2022, and little momentum was carried into 2023. We expect a shallow recession in London with a contraction of 0.5% in the year, compared to 0.7% in the UK. The UK economy should start to grow again in Q4 2023 and we expect London to lead the recovery.

Annual GDP growth



Source: Oxford Economics

UK: contributions to CPI inflation



Source: Oxford Economics

Economic forecasts – 2023 to 2035

London will lead UK growth and outperform its major European competitors over the medium to long term.

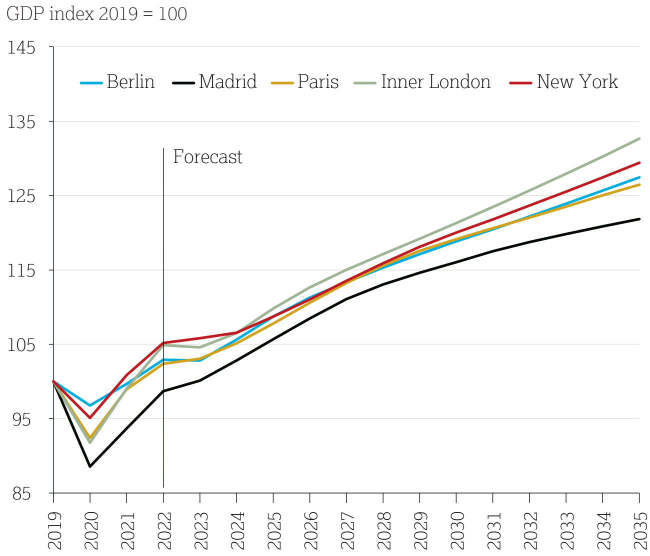
London will quickly begin to recover lost ground against its key European competitors such as Paris and Madrid. London should also outperform New York over the longer term.

London should achieve annual average GVA growth of 1.8% from 2023 to 2035, compared to 1.4% for the UK as a whole.

This growth will be supported by growth in key sectors, including information and communication, professional services, and business support services.

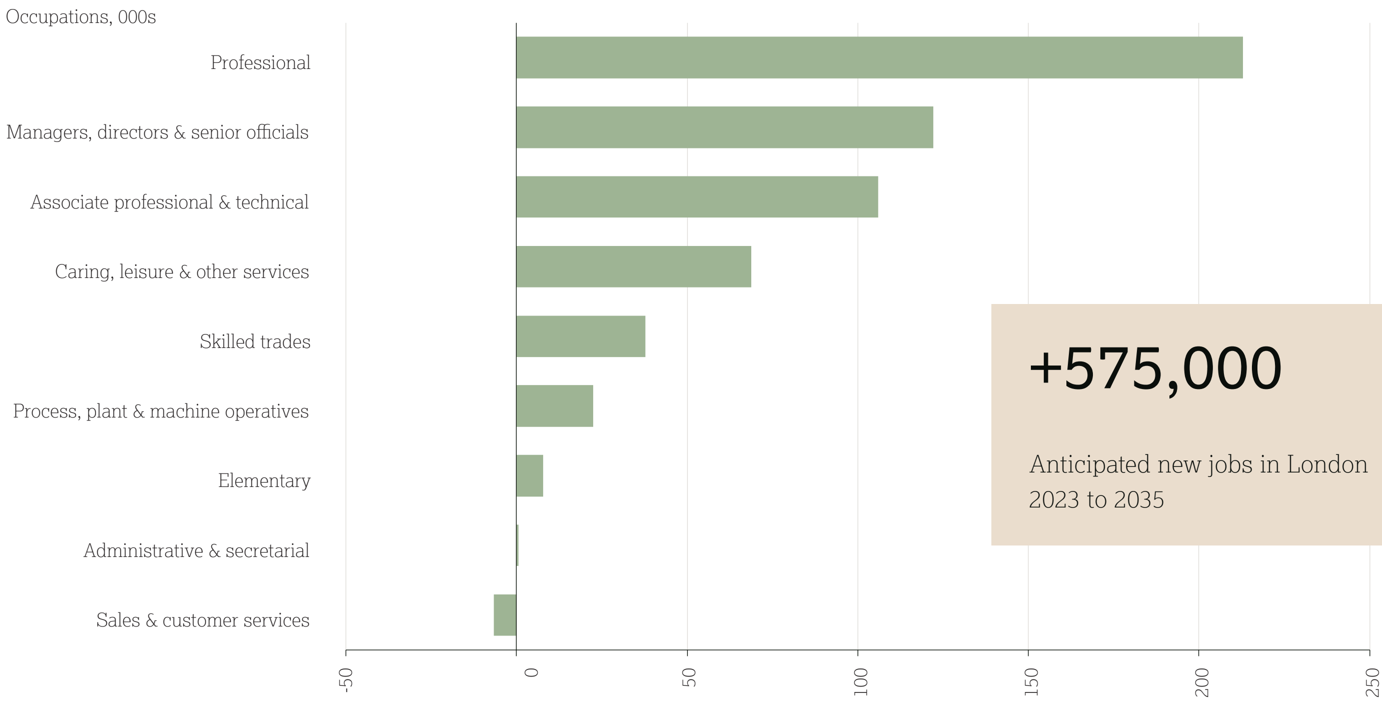
Over this period London's growth should create an additional 575,000 jobs, many of which are concentrated in higher skilled professional and managerial roles.

GDP forecasts for major international cities



Source: Oxford Economics

Net change in jobs by occupation, 2023 to 2035



+575,000

Anticipated new jobs in London 2023 to 2035

Source: Oxford Economics

Population forecasts

10,000,000

London's expected population in 2037

We expect London's population to reach 10 million in 2037.

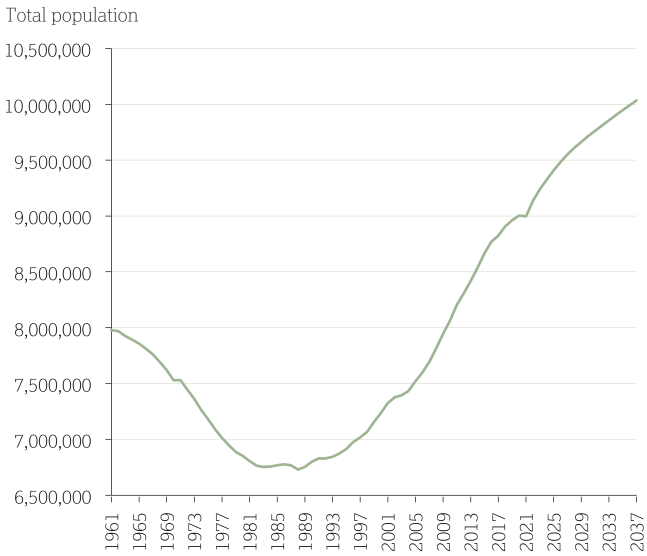
We believe that the population impact from the pandemic was temporary and population will continue to grow, supported by strong net migration in the short to medium term.

However, the key driver of population growth in London will continue to be natural change, although this will be somewhat lower than seen in the decade from 2009 to 2019.

We have revised our UK net migration assumption, with stronger international migration to the UK now expected. This filters through to London, but by the start of the 2030s we expect domestic migration to offset gains from international migration – a trend seen previously in London.

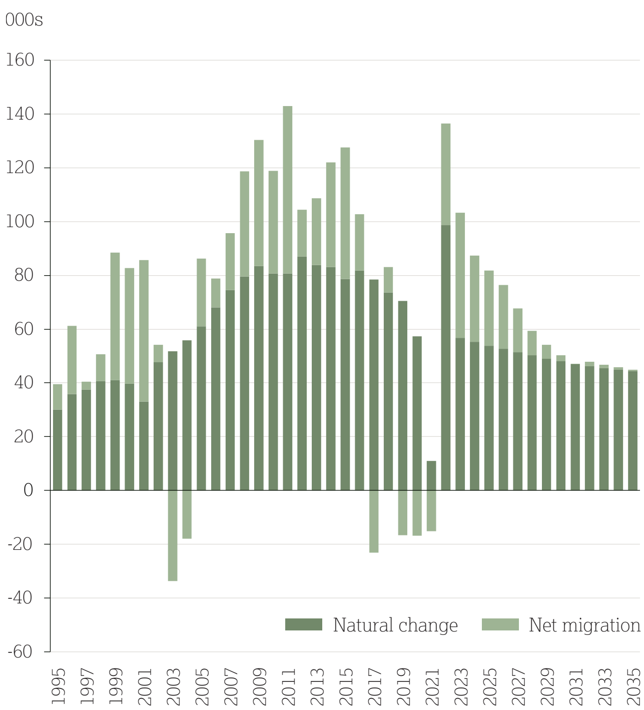
We maintain our view that working-age population will grow more quickly than total population in London, supporting employment and economic growth. Working-age population growth is expected to grow at an average of 0.8% per year from 2022 to 2035. Over the same period, Paris's working-age population will flatline (0% per year) and decline in cities such as Madrid and Berlin (both -0.1% per year).

London's long-term population trend and outlook



Source: Oxford Economics

Components of London's population change



Source: ONS, Oxford Economics

House prices

London house prices rose by an estimated 7% on average in 2022, but prices began to fall towards the end of the year.

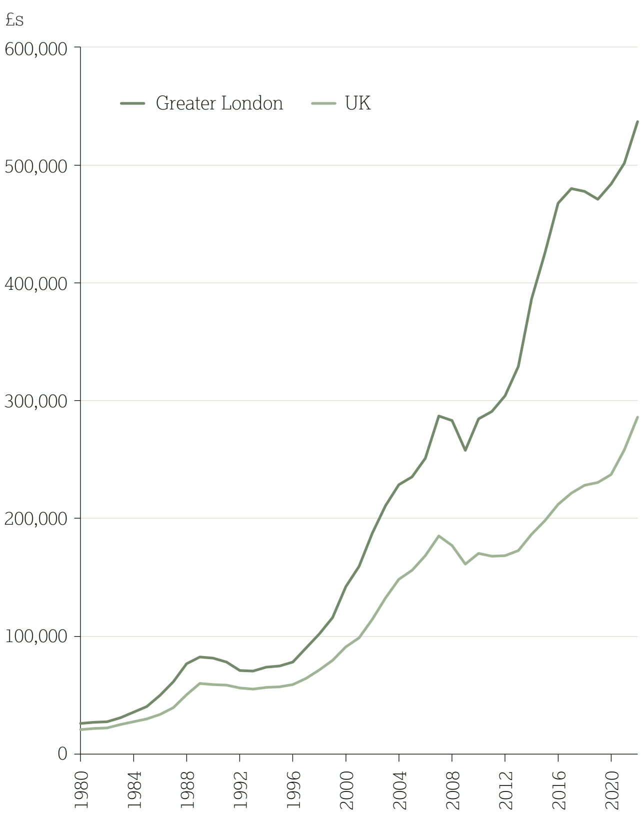
According to the ONS, London house prices rose 6.3% in the year to November 2022.

Rising borrowing costs and mortgage restraints saw house prices start to fall towards the end of 2022.

We expect this downward trajectory in house prices to continue in 2023 and 2024.

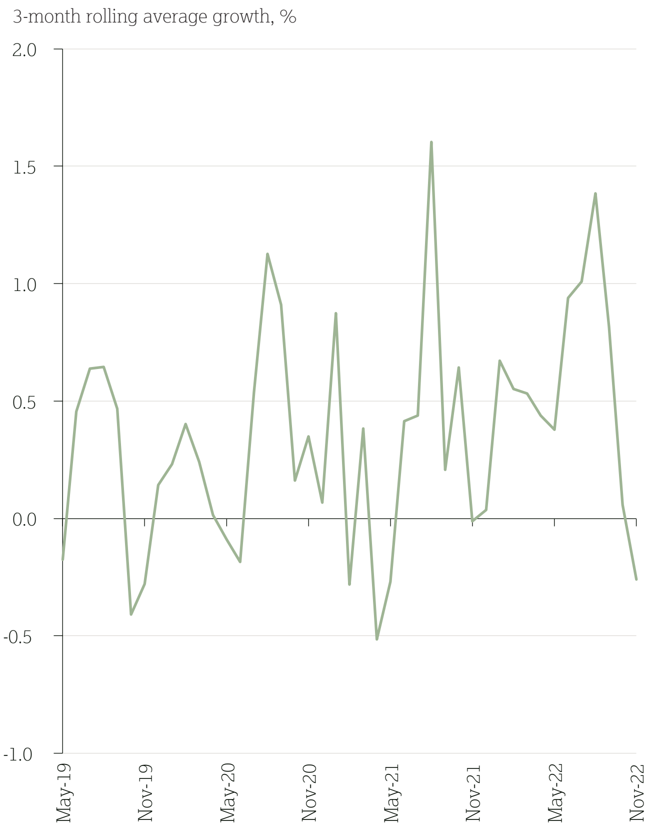
However, house price growth should return in 2025 and continue over the longer term, with London prices growing faster than the UK average over the 2025-2035 period.

London and UK median house prices



Source: Oxford Economics

London monthly house price growth



Source: ONS

Affordability

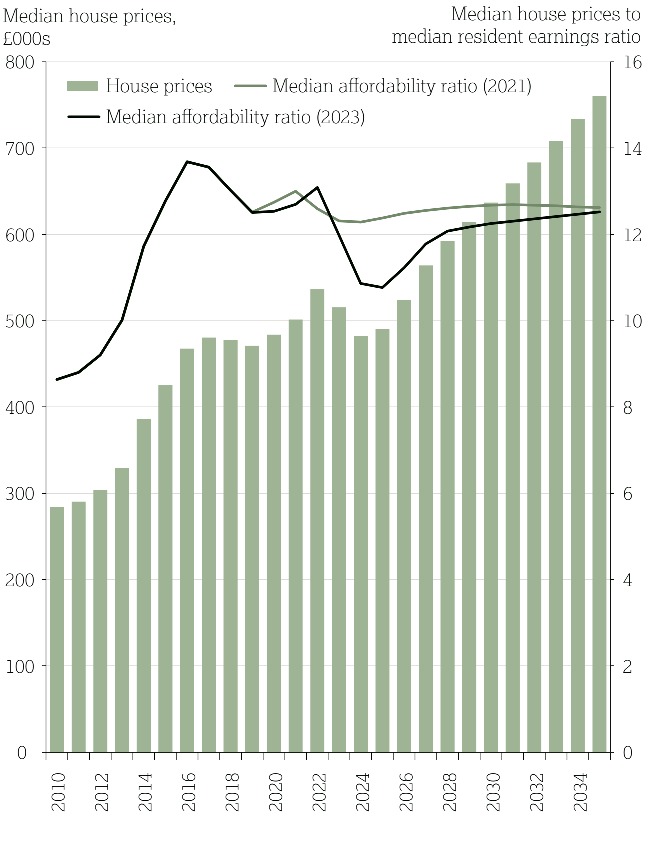
Affordability deteriorated slightly in 2022 as London's house prices rose more sharply than wages. The rise in borrowing costs further impacted affordability for home ownership.

The expected fall in house prices should ease affordability pressures, particularly in the short term. As prices begin to rise we expect the house price to earnings ratio to hit 12, lower than the peak seen in the mid-2010s, but considerably higher than the UK average of eight.

Analysis by UBS shows that London is ranked among the least affordable global cities, joining Paris, Tokyo and Tel Aviv as cities where the price-to-income multiples exceed ten.

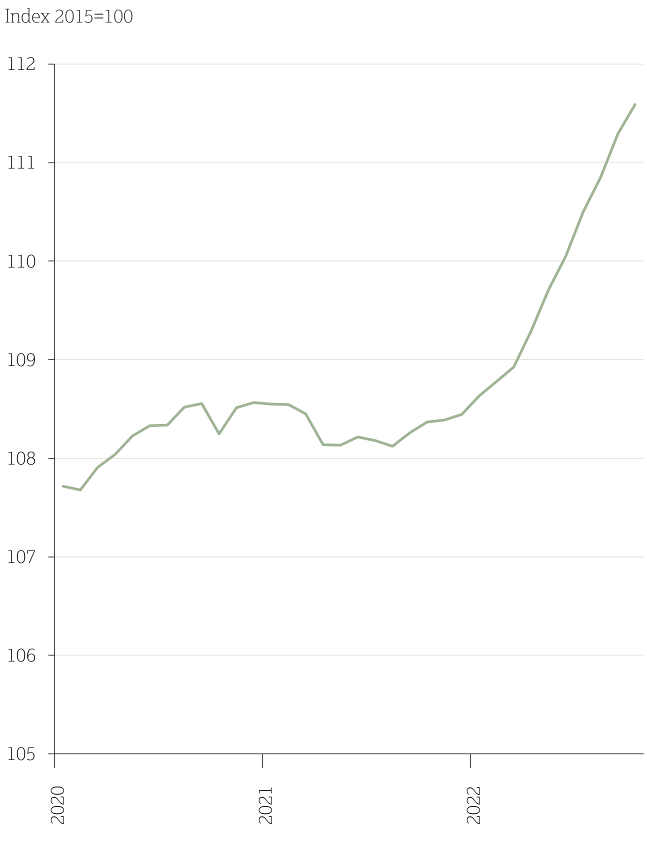
According to ONS data, all private rents rose sharply in the second half of 2022. GLA analysis of Rightmove's asking rents index shows average advertised private rents in London grew by 15.8% from Q2 2021 to Q2 2022. We expect that this will feed through to ONS data in 2023 and rents will rise faster than earnings, impacting affordability this year.

London house prices and affordability ratio



Source: ONS, Oxford Economics

London monthly private housing rents



Source: Oxford Economics

Housing supply

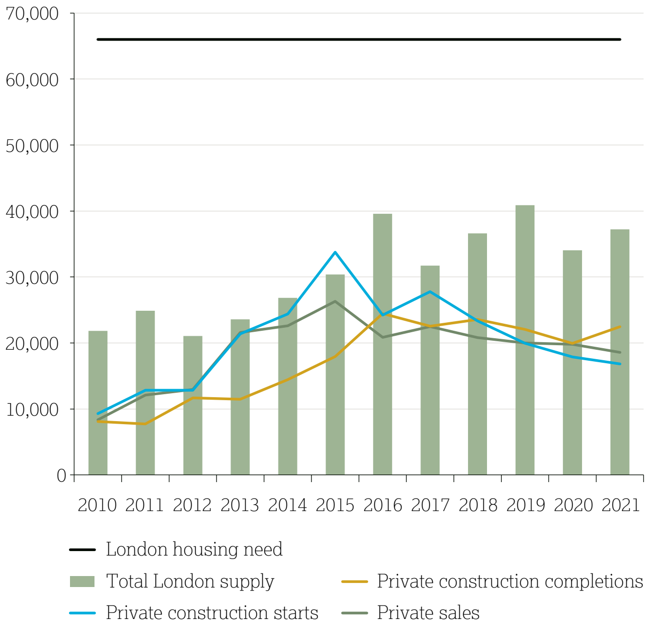
The supply of housing has increased in recent years, but the average over the 2010-2021 period falls well short of targets.

Annual housing supply in London has been increasing, most notably since 2015, when the stock increased by 30,000 homes. Supply reached around 40,000 in 2016 and 2019.

By extending the analysis period (2010-2019) to include 2020 and 2021, annual supply increases to 31,000 (from 30,000). This is some 21,000 short of the London Plan 2021 target and 35,000 short of the assessed housing market need.

Even at peak delivery (41,000 homes in 2019), the shortfall in supply to the London Plan target is over 10,000 homes a year.

Annual net change in London's housing supply, 2010 to 2021



Source: DLUHC, GLA

The shortfall in annual housing supply in London

Source: Oxford Economics

Construction costs

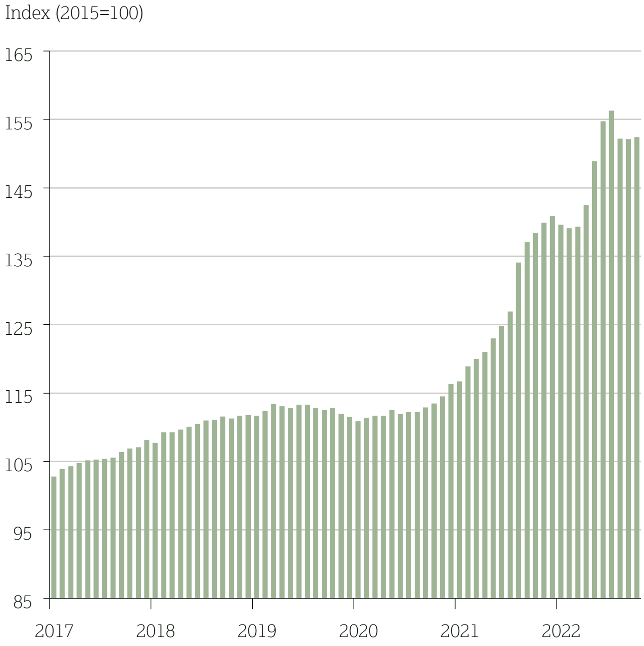
We expect inflationary pressures to begin to ease in 2023, and this should filter through to construction costs too. This aligns with forecasts from other providers, including MACE, BCIS and T&T.

Alongside an easing of general inflation, factors specific to construction costs are also supportive of reduced price pressures. Recent ONS materials price data shows construction prices for new housing have eased in recent months. Our materials price forecasts show a correction in steel and metals prices this year. The composite index shows materials prices rising by 4.5% in 2023.

Labour prices should also ease. We forecast average weekly earning wages to rise by 5% in 2023, compared to over 6% in 2022. However, it is likely that skills shortages in specific sectors roles could lead to much higher wage demands in these areas.

We forecast construction activity in London will fall by 0.3% in 2023 in GVA terms, picking up to 1.7% in 2024 and 3.2% in 2025.

Monthly construction materials price index – all new housing



Source: BEIS

	2022	2023	2024	2025	2026
Construction prices					
MACE (London data)	8	2.5	2	2	3
Gardiner-Theobald Market Intelligence (London data)	6	3	2.5	2.5	-
BCIS All in Tender prices (UK data)	7.9	6.2	3.3	3.4	-
Turner & Townsend (UK data)	9	3.5	3	4	4.5
Construction materials prices (Oxford Economics)					
Composite Index*	16.1	4.5	5.7	2.9	-
Earnings (Oxford Economics)					
Average weekly earnings (UK)	6.1	5.0	3.2	2.7	2.4
Consumer prices (Oxford Economics)					
CPI (UK)	9.0	7.5	2.6	1.2	0.8
Construction output (Oxford Economics)					
GVA (London)	6.3	-0.3	1.7	3.2	2.6

Sources as indicated above. * Equal weighting for the following components: wood & wood products; cement, plaster & masonry; ceramic, clay & refractory products; glass; iron & steel; non-ferrous metals; structural metal.

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