Market briefing: June 2019

Key developments in the housing and mortgage markets

Bob Pannell

Economic Adviser, IMLA

Executive Summary

- The ongoing recovery of real earnings has helped to offset some of the negative sentiment arising from Brexit uncertainties.
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- Housing market activity and property prices are flat, broadly speaking, across much of the country. First-time buyer numbers continue to rise modestly, underpinned for the time being by a strong jobs market and competitive mortgage deals.

- Levels of remortgaging are high, but there are early signs of waning borrower demand and limits to how much more intense competition between mortgage lenders can be.

- The market may enjoy a temporary "Brexit bounce" when the UK agrees a transition deal with the EU, but market fundamentals may dictate a quieter period down the track.

Economic overview

UK politics continues to be given over to Brexit, with elections for leadership of the Conservative Party and the UK's next Prime Minister currently under way. By the time the new occupant of 10 Downing Street is known, there will be precious little time to ratify a withdrawal agreement with the EU by the 31 October deadline. This raises the prospect of a disruptive departure or yet further delay, neither of which outcomes would be positive for the UK's short-term economic position.

Economic growth has disappointed recently, slipping back to a quarterly rate of 0.3% - similar to rates seen around the turn of the year. This supports the view that the earlier boost to UK activity was a temporary one, linked to firms stockpiling ahead of the original 29 March EU departure date.

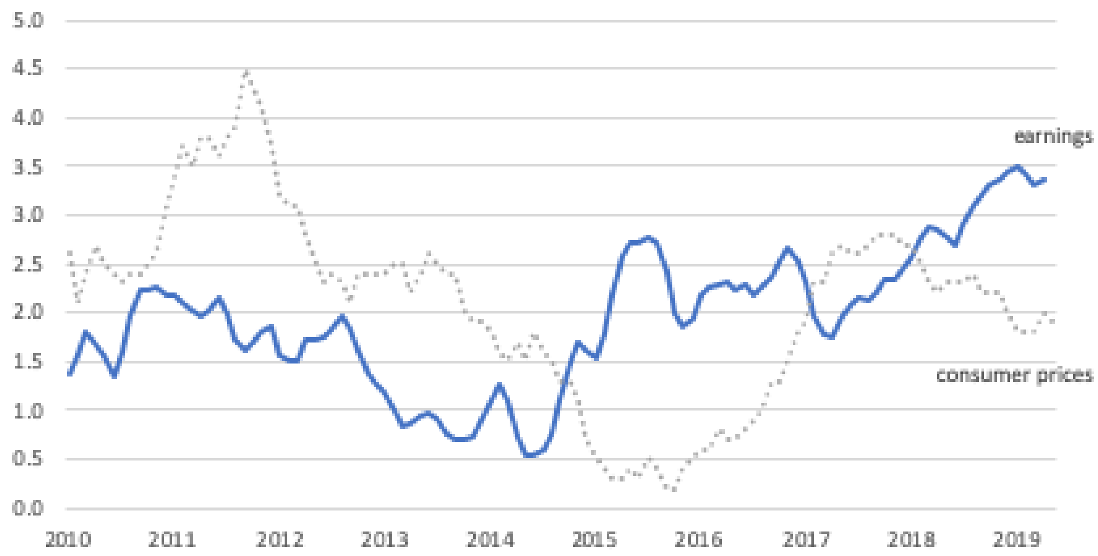
The ONS estimates that our economy shrank in both March and April. The contraction was particularly sharp in April, with widespread weakness across manufacturing and planned shutdowns in car production, and construction and services also in negative territory.

Business survey data suggest a modest pick-up in services more recently, but the overall picture is one of a faltering economy.

Despite the unpromising backdrop, there continues to be positive news on the jobs front, helped by the fact that many firms find it easier and cheaper to recruit workers to meet demand than to commit to extra business investment.

While jobs growth has slowed since last summer, the number in work hit a new record of 32.75 million in the three months to April and the unemployment rate - 3.8% - remains at its lowest level since 1974.

Chart 1: Earnings and inflation, % change year-on-year



Source: Office for National Statistics

The tightness of the labour market has underpinned the strongest rate of pay growth for a decade. Average weekly earnings, excluding bonuses, rose by 3.4% in the year to April, similar to the trend of recent months. After adjusting for inflation, wages continue to grow by 1.5%, the fastest rate for two years.

The better jobs market has lifted the sense of financial well-being. Household sentiment remains far from bullish, but recent surveys appear to show that consumer optimism about the future, and households' confidence in their own financial position in particular, have begun to improve a little.

Interest rates

Current inflationary pressures remain relatively benign. The annual rate of inflation, based on the Consumer Prices Index including owner occupiers' housing costs (CPIH) – the ONS's preferred measure – edged down to 1.9% in May from 2.0% in April 2019.

The Bank of England's Monetary Policy Committee (MPC) decided to leave monetary policy on hold at its June meeting, in the light of growing trade tensions and shortening odds concerning a no-deal Brexit for the UK.

The move brings the UK closer into line internationally, with growing expectations of an easing in monetary policy in both the United States and the EU.

But it does mark an abrupt reversal of the greater optimism about UK growth prospects shown in the Bank's May *Inflation Report* and talk from policy-makers about the need for earlier and more interest rate increases than financial markets had been expecting.

We now seem to be firmly back in the camp, where domestic monetary policy actions depend upon the nature and timing of EU withdrawal.

Fiscal Policy

The current political situation leaves fiscal policy stuck in neutral for the next few months.

Philip Hammond's hope had been that getting a Brexit deal over the line would allow him to conduct a three-year spending review this summer and to unveil an "end of austerity" Autumn Budget. It now seems likely that his tenure as Chancellor of the Exchequer will end with the change of Prime Minister and that the spending review will be limited to one year or even delayed.

With public finances relatively healthy, despite the economic slowdown, it seems likely that the new administration will loosen fiscal policy and feature a few populist measures in the Autumn Budget.

Housing Policy

Help to Buy has once more been in the news, following a National Audit Office (NAO) report[1].

The report covered a lot of familiar ground, noting that the scheme had supported house-building, but had helped large numbers who would have been able to buy anyway. The NAO echoed earlier IMLA findings, that those using the Help to Buy Equity Loan scheme had paid much the same as they would have paid for a similar new-build property bought outside the scheme, but that buyers looking to sell their property within a few years of purchase, and needing to repay their equity loans, might face a challenge because of new-build premiums.

The NAO reserved judgement as to whether the scheme delivered value for money because too little was known about its longer-term effects on the property market and whether MHCLG would recover its substantial investment. It saw the government's greatest challenge as being how to wean the property market off the scheme with as little impact as possible on its ambition of creating 300,000 homes a year from the mid-2020s – a recurring theme of IMLA discussions.

[1] *Help to Buy: Equity Loan scheme – progress review*, National Audit Office June 2019_

The suggestion from Housing secretary James Brokenshire, that first-time buyers should be allowed to dip into their pension pots to fund deposits for buying a home, has attracted little support (even though such schemes operate in several countries including Canada and New Zealand).

A number of concerns were raised, including the risk to pension income in later life, whether young adults would have large enough sums of pension money to fund a meaningful deposit, and the impact extra purchasing power would have on house price values. A common view expressed within the mortgage industry was that improving the ability of lenders to extend 95% LTV loans would go a long way to resolving the deposit constraint facing first-time buyers. Interestingly, a similar point about the relevance of higher LTV mortgages in the context of the forthcoming withdrawal of Help to Buy Equity Loan scheme can be found in a recent Bank of England working paper[2].

Housing and mortgage markets

Activity

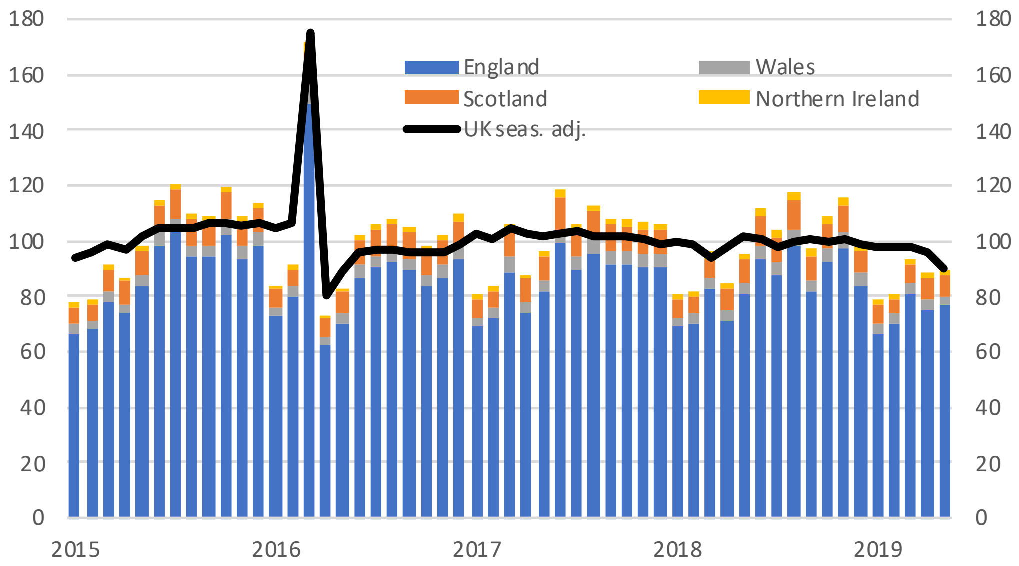
It has been clear for some time that the uncertainties associated with Brexit are acting as a drag on the housing market, discouraging buyer and seller interest and depressing market sentiment. As the Brexit process extends until later this year, the rather directionless state of the market seems likely to persist.

Allowing for seasonal factors (see Chart 2), the underlying pattern of property sales has changed little, with monthly sales continuing to hover around 100,000 in recent months although appearing to dip slightly in April and May.

Property transactions total a little below 1.2 million on a rolling 12-month basis, further extending the modest plateau that has been a feature of the housing market for the past four years (with the exception of the temporary spike associated with buying ahead of the 3% stamp duty surcharge on second homes from April 2016).

Chart 2: Housing market transactions, monthly, 000s

[2] *Housing consumption and investment: evidence from shared equity mortgages*, Bank of England Working Paper No 790 April 2019



Source: HMRC

While Brexit provides an unhelpful backdrop for the housing market, there are some grounds for cautious optimism.

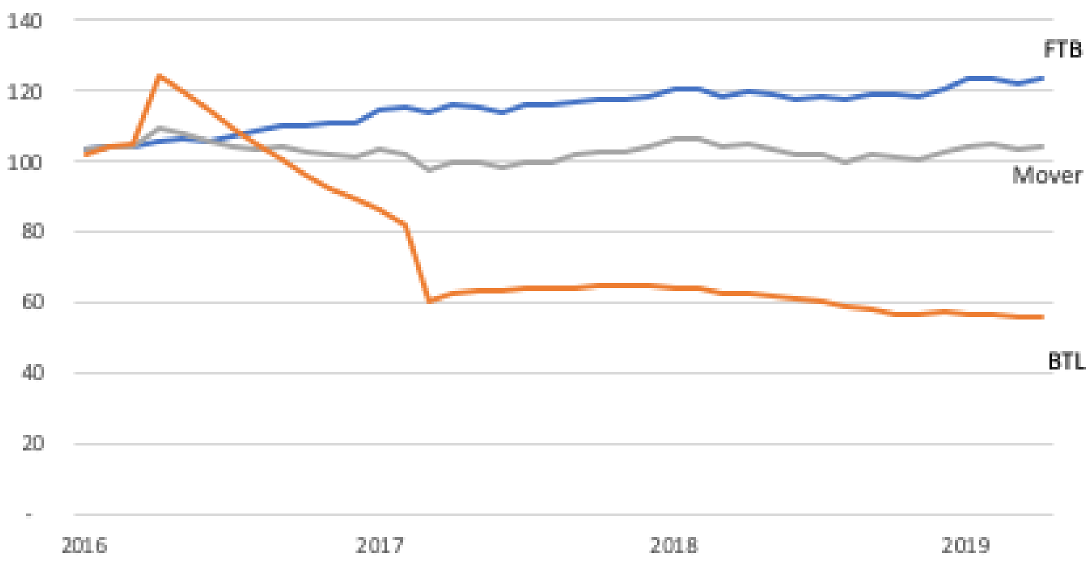
The regional mix of transactions seems to be stabilising, after several years in which the share of markets with the most stretched affordability metrics (basically, those in southern England) had shrunk noticeably.

Secondly, June's RICS residential survey report presents a less gloomy picture than for many months, with new buyer enquiries not recording a decline for the first time in nearly a year and less negative trends also for agreed sales, prices and new instructions.

As can be seen in Chart 3, first-time buyers are the only market segment showing any real signs of life. A number of factors have bolstered affordability, including competitive mortgage deals, the buoyant jobs market and the slowdown in property prices across much of the country.

UK Finance figures show 361,000 first-time buyers in the year to April, continuing the modest growth rate seen since 2016 (Note: Historic UK Finance figures were revised a few months ago). Northern Ireland continues to set the pace, as has been the case for some time, but even London has seen a modest pick-up over the past year following several years of decline.

Chart 3: How purchases by first-time buyers, movers and BTL landlords compare



Source: UK Finance
Note: Figures show rolling 12-month totals, rebased to 2015=100

The number of households taking out a mortgage to move home has nudged a little higher over recent months, although the broader underlying position has mostly been one of stability for several years. However, it is important to bear in mind that this understates the true importance of movers for the wider housing market, as older households have accounted for a larger share of moves increasing and a significant and growing proportion of their moves are cash-financed[3].

Meanwhile, the welter of adverse tax and regulatory measures introduced over recent years, and their detrimental effect on costs and cash flow, continue to act as a serious drag on investment activity by landlords.

April was the first month in well over a year when a year-on-year decrease in house purchase activity by landlords was not reported. Even so, monthly property purchases by BTL landlords have barely averaged 5,000 so far this year, still 5% below what was already a weak level the year before.
A recent survey by the Residential Landlords Association suggests that just over a quarter of private landlords are looking to sell at least one property over the next year. This is the highest proportion since the RLA started asking this question three years ago.

The ban on letting fees from June and the government's consultation on abolishing Section 21 "no fault" evictions may encourage more landlords to sell up. But, on a rare brighter note for the sector, the changes in tax and national insurance payments

[3] See Last-time buyers: The challenges and opportunities for 55+ home-owners wanting to move home, IMLA April 2019

for those in higher income brackets, mooted by Conservative Party leadership contender Boris Johnson, might actually benefit smaller-scale landlords.

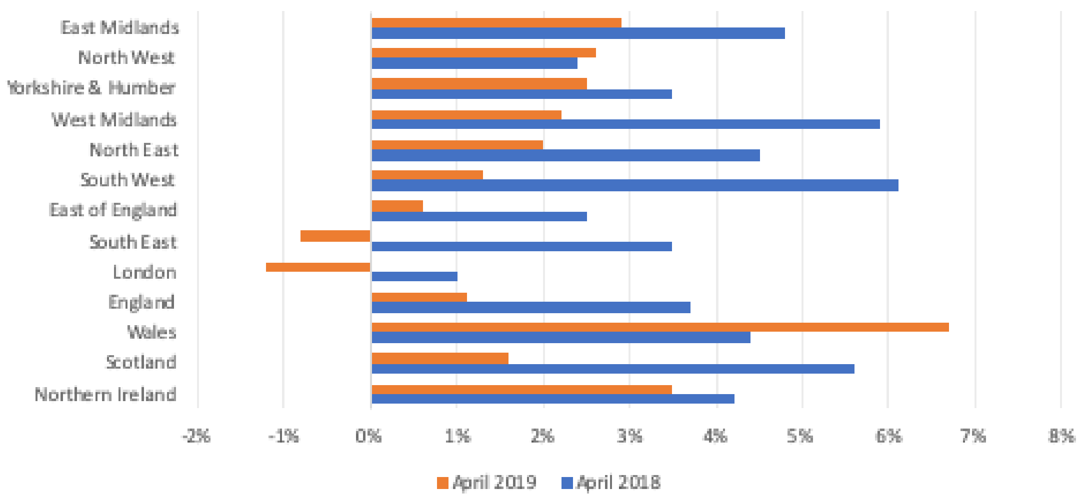
Prices

Property prices are at or very close to peak levels in many parts of the country.

The main exception to this is Northern Ireland, which experienced a massive boom in the years before the global financial crisis, then a subsequent bust and still remains far below record highs.

Residential property price inflation in most regions and countries of the UK is more subdued than a year ago (see Chart 4).

Chart 4: Changes in residential property process by regions and countries)



Source: Office for National Statistics

According to some metrics, it is only in Wales, Scotland and Northern Ireland that property prices continue to increase by more than consumer prices. Elsewhere, there are signs that in London, where prices have been falling for some time, the market has begun to stabilise and it is other parts of southern England, mainly the South East and East of England seeing a downwards correction, as vendors become more realistic about asking prices.

Property prices nationally have got close to stagnating, according to most data sources.

According to Nationwide Building Society, the year-on-year increase in house prices has been below 1% for the six months to May. More forward-looking measures, such as from Rightmove, hint at a slightly more resilient picture over the summer period.

Mortgage lending

The picture for gross mortgage lending has not changed greatly over recent months. Total lending (excluding product transfers data) continues near its post-crisis high of £269 billion, on a rolling 12-month basis.

UK Finance figures report that loans for house purchase totalled about £138 billion for the 12 months to April. This is only about 3% higher than a year earlier, on the back of a sluggish housing market and slowing property price inflation. Growth is heavily dependent upon the first-time buyer segment.

A shrinking level of property purchase by BTL landlords has been reflected in the corresponding value of lending – £8.1 billion in the past 12 months, the lowest level since 2012.

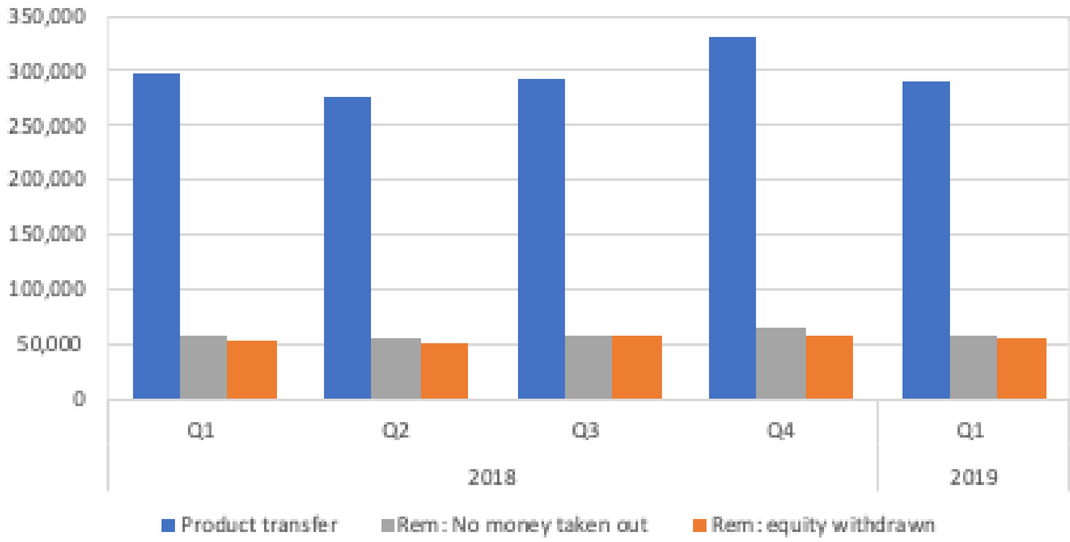
Competitive mortgage deals and greater risk appetite from lenders continue to drive remortgage volumes for the time being. Remortgages worth £83 billion were advanced in the year to April, continuing the strongest performance since 2009.

However, there are signs that the growth trajectory of refinancing activity has begun to flatten after several years of strong performance. Remortgaging by home-owners fell back compared with a year earlier in April for the first time in over a year.

UK Finance has recently begun to distinguish between cases of switching to get a better deal and cases where the borrower also withdraws some housing equity. The figures reveal a stable and more or less equal split of borrowers and no obvious trend over time in the proportion of equity that is withdrawn. The rising pace of remortgaging over recent years has modestly inflated the amount of equity withdrawn, which we estimate currently to be about £1 billion each month.

Borrowers just looking for a follow-on deal also have the option of opting for a product transfer – switching to a new deal but staying with the same lender. This continues to be extremely popular for borrowers, dwarfing instances where the borrower remortgages to a better deal without taking out any equity by roughly 5:1.

Chart 5: Product transfers v remortgages



Source: UK Finance

There were an estimated 290,000 transfers, worth £39 billion, in the first quarter of the year, according to UK Finance.   This was almost exactly the same as a year earlier.

The proportion conducted on an advised basis - including instances where the mortgage lender has provided advice - increased to 56% (161,100 transfers, worth £23 billion).

Refinancing also dominates activity within the BTL space, outweighing house purchase loans roughly 3:1, although here too lending may be on the wane.

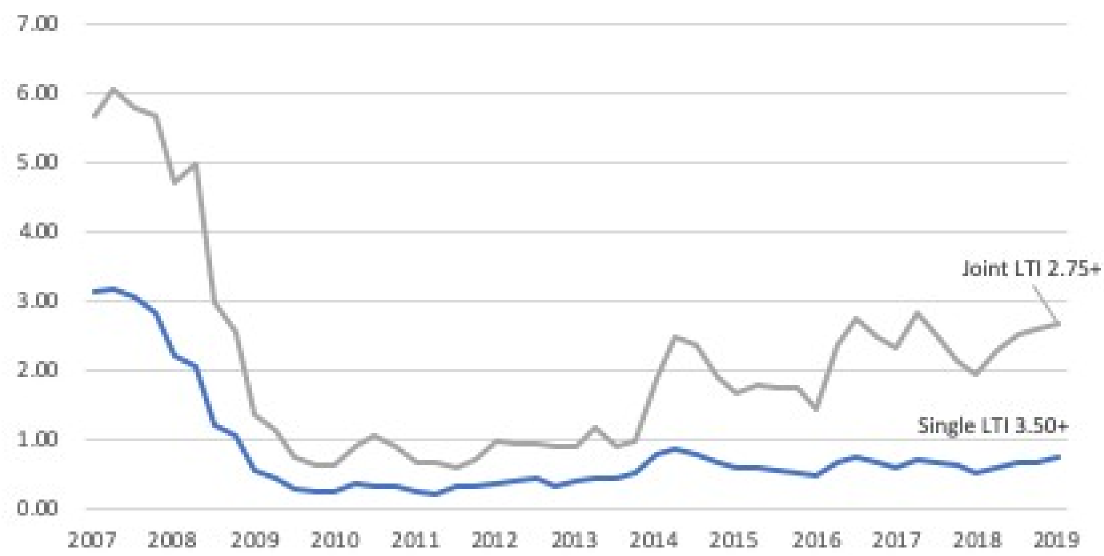
With so much lending activity representing churn, overall mortgage credit growth is running a little over 3% annually - broadly in line with household earnings.

The pace of net mortgage lending has picked up fractionally this year and is now running at a rate of nearly £46 billion per annum. Buy-to-let lending has recently accounted for a larger share of industry net lending, for the first time in two years, but this says more about the subdued nature of lending generally than any landlord revival.

The recent decision by Tesco Bank – a mainstream lender - to stop mortgage lending speaks to the challenging market conditions facing mortgage lenders.

With borrower demand weak, mortgage pricing near historic lows, upwards pressure on bank funding costs and a by-product from the implementation of bank ring-fencing being fierce competition for mortgage business up to 75% LTV, there are limited options for firms. Sam Woods, Deputy Governor at the Prudential Regulation Authority, recently cautioned about shifts to lending at higher LTVs and higher income multiples.

Chart 6: LTVs and Income multiples



Source: Financial Conduct Authority
Note: Figures show % of new lending that is over 90% LTV and satisfies income multiple shown

Meanwhile, Michael Saunders, an external member of the Bank's Monetary Policy Committee, has suggested that mortgage spreads might remain at current low levels until there are increases in policy interest rates.

Prospects

The market is likely to move sideways over the coming months, as a number of households sit on their hands, pending more clarity around Brexit.

If and when a Brexit deal is ratified, we may see an immediate upswing in housing and lending activity, as the pent-up demand of people waiting to buy and pent-up supply of people waiting to sell are released.

The timing and nature of any such upswing are uncertain, however, and will be influenced by how disruptive any Brexit deal is for the UK economy and the jobs situation.

There is a danger that commentators view all market developments through the prism of Brexit, and so risk overstating the positives for the housing and mortgage markets following a deal. But, Brexit aside, market fundamentals appear strong and there appears a good prospect of a pick-up through 2020.

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