Market briefing: June 2020

Key developments in the housing and mortgage markets

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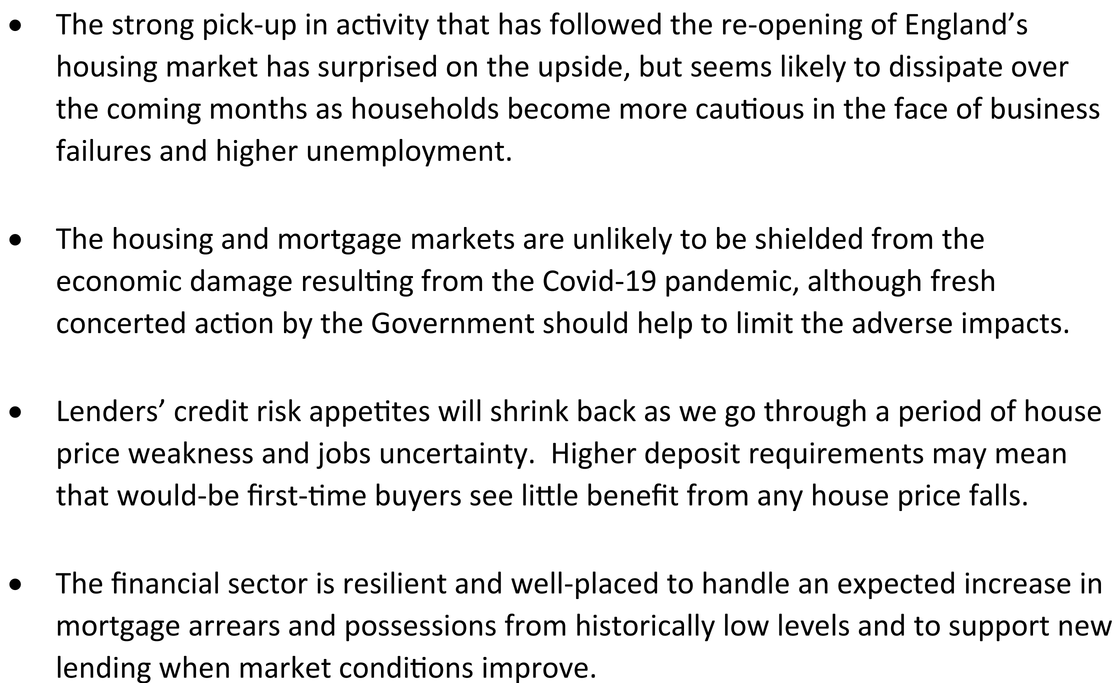
Executive Summary



- The strong pick-up in activity that has followed the re-opening of England's housing market has surprised on the upside, but seems likely to dissipate over the coming months as households become more cautious in the face of business failures and higher unemployment.

- The housing and mortgage markets are unlikely to be shielded from the economic damage resulting from the Covid-19 pandemic, although fresh concerted action by the Government should help to limit the adverse impacts.

- Lenders' credit risk appetites will shrink back as we go through a period of house price weakness and jobs uncertainty. Higher deposit requirements may mean that would-be first-time buyers see little benefit from any house price falls.

- The financial sector is resilient and well-placed to handle an expected increase in mortgage arrears and possessions from historically low levels and to support new lending when market conditions improve.

Introduction

Global efforts to limit the loss of life arising from the Covid-19 pandemic have resulted in the most severe economic dislocation in living memory.

The UK is experiencing its sharpest decline in GDP since the Great Frost of 1709.

Far-reaching interventions by the Government and the Bank of England have cushioned many businesses and households from the immediate adverse effects of economic meltdown. They will prop up the economy through the summer months, but several key measures expire from the end of October.

What happens next depends crucially on two things - how the pandemic evolves (specifically, whether there is a material second spike in infections) and the success of measures to re-boot our economy.

The Chancellor, Rishi Sunak, has been admirably frank about the damage to our economy and plans to unveil a summer statement in early July. As Boris Johnson has effectively ruled out a return to the austerity measures that characterised the fiscal response to the global financial crisis, the stage seems to be set for a broad and activist agenda for the medium- to longer-term. We should expect to hear a lot about the need to limit the degree of economic scarring over the coming weeks.

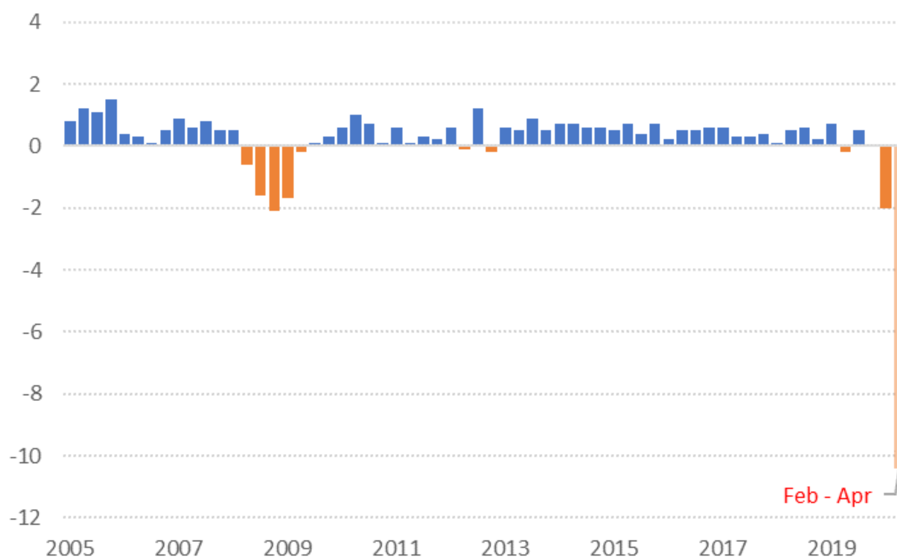
At this juncture, however, there is considerable uncertainty about the pace and timing of any economic recovery.

We should avoid reading too much into the strong pick-up in activity that has followed the re-opening of England's housing market. Given the economic clouds, it is hard to see how this recovery can be anything other than short-lived. The key issue for the mortgage sector is what happens over the closing months of the year and through 2021, where the economic risks lie heavily on the downside.

Covid-19 and the economy

Social distancing has had a sharply negative and wide-ranging effect on economic activity.

Chart 1: UK GDP growth, rolling 3 months



Source: Office for National Statistics

Even though the UK did not formally enter lockdown until the last week of March, many households and businesses started to apply steps independently in the preceding weeks. Monthly gross domestic product (GDP) fell by 5.8% in March 2020, the biggest monthly fall then on record.

There was always going to be a much larger effect in April, the first month when the lockdown was in full swing, and figures from the Office for National Statistics (ONS) now confirm that GDP contracted by 20.4% in the month.

Over the three months to April, GDP fell by 10.4%, dwarfing the quarterly corrections experienced a decade ago (Chart 1).

Business survey data indicates that activity has been stabilising at very low levels more recently.

A progressive relaxation of lockdown measures has begun in recent weeks, but there is considerable uncertainty about how quickly, and to what extent, the economy will revive. Presuming that we do not see a resurgence of Covid-19, Q2 should mark the low point for the UK economy. Publication of second quarter GDP figures in mid-August will provide an important reference point.

One of the most gloomy assessments so far has come from the Office for Budget Responsibility (OBR), when in mid-April it published a scenario looking at the potential impact of the coronavirus on the economy and public finances. Even assuming that economic activity would gradually return to normal in the three months following the end of lockdown, the OBR envisaged that GDP might contract by more than a third in Q2 and by 13% for 2020 as a whole.

The Bank of England has scarcely been more upbeat, with its warning that Britain was heading for its worst recession in 300 years and an “illustrative scenario” in May’s *Monetary Policy Report* suggesting that the economy could contract by 25% in the second quarter and by 14% over the year. It has subsequently back-pedalled a little on the severity of the Q2 fall.

Generally speaking, private sector economists are less negative about the short-term hit to the economy, but even so the emerging consensus view is for an overall contraction of about 9% for 2020 as a whole, according to the latest HM Treasury compilation of forecasts.

As life returns towards something like normality, we should expect to see a sharp recovery over the coming quarters, but even so it may be 2022 or even 2023 before the UK economy returns to the size it was at the start of this year. Although the details vary and the UK may fare relatively poorly (at least according to a recent report from the OECD), many developed countries face a similar prospect, as business failures dent productive capacity and precautionary behaviour by households and businesses hinders growth.

Government action

The Government has intervened to an unprecedented degree to safeguard as many businesses and jobs as possible over recent months (see Table 1).

We have seen cash grants to help businesses involved in the hospitality, retail and leisure sectors, enhanced welfare benefits and tax deferral schemes, as well as high-profile efforts to support household incomes and provide cash to businesses.

Currently, about 11.7 million people are being bankrolled by HM Treasury, at a cost of more than £28 billion so far. This corresponds to more than 40% of private sector employment. Latest figures indicate that 9.1 million employees have been furloughed under the Coronavirus Job Retention Scheme and 2.6 million self-employed claimed support under the Self-Employment Income Support Scheme.

Table 1: Selected Government measures, as at 14 June

Name of scheme	When launched	Description	Value of claims made/approved £ billion
Coronavirus Job Retention Scheme (CJRS)	20 April	State pays 80% of wages up to £2,500 a month for workers who would otherwise have been made redundant. Initially for 3 months, but now extended until the end of October. Now closed to new claims. Flexible working supported from July. Employers to face (an increasing) share of costs from August.	20.8
Self-Employment Income Support Scheme (SEISS)	13 May	State support to self-employed workers in the form of a cash grant of 80% of their profits, up to £2,500 per month for 3 months. A "second and final" grant covering three months to October.	7.6
Coronavirus Business Interruption Loan Scheme (CBILS)	17 March	80% state-backed guarantee on loans of up to £5 million.	10.11
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	20 April	80% state-backed guarantee on loans of up to £50 million.	1.77
Bounce Back Loan Scheme (BBLS)	4 May	100% state-backed loan of between £2,000 and £50,000 for small firms and sole traders. No interest or repayments are due for the first 12 months. After this, a fixed annual interest rate of 2.5%.	26.34

Source: HM Treasury

At the same time the authorities have facilitated £38 billion of coronavirus business interruption loans and "bounceback" loans to more than 900,000 businesses to help them through the period of economic disruption. One of the most recent steps has been the launch of a Future Fund, designed to fund continued growth and innovation in sectors as diverse as technology, life sciences and the creative industries.

The Bank of England has also implemented a range of complementary actions to limit the economic fallout from the coronavirus crisis:

- Need for banks to hold a countercyclical capital buffer suspended for at least a year (potentially supporting an extra £190 billion of lending to businesses)
- UK base rate slashed to a record low of 0.1%
- A total £300 billion to be injected into the economy (£100 billion of which was agreed at the June meeting of the Monetary Policy Committee), boosting total quantitative easing (QE) to £745 billion by the turn of the year.
- The Bank's Contingent Term Repo Facility (CTRF), offering an unlimited and cheap source of short-term funding in the event that commercial banks need liquidity, has been re-activated as a precautionary measure.
- A new term funding scheme (TFSME), offering cheap funding to banks with additional incentives to support lending to SMEs. To date, nearly £12 billion has been advanced.
- A Covid-19 Corporate Financing Facility (CCFF), under which the Bank buys short-term commercial paper issued by big businesses, to help bridge them through Covid-19-related disruption to their cash flows. As at 10 June, the Bank had bought £16.3 billion worth of such paper.

With UK monetary policy already very lax as the Covid-19 pandemic hit, much of the Bank's conventional policy headroom has now been used up. The Governor, Andrew Bailey, has not ruled out the use of unconventional measures, including the possibility of negative interest rates.

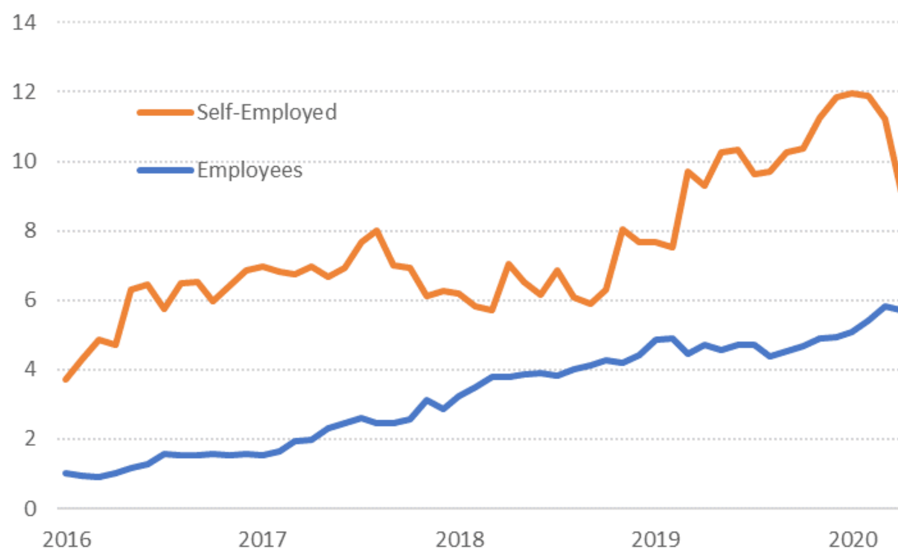
Despite massive support from the authorities, we have started to see the impact of Covid-19 on the jobs market, albeit not yet in the headline unemployment rate which for the time being remains close to record lows at 3.9%.

Claimant count numbers have increased by more than 1½ million since March, although this will overstate any underlying change in unemployment, because the Government has widened eligibility for benefits criteria for those who are still employed, as part of its response to coronavirus.

Elsewhere, the latest labour market figures also make dismal reading:

- 612,000 fewer employees on payrolls compared with March 2020;
- a record 131,000 quarterly fall in the number of self-employed (see Chart 2);
- the number of hours worked nearly 9% lower than the previous year (the largest such decrease on record), reflecting the large number of people temporarily away from work;
- the largest quarterly decrease in vacancies on record;
- total pay falling in real terms (after adjusting for consumer price inflation) for the first time since January 2018, with the pay of private sector workers declining in nominal terms for the first time since records began in 2001.

Chart 2: Employment for employees and self-employed, rolling 3-month % change



Source: Office for National Statistics
Note: UK seasonally adjusted figures for those aged 16 years and over

The Chancellor, Rishi Sunak, acknowledges that worse is to come and that a return to double-digit percentage unemployment is feasible. This compares with 3.9% in the

first quarter, shortly before the country went into lockdown. Not only would this exceed the 8.5% peak in the wake of the financial crisis a decade ago, but it also implies a return to unemployment levels of 3 million plus, not seen since the early 1990s.

The furlough scheme is currently safeguarding millions of jobs, but its temporary nature also means that it provides a slightly false sense of security.

While the end of October may seem a while away, the statutory requirement for employers to consult on redundancies means that we will begin to get some early pointers as to how firms perceive their ability to start contributing to the cost of the furlough scheme and survive beyond it.

Successfully weaning businesses and individuals off huge levels of state support represents a monumental challenge for the Government. The tensions between economic and health concerns have become more apparent over recent weeks, as economic considerations nudge politicians to accelerate plans to ease the lockdown and social distancing requirements.

Rishi Sunak plans a Summer statement for early July. Reporting suggests that this will include plans for huge extra infrastructure spending, large-scale apprenticeships, and retraining packages. Past experience suggests that housing stimulus measures will also feature.

All things considered, the profound economic uncertainty engendered by Covid-19 looks set to persist for the foreseeable future.

Housing and mortgage markets

Alongside efforts to support the wider economy, the authorities have moved quickly on measures designed to keep people in their homes:

- An increase in Housing Benefit and Universal Credit so that the local housing allowance (LHA) covers at least 30% of local market rents (Note: LHA was set at the median figure from its introduction in 2008 until 2011).

- The Financial Conduct Authority (FCA) advised lenders to allow payment holidays for owner occupiers and buy-to-let landlords. This was initially for a period of 3 months, but since extended for a further three months to the end of October.

- Housing possession actions in England and Wales (the majority of which relate to social landlords) has been suspended since late March. Again, this was initially for three months, but Government has now extended the suspension of new evictions until 23 August.

- A minimum notice period of three months for tenants in England and Wales when a landlord is seeking to recover possession of their homes through to the end of September.

- Private landlords in England and Wales are now required to adhere to The Pre-Action Protocol for Possession Claims by Social Landlords, in effect ensuring that they reach out to tenants to understand the financial position they are in. Ministers are also looking at new rules to ensure that landlords and tenants exhaust all possible options before resorting to court action.

Further measures to strengthen tenants' security of tenure and limit possessions have also been taken forward in Scotland and Northern Ireland.

Mortgage payment holidays

Lenders have made an impressive effort to provide mortgage holidays to all borrowers that have requested them.

An estimated 1.86 million mortgage borrowers, 17% of the total, had opted for a mortgage holiday by late May. The typical monthly saving is estimated at a little over £750, according to UK Finance. It is likely to be slightly less for recent first-time buyers because of their longer repayment terms.

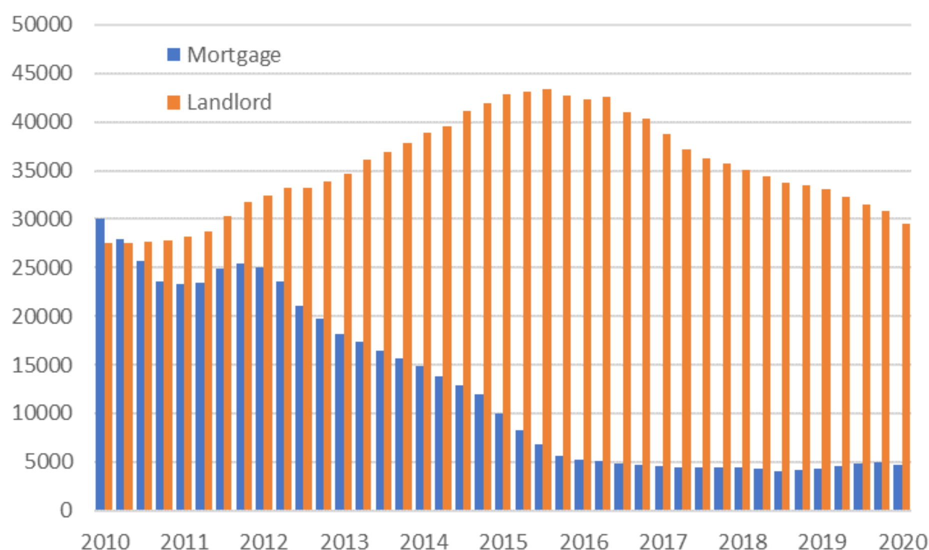
While the initial decision to allow payment holidays was undoubtedly correct (from a macro-economic standpoint), the blanket extension has prompted some unease within the industry.

Lenders are committed to helping customers and providing further breathing space where that is needed, but they are also aware that large numbers of borrowers have taken a holiday unnecessarily. With widespread take-up of holidays for credit cards and unsecured loans, a key concern is that the ready availability of payment holidays may deter households from discussing their financial situation with their lender and being offered tailored help from the full range of forbearance options that are available. Also, that, with interest still accruing, households will end up paying higher interest charges over the remaining life of their borrowings.

The payment holiday extension did carry stronger messaging, to the effect that it will always be in the borrower's best interests to make payments if they are able, but going forwards the industry very much wants to move away from blanket policy actions in favour of help tailored to individuals' circumstances.

It is worth noting that, in recent years, mortgage lenders have had a relatively good record of keeping people in their homes (see Chart 3).

Chart 3: County court possessions, rolling annual totals, England and Wales



Source: Ministry of Justice

With numbers on mortgage holiday approaching a fifth of lenders' overall mortgage books, the temporary loss of income – in aggregate about £1.4 billion each month - may present financing issues for some lenders.

There is a particular challenge for the non-bank lenders, as IMLA has been pointing out since early on during the pandemic crisis. Such firms do not have access to the Bank of England's term funding scheme and funding constraints risk making it harder for them to support their customers financially and/or to continue lending.

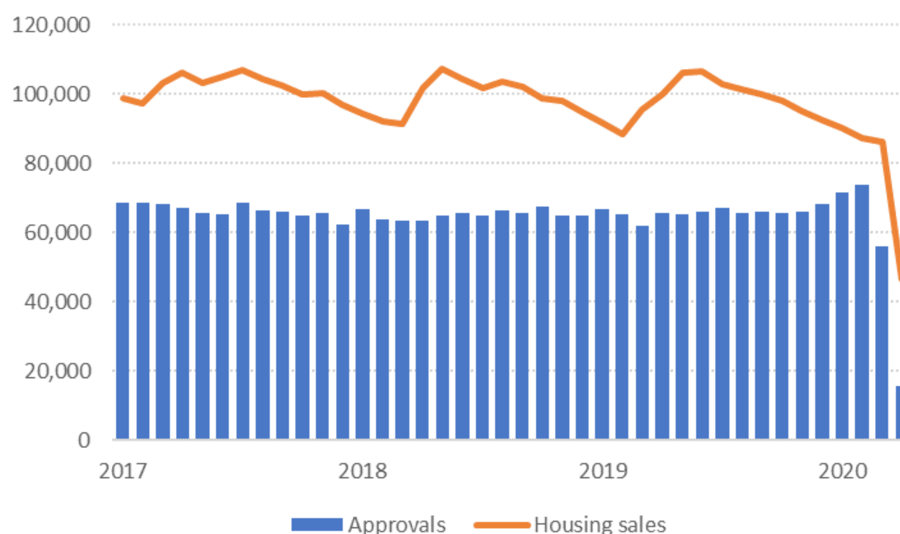
Market activity

Market activity has been profoundly shaped by the impact of social distancing measures.

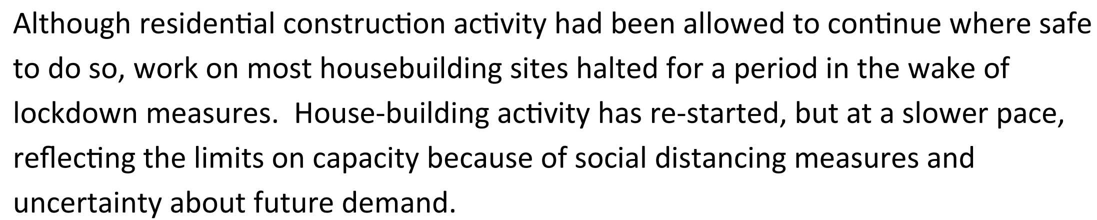
The housing market was effectively suspended by the government from late March, after Ministers banned visits to properties and told people in the early stages of buying or selling their home to delay transactions.

From mid-May the market has re-opened in England. Northern Ireland has also re-opened and the other devolved nations are expected to do so over the coming weeks.

Chart 4: Housing sales and loan approvals, UK, seasonally adjusted



Source: HM Revenue & Customs; Bank of England



Although residential construction activity had been allowed to continue where safe to do so, work on most housebuilding sites halted for a period in the wake of lockdown measures. House-building activity has re-started, but at a slower pace, reflecting the limits on capacity because of social distancing measures and uncertainty about future demand.

The closure of the housing market has inevitably meant a sharp drop in house purchase activity across the board.

The latest figures from HM Revenue and Customs show that property sales, which had already been edging lower, shrank in April to 46,440 - less than half the figure a year earlier.

UK Finance no longer publishes monthly activity data, although it seems likely that the decline was steeper for those moving house (and so necessarily involved in a housing chain).

Bank of England data on the number of mortgages approved to finance house purchases, a forward indicator of house sales, provides scant ground for optimism. Its latest figures report 15,848 approvals for house purchases in April 2020, compared with 65,785 a year earlier, a fall of 76%.

Mortgage lending has for some while been skewed towards remortgages and product transfers, and this seems likely to persist over the short-term, especially as mortgage pricing has eased since the start of lockdown and lenders have committed to providing product transfers to borrowers taking payment holidays, on furlough or otherwise had their income reduced.

Lenders' initial response to the Covid-19 lockdown was to adopt more conservative lending policies, withdrawing large numbers of mortgage products – in early April MoneyFacts reported a halving in under a month - and especially those offering higher LTVs. This reflected a number of factors, including staff shortages, the need to prioritise payment holidays, an inability to carry out physical inspections, liquidity considerations and uncertainty about the wider economic ramifications.

Over the past six weeks or so, as some of these concerns have eased, the availability of mortgage products has improved and the mix is returning to pre-pandemic levels, with the exception of lending at 90% LTV and above, deals for the self-employed and those with complex incomes. With respect to underwriting criteria, we would expect lenders to be looking more critically at the incomes of those in sectors heavily reliant on the furlough scheme and bonuses. In addition, while mortgage holidays do not leave an adverse credit footprint, lenders have indicated that the behaviour of borrowers may inform future lending decisions.

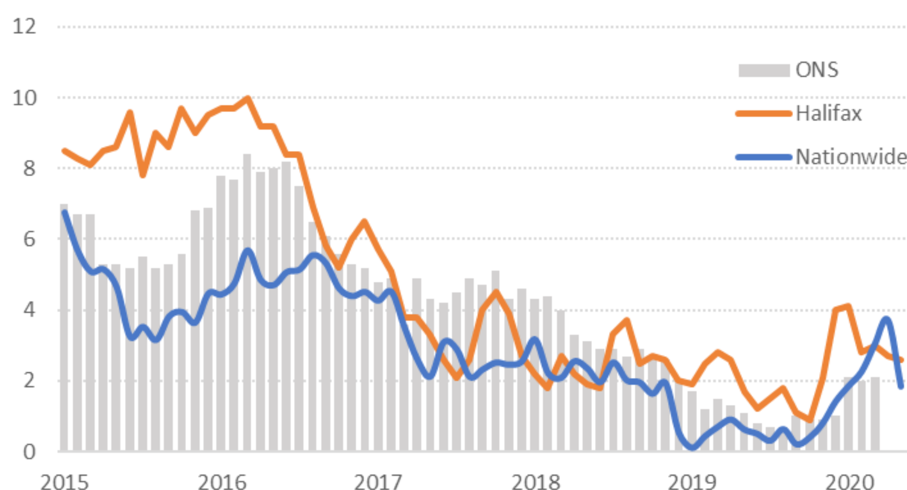
This is probably the new normality for the time being.

There is currently huge uncertainty about the future direction of house prices, and this is one obvious reason for lenders' reticence to offer high LTVs.

Annual UK house price inflation – helped by a recovery in London - had been experiencing a modest pick-up since late 2019, increasing to 2.1% in March, according to the ONS UK House Price Index.

The more recent picture is hard to discern, however. The closure of the housing market has badly disrupted the supply of market data, causing several organisations including the ONS, LSL Acadata and Rightmove temporarily to suspend their publication of house price information. Halifax and Nationwide have published figures for April and May. Both lenders report house price falls in May and a slowdown year-on-year, but their numbers should be treated with a degree of caution as the volume of transactions underpinning their metrics is likely to be thin. The post-lockdown picture from Rightmove and Zoopla has been much more upbeat.

Chart 5: Annual house price inflation



Source: ONS, Nationwide, Halifax

Looking forward, it is important to look past the surge of pent-up demand following the re-opening of the English housing market on 13 May, which may well prove to be short-lived, given the wider economic context.

According to Zoopla, some 373,000 property sales worth £82 billion – roughly a third of annual sales - were held up by the lockdown. What proportion of these sales complete, how quickly and how many deals are renegotiated in the process, will provide strong clues as to the future direction of house prices.

We will also need to see whether the demand that has recently surfaced, which includes new buyer interest forged by lockdown experiences and lifestyle aspirations, is sustainable. A recent consumer survey for Zoopla found that 41% of those searching for a home before the COVID pandemic had put their search on hold, whilst June's Property Tracker survey from the Building Societies Association highlights the adverse impact that job insecurity is starting to pose on sentiment.

Prospects

The UK is navigating uncharted waters and it may be several months before we get a clear sense of where housing and mortgage markets are heading.

Government measures have cushioned many from the adverse effects of countering Covid-19 on incomes and livelihoods so far, and restrictions have meant that some households have seen their savings increase. But our future economic prospects hinge on the success or otherwise of attempts to wean business and households off public support.

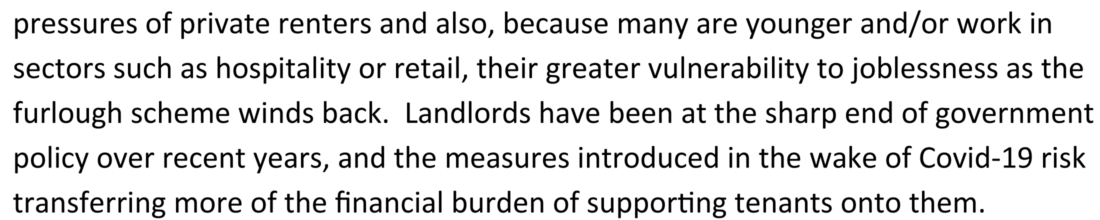
The economic risks are skewed heavily on the downside, and we are likely to see large-scale job losses. Debt charities are already warning of an unprecedented increase in their caseloads later this year.

Anticipating difficult times ahead, household sentiment has already anchored at the depressed levels seen during the global financial crisis over a decade ago.

At times of heightened economic uncertainty, households often opt to sit on their hands and personal caution may well become a feature of the housing market over the coming months and through 2021. As numerous commentators (including the Bank of England and the OBR) have indicated, there is also potential for some short-term house price weakness, once the furlough scheme and other support measures end. However, exceptionally low mortgage rates, few borrowers with high debt-service ratios, mortgage holidays and forbearance arrangements should limit the number of distressed sellers and so the downward pressure.

First-time buyers may not benefit significantly from any house price weakness. Some have already been adversely affected by the dearth of low deposit mortgages, and lenders' credit risk appetites are likely to shrink further if there is a period of falling house prices.

It may be worth keeping a close eye on buy-to-let landlords. Numerous studies, including from the Resolution Foundation, highlight both the rising financial



pressures of private renters and also, because many are younger and/or work in sectors such as hospitality or retail, their greater vulnerability to joblessness as the furlough scheme winds back. Landlords have been at the sharp end of government policy over recent years, and the measures introduced in the wake of Covid-19 risk transferring more of the financial burden of supporting tenants onto them.

Whereas in the past, lenders have drawn comfort from the view that the private rented sector is counter-cyclical (with demand for rental properties growing when households delay house purchase decisions), this may not hold true if this recession causes large numbers of tenants to seek rent reductions or to abandon their tenancies.

Given a market outlook that holds many challenges, one of the few positives for the mortgage industry is the assessment by the Financial Policy Committee (FPC) that UK banks are well-placed to withstand a sharp recession along the lines set out in May's *Monetary Policy Report.*

The Bank sees very low interest rates offsetting some of the impact of sharply higher unemployment on house prices - the short-term 16% fall in UK house prices in the Bank's illustrative scenario is only half that used in its 2019 stress test scenario. This in turn restricts (to 6%) the proportion of loans moving into negative equity and materially reduces mortgage credit losses. The FPC sees the furlough scheme, mortgage holidays and more conservative lending because of its macro-prudential housing tools as other factors helping to mitigate credit losses. The FPC estimates that overall credit losses of £80 billion this year and next would include £18 billion relating to consumer credit and £4 billion for residential mortgages (about 10% of overall impairments relating to UK exposures).

Finally, there is of course the prospect that the Government will introduce housing measures to help steer the UK economy through the difficult period ahead. It seems very likely that house-building will feature prominently in the Chancellor's summer package of measures. There may be several elements, including looser planning rules, but an extension of the existing Help to Buy scheme looks like a strong contender, not least because the scheme is already in place and a delay in moving to the first-time buyer only successor regime (currently scheduled for April 2021) would avoid some unhelpful hard cut-off issues over the coming months.

A stamp duty holiday (over and above that currently enjoyed by first-time buyers) is another popular proposal.

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