Market briefing: March 2021

Key developments in the housing and mortgage markets

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Executive Summary

- While the UK economy is currently stuck in reverse gear because of the third national lockdown, there is a growing confidence that the successful roll-out of our Covid vaccination programme and further fiscal stimulus measures herald a sustained economic recovery.

- A shift in housing demand, triggered by the social distancing measures made necessary by Covid-19, rather than the temporary stamp duty holiday, appears to underpin the recent strength of housing market sales and house prices.

- While the end of the stamp duty holiday may mean that activity levels are more subdued for a period, widespread market disruption or house price falls now seem very unlikely.

- The new mortgage guarantee scheme will encourage mortgage firms to return to 95% LTV lending sooner, but it does not represent a panacea for first-time buyers nor will it transform the affordability challenge facing them.

The Economy

Growth

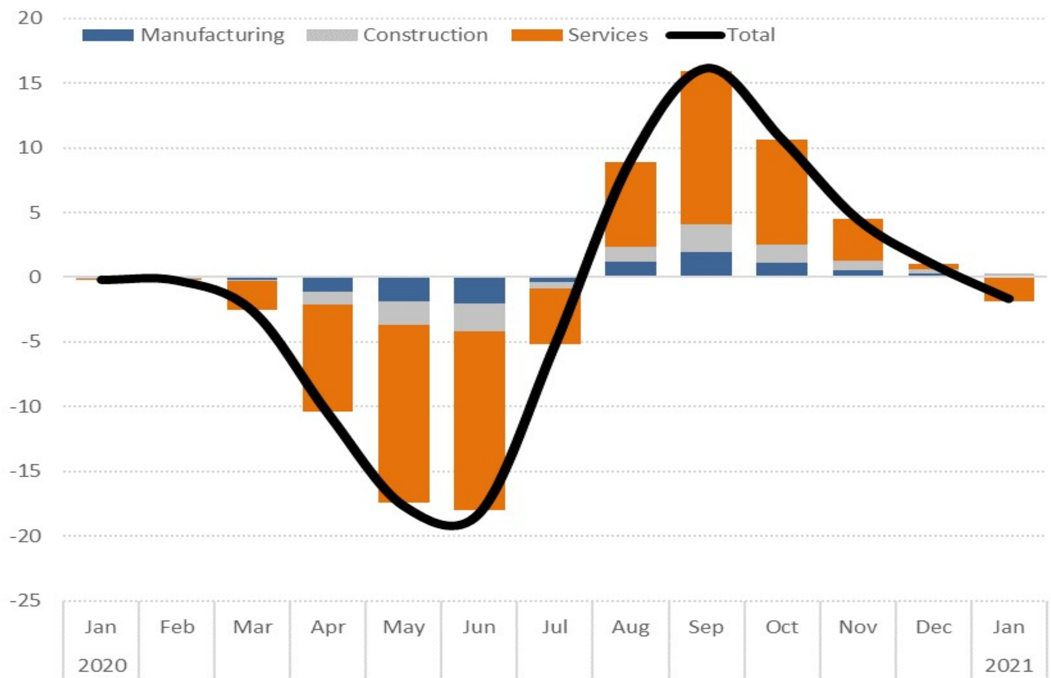
For the time being, the UK continues to be subject to Coronavirus lockdown measures.

The current restrictions have reduced economic activity, with GDP down by nearly 3% in January and 1.7% lower for the latest three months, mainly because of weaker services activity especially consumer-facing activities.

January's economic output was 9% below that seen in February 2020.

Restrictions will take their toll on first quarter growth overall, although by a lot less than in the first lockdown as consumers and businesses have become more adept at coping with public health restrictions. The Office for Budget Responsibility (OBR) expects the economy to shrink by about 4% in the three months to March, leaving the economy about 12% smaller than pre-Covid.

Chart 1: Sector contributions to 3-month GDP growth



Source: Office for National Statistics
Note: Figures show contribution to growth, latest 3 months on previous 3 months

March 2021 Budget: overview

A key policy decision has been to extend support measures for individuals and businesses through to the Autumn to reflect the cautious easing of social distancing rules and reopening of the economy.

- The Coronavirus Job Retention Scheme (CJRS) will now run until the end of September with employees receiving 80% of their current salary for hours not worked. Employers will have to start contributing a share of the cost, over and above National Insurance and pension contributions, from July.

- A fourth and (means-tested) fifth grant under the Self-Employment Income Support Scheme (SEISS) will be paid and its scope will be widened to include 600,000 newly self-employed.

- The Budget extends the temporary £20 per week increase in the Universal Credit allowance for a further six months and makes a one-off payment of £500 to eligible Working Tax Credit recipients.

- The Budget extends business rate reliefs, Statutory Sick Pay support and the VAT cut for the UK's tourism and hospitality sector.

The main surprise was a temporary "super-deduction" tax incentive for companies investing in qualifying plant and machinery, although the OBR concludes that this would mainly serve to bring forward new investment from later years.

Rishi Sunak has signalled his desire to repair public finances – departmental spending has been shaved further, personal tax allowances and thresholds frozen for several years and the rate of corporation tax paid by the largest and most profitable businesses will increase from 19% to 25% from 2023-24.

This is best viewed as "work in progress" – there is no formal fiscal framework in place and fiscal projections are hazardous post-Coronavirus. But the message is clear: 2021-22 is the last year of major stimulus and future years will see the highest tax-to-GDP ratio in half a century.

But several factors are expected to support a more sustained recovery in the UK economy after Q1:

- The global economy has already begun to recover from its biggest downturn in living memory and President Biden's US$1.9 trillion stimulus package will add to growth prospects.

- Here in the UK, the successful roll-out of effective Covid vaccines has raised expectations that social distancing measures can be progressively eased

- Rishi Sunak’s March Budget (see boxed section) extended the furlough scheme and other key support arrangements through to September and deferred tax increases.

The OBR now expects the economy to grow by 4% this year and just over 7% next, and for output to return to its pre-pandemic level by the middle of 2022, around six months earlier than it predicted back in November.

Jobs

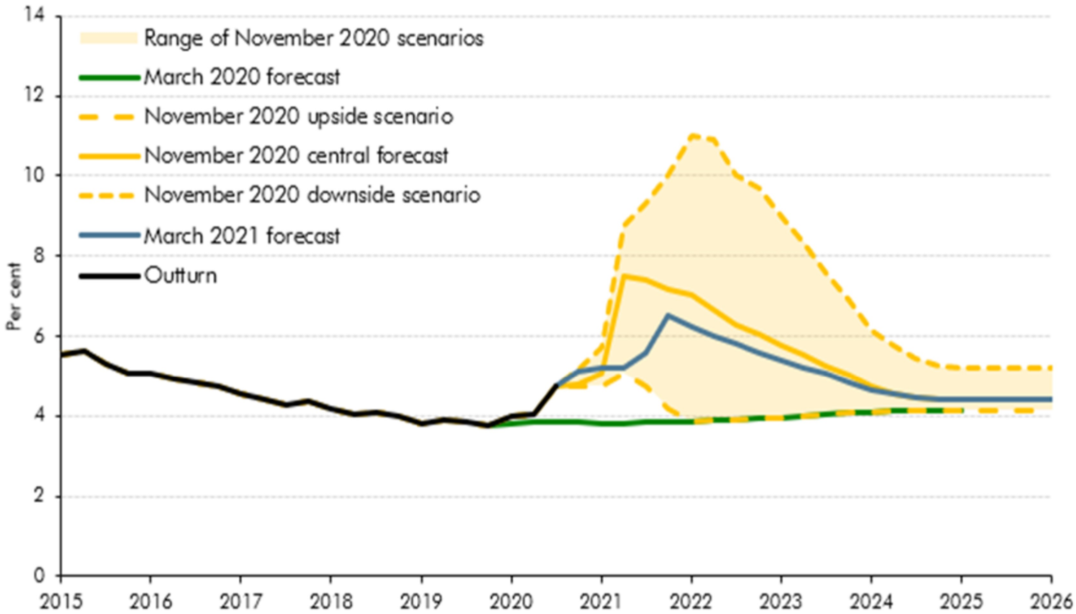
It has also become more optimistic about the jobs market, reflecting the Budget announcement to extend support arrangements.

Its current central view is that the unemployment rate will peak, in the fourth quarter of this year, at 6.5% - a full percentage point lower than it expected last November (see Chart 2).

Labour market developments have not been easy to interpret, because of distorting factors such as the Government support measures and the large-scale emigration of foreign workers (an estimated 795,000 non-UK workers left their jobs last year, according to the ONS).

That said, there are some encouraging signs in the latest jobs data.

Chart 2: OBR has become more positive about unemployment



Source: ONS, OBR

While the official unemployment rate nudged a little higher to 5.1% in the three months to December (up from 3.8% a year earlier), more up-to-date payroll data and other indicators suggest that the worst of the jobs crisis may be passing.

Payrolls have risen for two consecutive months, with the number of staff more than 150,000 higher in January than November's low point.

Meanwhile, claimant count numbers (comprising the unemployed and lower income workers eligible for benefit) have held steady since mid-2020 and vacancy numbers have improved over the same period.

Private sector economists are also becoming more positive about short-term UK economic prospects, with the latest consensus view pointing to 4.7% growth overall this year.

As ever, there are considerable uncertainties ahead. Whilst the future course of the Covid pandemic and the efficacy of our vaccination programme loom large, it is worth noting two other "wild cards".

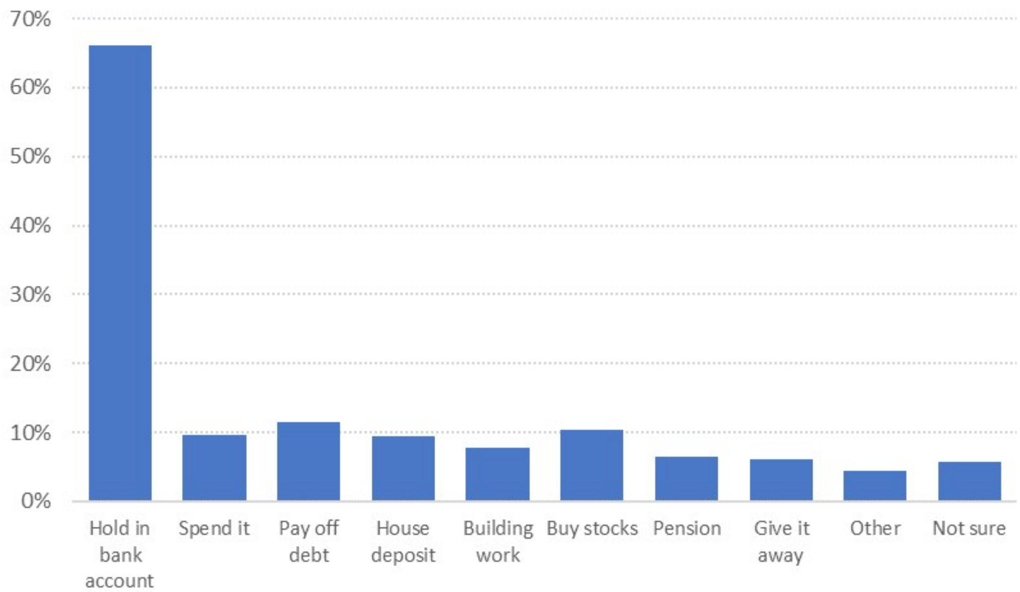
Unplanned savings

The first - an issue IMLA highlighted in its *The new 'normal' – prospects for 2021 and 2022* report - concerns how UK households treat the huge involuntary build-up in personal savings as a result of lockdowns.

The OBR estimates that these stood at more than £100 billion at the turn of the year and are set to reach around £180 billion by mid-year, equivalent to about 12% of total consumer spending in 2019.

It assumes that households will continue to save most of this unplanned increase in wealth and that only about a quarter of this unplanned wealth will be drawn down over its 5-year forecast period. This adds about ½% a year to consumer spending, but with some of it being front-loaded as households buy more durables, such as cars.

Chart 3: What households plan to do with pandemic savings



Source: Bank of England, OBR
Note: Figures do not sum to 100% because some respondents picked more than one option

This echoes Bank of England thinking and appears to be borne out by survey results published by the latter.

A key point here is that most of the wealth is held by higher-income and older households. While the assessment is in line with standard economic theory, Covid takes us into uncharted territory and there is an obvious upside risk that these savings could support a (much) stronger rebound in consumer spending once restrictions are eased.

Monetary policy

The other “wild card” is inflation.

In recent weeks, global bond markets have flashed warning signs that monetary easing and fiscal stimulus packages could feed through into inflationary pressures, pushing government bond yields up to the sort of levels seen before the pandemic. A knock-on consequence for the UK is that financial markets no longer anticipate a future reduction in Bank Rate from its current 0.1%.

Whilst consumer price inflation has been subdued over the past year, the Bank of England expects it to rise quite sharply towards the 2% target over the coming months, as the effects of earlier falls in oil prices drop out of the annual comparison and reflecting more recent increases in energy prices.

Monetary Policy Committee (MPC) members have become a little more optimistic about near-term growth prospects, because of generally positive Covid developments and measures in the March Budget, but their current judgement is that CPI inflation will remain close to its 2% target over the medium-term.

The current stance of monetary policy therefore continues to lean strongly in favour of supporting growth.

That said, MPC members do recognise that recent simultaneous shocks to both the demand and supply sides of the economy have created an unusual degree of uncertainty and they seem to be creating some policy flexibility for themselves.

At its February meeting, as well as acting to ensure that it had the option to implement a negative Bank Rate from August onwards, the Committee also agreed to review its current guidance for tightening monetary policy. At present, this states that the Bank would not reduce its QE stock of purchased assets until Bank Rate has reached around 1.5% (that is, a level from which it could be cut materially).

Housing and mortgage markets

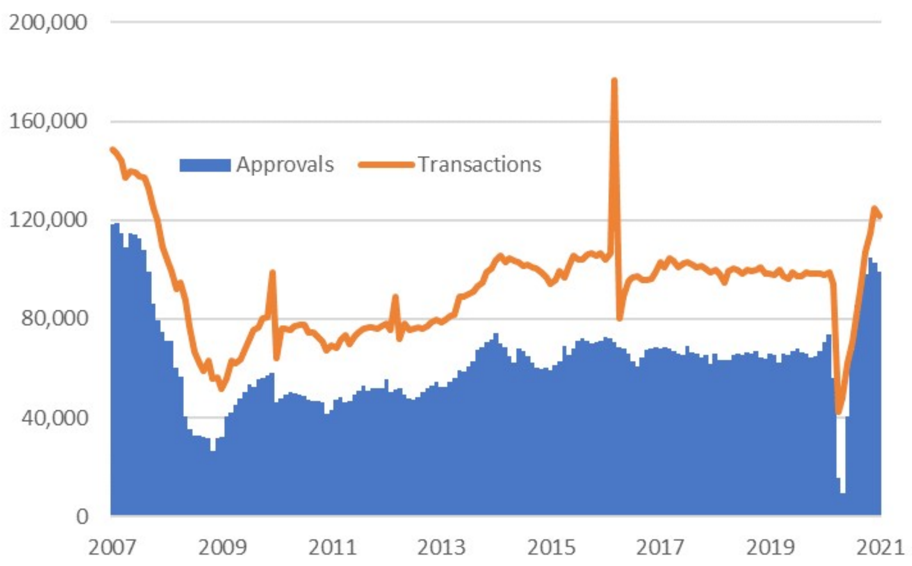
Towards the end of last year, the housing market was enjoying something approaching boom-like conditions, as buyers rushed to complete purchases before the original 31 March deadline for the end of the stamp duty holiday.

Halifax and Nationwide figures showed house prices increasing by 7-8% annually during the closing months of 2020.

All parts of the UK have posted strong gains, with property prices in recent months reaching new record levels in all nations and regions except for Northern Ireland. Flats, where demand and sales have been hit by the shift in demand away from urban centres and smaller homes and the adverse consequences of the cladding crisis, have bucked the general trend, falling by about 3% on average post-Covid according to Acadata Limited (and by considerably more in Inner London).

Monthly approvals for house purchase were the strongest since the global financial crisis, rising above 100,000 in November and December and taking the 12-month total higher than before the Covid crisis.

Chart 4: Monthly approvals and transactions



Source: HMRC and Bank of England

Although activity levels have been continuing at high levels, organisations reported fewer new buyer enquiries and house price inflation dipping in the opening weeks of

2021. Initially, this looked like the normal sort of market distortions one would expect as we get near the end of stamp duty holidays, but more recently there have been signs of a fresh pick-up in demand. Meanwhile, vendors have been hesitant to offer their homes for sale, because of lockdown considerations or uncertainties associated with the original 31 March stamp duty deadline, and the resulting shortage of supply has rekindled house price inflation.

March 2021 Budget: housing measures

Stamp duty
Temporary increase in the residential SDLT Nil Rate Band to £500,000 in England and Northern Ireland extended until 30 June 2021. From 1 July 2021, the Nil Rate Band will reduce to £250,000 until 30 September 2021 before returning to £125,000 on 1 October 2021.

Mortgage guarantee scheme
A new mortgage guarantee scheme aimed at boosting availability of 95% LTV mortgages to run from April 2021 to December 2022. Closely modelled on former Help to Buy Mortgage Guarantee Scheme.

Support for Mortgage Interest
The Government will help Support for Mortgage Interest claimants in Great Britain to move home by allowing them to add the legal costs associated with transferring their claim to a new property to the value of their loan from 15 March 2021. Northern Ireland Executive will be funded to replicate this change in Northern Ireland.

Flood schemes
The £5.2 billion flood and coastal defence programme for England announced at Budget 2020 will start in April this year, with schemes in Waltham Abbey, Sunderland, Preston, Warrington, Salisbury, Rotherham and Doncaster expected to start construction in 2021-22. These schemes will better protect over 3,700 homes from flooding.

Look out for:

The Government to offer a green retail savings product through National Savings and Investment (NS&I) in the summer of 2021.

The Government to announce some consultations separately from the Budget, via a Command Paper, *Tax policies and consultations (Spring 2021)* on 23 March.

Stamp duty

With surveyors, conveyancers, local authorities, mortgage lenders and other firms involved with home-buying operating with restricted capacity because of the third national lockdown, there had been genuine concern in the market at the prospect of severe market disruption in the months leading up to and following the 31 March deadline.

The Government's move to extend stamp duty – even by three months - is welcome, as it will give many households the breathing space they need to complete transactions and benefit from lower stamp duty payments. This will help to mitigate severe market disruption because of the logjam associated with the post-Covid boom in housing market activity.

Fears of a "cliff-edge" in the housing market have substantially receded because of the stamp duty move in the Budget, together with the decision to extend job support measures to the Autumn. That said, the Government's decision not to taper the new arrangements is unhelpful, as it risks some disruption around the new deadlines created.

Table 1: Stamp duty arrangements across the UK

	England & Northern Ireland		Wales	Scotland	
	Stamp Duty Land Tax		Land Transaction Tax	Land & Buildings Transaction Tax	
	Main	FTBs		Main	FTBs
Current: Nil rate band, up to:	£500,000	£500,000	£250,000	£250,000	£250,000
From 1 April: Nil rate band, up to:	£500,000	£500,000	£250,000	£145,000	£175,000
From 1 July: Nil rate band, up to:	£250,000	£300,000	£180,000	£145,000	£175,000
From 1 October: Nil rate band, up to:	£125,000	£300,000	£180,000	£145,000	£175,000
Maximum saving compared with default position					
Current	£15,000	£10,000	£2,450	£2,100	£1,500
From 1 April	£15,000	£10,000	£2,450	NIL	NIL
From 1 July	£2,500	NIL	NIL	NIL	NIL
From 1 October	NIL	NIL	NIL	NIL	NIL

Notes:

1. Current stamp duty concessions in Wales are for main house purchase only.
2. First-time buyers in England and Northern Ireland are eligible to claim first-time buyer relief on purchases up to £500,000
3. Default position shaded in blue

One side-effect of the Chancellor's Budget move, and different responses to it in Wales and Scotland, is that the different nations of the UK will revert to their default stamp duty arrangements at different times (see Table 1).

An odd quirk is that, from mid-year, only those moving home or buying an additional property in England or Northern Ireland will continue to enjoy any ongoing benefit from the holiday. The third quarter concession offers a maximum saving of £2,500, compared with £15,000 under the current arrangements.

From October onwards, stamp duty arrangements in all parts of the UK revert to those prevailing before last July.

It will be interesting to see how the housing market reacts.

Several commentators have noted that the benefit of the current stamp duty holiday has been cancelled out by recent house price gains and even by the higher deposit requirements associated with those higher prices across much of the country (except London and the South East).

This does look like an overblown response to a temporary cut in stamp duty, and suggests to the author that, while stamp duty may have been the catalyst for some house moves, the recent spike in demand stems primarily from a one-off shift in demand brought by the Covid restrictions.

If so, whilst there might still be a period of more subdued activity around the end of the stamp duty holiday, we should not expect to see a correction in house prices.

In this context, it is worth noting that several market commentators, including the OBR, have been revising away their previous forecasts of house price falls.

Mortgage Guarantee Scheme

The scheme announced by Rishi Sunak mimics the Help to Buy Mortgage Guarantee (HTBMG) Scheme launched in 2013 and has the same aim of boosting the appetite of mortgage lenders to offer higher LTV loans. Recent data published by the Financial Conduct Authority shows that the proportion of mortgage lending above 90% in the fourth quarter of last year (1.22%) had collapsed to the lowest rate since records began in 2007.

The parameters of the schemes are similar in most respects, including the need for them to be self-financing. All borrowers looking to buy or remortgage an owner-occupied property are eligible, although as we know from last time most guaranteed loans (about 80%) were taken up by first-time buyers.

Although the firepower of the new scheme appears to be a lot less – it allows a contingent liability of £3.9 billion versus the former £12 billion – this reflects the fact that this time round the Government is solely focused on boosting the availability of 95% LTV mortgages. The new facility would potentially support higher LTV lending of £25-26 billion over the period April 2021 through to December 2022, broadly equivalent to the total volume of such lending in 2018 and 2019.

While the industry has welcomed the new initiative, it is not clear that it will transform the affordability position of first-time buyers in the way hinted at in the lofty ambitions of the Conservative Party's manifesto document or the Centre for Policy Studies' *Resentful Renters* report. Giving evidence on the Budget to the Treasury Select Committee, OBR member Charlie Bean intimated that the impact of the mortgage guarantee scheme would be modest.

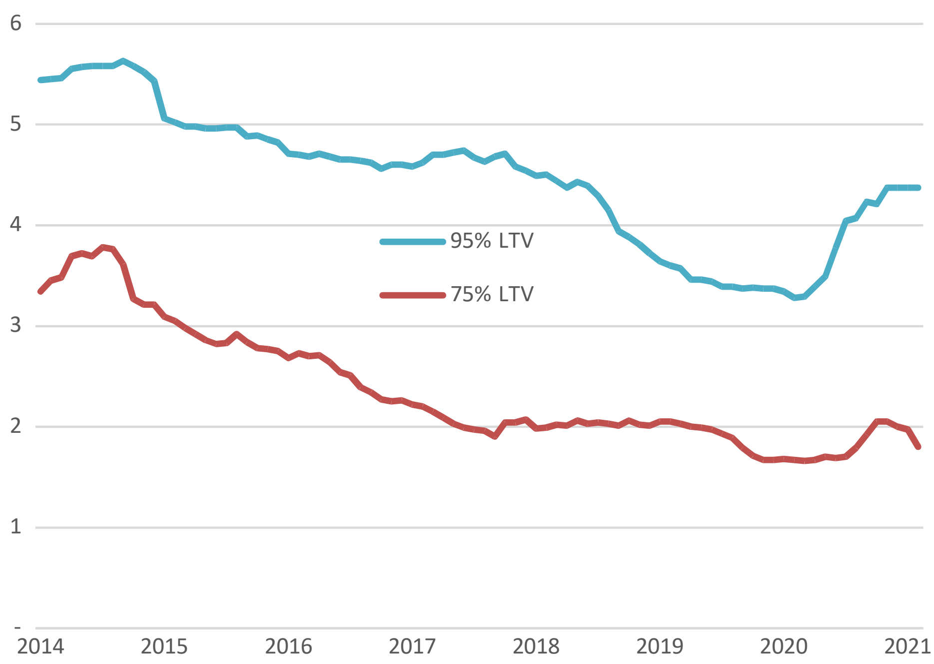
Even if lenders choose to participate, the scheme rules merely stipulate that lenders using the facility must offer 5-year fixed term mortgages to borrowers. That does not necessarily imply that 5-year fixes will be the products of choice for borrowers, nor that they will find 95% LTV products attractive anyway.

The latter point is crucial.

There have been unrealistic expectations about what the guarantee scheme may mean for the pricing of 95% LTV loans. Comparing 95% with 75% five-year fixed rate products, the typical premium back in 2014-15 (when the former HTBMG scheme ran) was about 2%. This did subsequently drop to as low as 1.5% pre-Covid. The average quoted rates on the few 95% LTV products available in February 2021 were 4.37%, compared with 1.80% at 75% LTV (1.62% on 2-year deals). Given that lenders will also face scheme compliance costs on top of the 90 bps commercial fee, a successful scheme could drive the pricing of 95% LTVs below 4% but such products are still likely to command what is seen as premium pricing.

Many households may think long and hard about saving for a bigger deposit to get a cheaper mortgage, especially as competition has begun to improve the availability and pricing of 10% deposit mortgages over recent months.

Chart 5: Quoted rates, 5-year fixed rate mortgages



Source: Bank of England

Given this, a key issue around the impact of guarantees may be the extent to which lenders feel able to relax their underwriting of such loans. For the time being, their actions are constrained by the fact that the new scheme sets an upper limit on income multiples of 4.5 times. A similar cap applied under the original HTBMG scheme, after the Financial Policy Committee (FPC) introduced its twin housing levers.

The levers are currently being reviewed by the FPC, and we may learn the outcome of that review when the next FPC report is published on 26 March.

Until now, lenders offering longer-term fixed-rate products have for the most part chosen not to differentiate their underwriting standards by product choice, even though the FPC's rules already allow this. The primary reason appears to be how to navigate the perceived conduct risk issues associated with offering a borrower a larger mortgage but one that is more expensive. There are also likely to be concerns about demand swamping a lender that offers customers greater borrowing power, which may resonate very strongly at present given lenders' recent actions to maintain customer service levels.

All told, it is hard to see this impasse easing without the regulator formally sanctioning gentler lending rules in some way. Without those, it seems likely that large numbers of borrowers on lower incomes or looking to buy in expensive markets such as London and the South East will not be able to access 95% LTV products.

Private Rental Sector and tenants

The overall picture is one where rental demand has been strong and rents increasing, except for city centres, and in particular central London, where new supply has been boosted by previously Airbnb short-let and unlet properties. Latest reports from Zoopla and Savills suggest that outside of London, average private rents are increasing in the 2-3% range but are as much as 8% lower for London.

UK Finance recently reported that purchase activity by buy-to-let landlords in the fourth quarter (22,500 loans worth £3.4 billion) was the strongest performance since Q1 2016 (when landlords completed sales ahead of the introduction of the stamp duty surcharge).

While some landlords will undoubtedly have used the current stamp duty holiday to add to their portfolios, in the face of strong tenant demand, these figures may also reflect landlords using the holiday to move properties into a corporate structure. Hamptons International has recently reported a sharp increase in number of landlords forming limited companies in 2020.

The Government has recently extended the ban on evictions in England to the end of May, perpetuating the unsatisfactory position in which landlords are expected to continue absorbing rent arrears. Numerous studies confirm that hundreds of thousands of private tenants have developed rent arrears (adding to existing arrears or moving into arrears for the first time) during the Covid crisis. An LSE report *Where Now for the Private Rented Sector?* suggests that this will give rise to a slow-burn problem with more formal evictions, tenant insecurity and debt arrears over several years.

Payment difficulties

Lenders should be careful not to draw false comfort from fourth quarter arrears and possessions data. While these provide few signs of difficulties, for landlords or homeowners, current reporting is flattered by mortgage deferral arrangements and the ban on evictions.

The FCA's *Financial Lives 2020 survey* report provides a timely reminder that, as at October 2020, not all adults felt confident about being able to meet their mortgage commitments over the following six months. Meanwhile, a report sponsored by the Building Societies Association suggests that, prior to the Coronavirus pandemic, nearly 800,000 mortgage holders risked losing their homes in the event of a loss of income.

Some of these challenges will begin to surface as the authorities unwind support arrangements later this year.

Prospects

Although the UK economy continues to face significant headwinds and uncertainties, prospects appear much brighter than a few months ago. The roll-out of a successful Covid vaccination programme and a further extension of Government support measures has improved prospects for the economy and jobs over the coming year and begun to revive household confidence.

For mortgage lenders, the March Budget has also gone a long way to removing the danger of a "cliff edge" at the end of March and a period of acute market disruption.

While the mortgage guarantee scheme is unlikely to transform the affordability picture for first-time buyers, there are good reasons for short-term optimism.