Market briefing: September 2020

Key developments in the housing and mortgage markets

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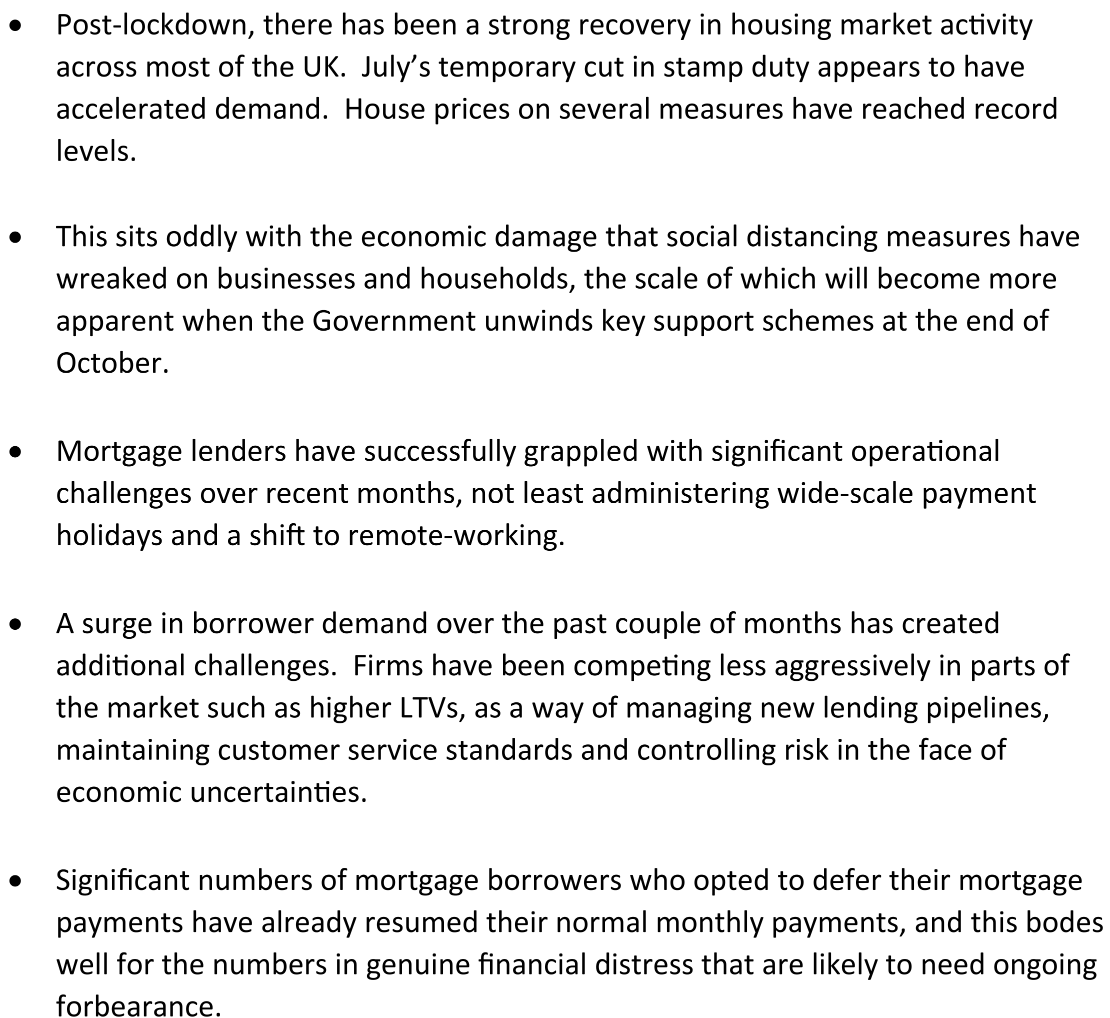
Executive Summary



- Post-lockdown, there has been a strong recovery in housing market activity across most of the UK. July's temporary cut in stamp duty appears to have accelerated demand. House prices on several measures have reached record levels.

- This sits oddly with the economic damage that social distancing measures have wreaked on businesses and households, the scale of which will become more apparent when the Government unwinds key support schemes at the end of October.

- Mortgage lenders have successfully grappled with significant operational challenges over recent months, not least administering wide-scale payment holidays and a shift to remote-working.

- A surge in borrower demand over the past couple of months has created additional challenges. Firms have been competing less aggressively in parts of the market such as higher LTVs, as a way of managing new lending pipelines, maintaining customer service standards and controlling risk in the face of economic uncertainties.

- Significant numbers of mortgage borrowers who opted to defer their mortgage payments have already resumed their normal monthly payments, and this bodes well for the numbers in genuine financial distress that are likely to need ongoing forbearance.

The Economy

The economic outlook continues to be highly uncertain as a result of the ongoing Covid-19 crisis.

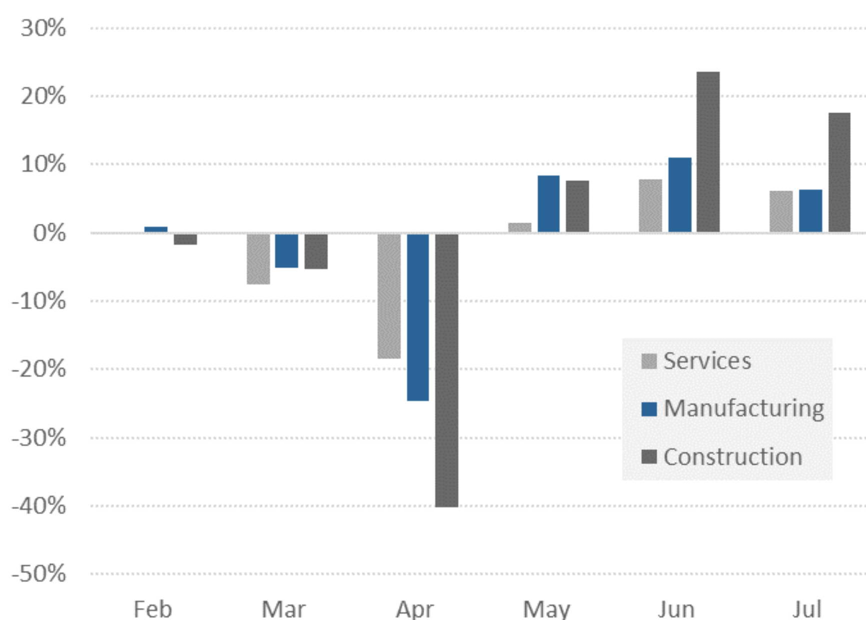
In line with expectations, UK gross domestic product (GDP) contracted by a fifth in the second quarter.

This was one of the weakest performances of all the major economies, although comparisons are distorted by differences in the timing of lockdown measures and GDP methodology and the greater role played by our services sector.

Economic activity has recovered significantly from the trough in April, as we have experienced a relaxation of lockdown measures.

Monthly GDP grew by 6.6% in July, following growth of 8.7% in June and 2.4% in May.

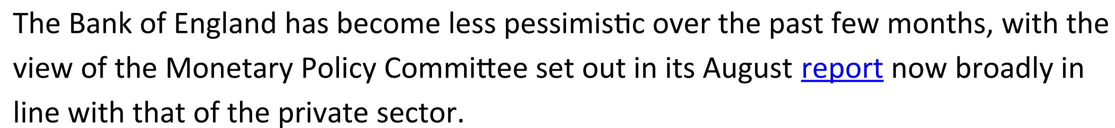
Chart 1: Monthly growth by sector



Source: Office for National Statistics

Across the sectors, construction has rebounded strongly, driven by housing and by private new build in particular.

Surveys suggest that the vital services sector in August grew at its fastest pace for several years.



The Bank of England has become less pessimistic over the past few months, with the view of the Monetary Policy Committee set out in its August report now broadly in line with that of the private sector.

The consensus view of private sector economists appears to be settling around an overall contraction in GDP of about 10% for 2020 as a whole, followed by growth of more than 6% next year, according to the latest HM Treasury compilation of forecasts.

That being said, there is considerable uncertainty about the ongoing pace and nature of the UK's economic recovery.

Much hinges on how Covid-19 evolves, specifically whether the current upward trend in infections triggers further action at the national level and progress with developing vaccines and other treatments.

A strong recovery depends upon households, whose savings in aggregate have risen since the Spring, feeling confident enough to spend freely. Recent consumer sentiment surveys suggest that this is by no means a given.

Government policy will continue to play a pivotal role, as it plans to unwind some of the support schemes that have cushioned the impact of the economic fall-out from social distancing measures.

Finally, we should not overlook the fact that trade negotiations between London and Brussels have reached a critical stage and which may determine whether UK businesses will face a smooth or disruptive transition to new trade relations with the EU around the turn of the year.

Even if the UK continues to see strong economic growth figures, we should not lose sight of the fact that April marks a very low starting point for our recovery. July's GDP was 12% lower than in February, before we had the disruption from coronavirus, and output in the three months to July was still 17% lower than the same period a year ago. Even with a fair wind, it is likely to be late 2021/early 2022 before the UK economy returns to the size it was at the start of the year.

Government action

The Government has intervened to an unprecedented degree over the past six months, coordinating its interventions with the Bank of England, to cushion businesses and households from the immediate adverse effects of economic meltdown:

- More than 12 million people have been bankrolled by HM Treasury at some point during the coronavirus period, at a cost of £34 billion so far. Latest figures indicate that 9.6 million employees have been furloughed under the Coronavirus Job Retention Scheme and at least 2.7 million self-employed claimed support under the Self-Employment Income Support Scheme at some point.

- The authorities have facilitated £50 billion of coronavirus business interruption loans and "bounceback" loans to more than 1.2 million businesses to help them through the period of economic disruption.

- The Bank of England has implemented a range of complementary actions to limit the economic fallout from the coronavirus crisis. This has included £34 billion of cheap funding advanced to banks under its new term funding scheme (TFSME), which offers additional incentives to support lending to SMEs.

- UK monetary policy is very loose ("accommodative" in Bank-speak), with base rate at a record low of 0.1% and quantitative easing (QE) set to reach £745 billion by the turn of the year. In August the Bank issued forward guidance, indicating that the Committee does not intend to tighten monetary policy any time soon. The Governor, Andrew Bailey, has also made it clear that the Bank continues to have firepower at its disposal, including more QE and the possibility of negative interest rates.

A critical issue for the coming months will be how the UK copes with the planned unwinding of the Coronavirus Job Retention and Self-Employment Income Support Schemes (SEISS) from the end of October.

Rishi Sunak announced a significant package of measures to support jobs in July's Summer Economic Update. These included a Job Retention Bonus of £1,000 for furlough staff still employed by 31 January next year, support for work placement and training schemes, temporary cuts in VAT for the hospitality and tourism sectors, together with more than £30 billion of extra public spending.

But these are intended to soften rather than avert a sharp rise in unemployment.

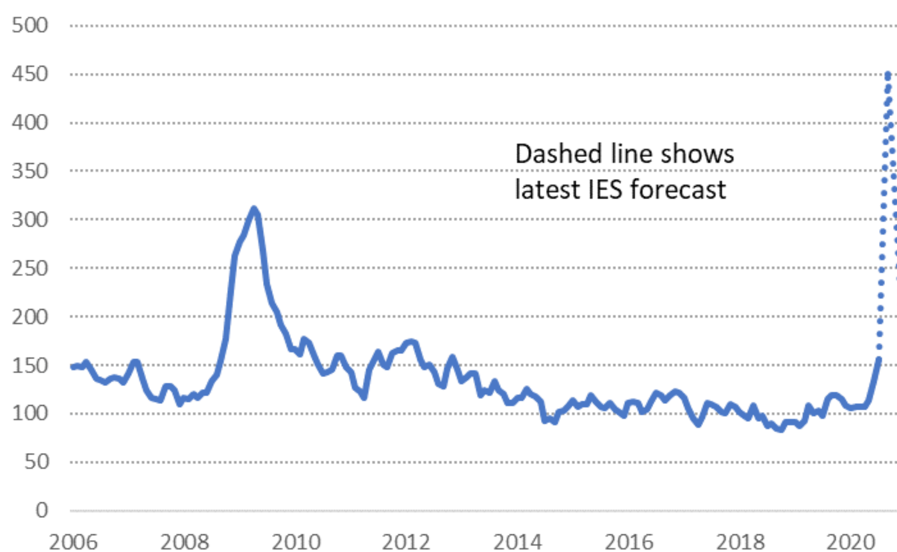
The modest uptick in the headline unemployment rate seen so far, up to 4.1% in the three months to July, does not give a true reading of the state of the jobs market.

Whilst hours worked, vacancies and pay growth have improved a little recently as coronavirus lockdown measures have eased, the underlying labour market situation is one of fragility.

Early estimates for August 2020 from Pay As You Earn indicate that the number of payroll employees is nearly 700,000 lower than in March. Self-employed numbers, meanwhile, are down by a quarter of a million.

Although surveys indicate that large numbers of workers have now returned to work from furlough, those remaining will include a disproportionate number who are vulnerable to unemployment. Claimant count numbers reached 2.7 million in August 2020 - up by nearly 1½ million since March.

Chart 2: UK redundancies, 3-month rolling totals



Source: Office for National Statistics, Institute for Employment Studies

This will overstate the likely spike in joblessness beyond October, given that the metric includes both those working with low income or hours and those who are not working, but underscores that a material loss of jobs is around the corner.

Analysis by the Institute for Employment Studies (IES) gives a central estimate of 450,000 redundancies in the third quarter and a further 200,000 in the final quarter. As Chart 2 shows, this would be a worse outcome than during the global financial crisis.

Housing and mortgage markets

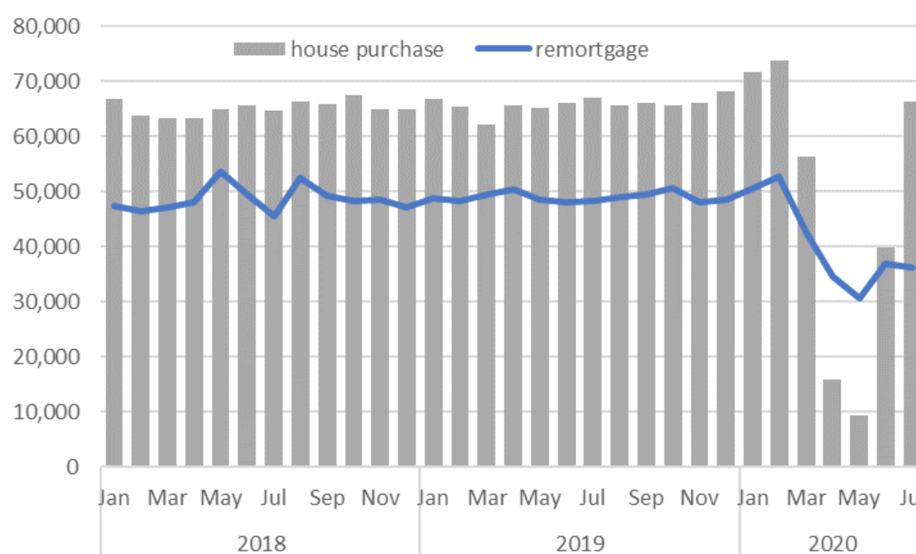
This makes the strength of the post-lockdown recovery of the housing market all the more surprising (for economists, at least).

A surge in demand has followed the re-opening of national housing markets from mid- to late-May.

Initially evident at the upper end of the market, we are now experiencing a broad-based recovery, reflecting the release of pent-up demand, a reappraisal of housing needs during lockdown and – more recently – the stamp duty cuts announced as part of Sunak's July package of measures.

The nil rate band for Stamp Duty Land Tax (SDLT, that applies in England and Northern Ireland) has been raised from £125,000 to £500,000, saving buyers up to £15,000. Parallel cuts have been made in Scotland and Wales. All the temporary measures last until the end of March 2021. With the exception of Wales, all purchasers are eligible for the stamp duty saving, including landlord investors and those buying second homes.

Chart 3: Mortgage approvals



Source: Bank of England

While much of the recovery reflects pent-up demand and a re-appraisal of housing needs because of lockdown, the stamp duty cuts have undoubtedly been a catalyst prompting households to crystallise or bring forward their plans to move.

The Office for Budget Responsibility (OBR) reckons that the SDLT cut will increase transactions by 100,000 in 2020-21, with around a quarter of these being truly additional but most being brought forward from 2021-22.

Few industry metrics describe the full strength of the pick-up in activity as yet, with many familiar measures still showing unfavourable year-on-year comparisons:

- Residential property transactions have picked up from April's lows, but in July were still running at only three-quarters the level of a year earlier, according to the latest HMRC figures.
- UK Finance's *Household Finance Review* describes the weakness of house purchase activity in the second quarter, with a Lloyds Bank report indicating that both first-time buyer and home mover numbers in the first half were about 30% lower year-on-year.
- Bank of England approvals data, a more forward-looking indicator, show a sustained recovery in approvals for house purchase through July and a near-recovery to year-earlier levels (Chart 3).

Zoopla and Rightmove have done a good job in presenting the more buoyant data that relates to the earlier stages of the sales/purchase process, and mortgage industry data on broker search activity and ESIS reports corroborates the positive picture.

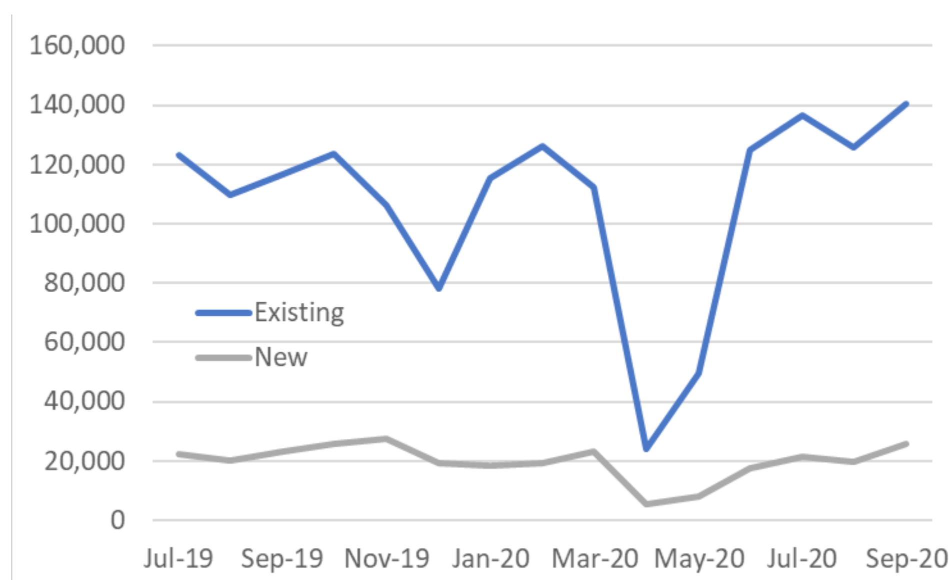
Daily energy performance certificate (EPC) numbers - part of a much wider body of Coronavirus-related statistics newly reported by ONS – are not a perfect guide to future property sales, but usefully illustrate the scale of turn-round. IMLA estimates that third quarter cases will be 14% higher than a year ago and the strongest in five years.

The strength of house price recovery has been helped by the low stock of properties listed for sale post-lockdown. While higher prices have encouraged more properties to be listed for sale, this is from a low base and as a result there continues to be a supply-demand imbalance for the most part.

London appears to be the odd one out, with ready supply but demand impacted by less international travel and tourism and a shift in consumer preferences away from inner-city living.

House prices nationally are hitting new record highs. Weakness during the lockdown period has been replaced by year-on-year increases of 4-5%, according to Halifax and Nationwide, the strongest showing for several years.

Chart 4: Energy Performance Certificates, England & Wales



Source: MHCLG EPC Lodgement Statistics
Note: September figure is author estimate based on first part of the month

With sales agreed running much higher than a year ago, and feeding through into completed transactions over the coming months, there is further upward momentum over the short-term.

Market commentators suggest that higher house prices may continue for a few more months, but there is a wide recognition that they sit oddly with the economic damage that Covid-19 has wrought and the prospect of large-scale job losses and financial difficulties once furlough and payment holidays end.

However, there are good reasons to hope that a sharp market correction can be avoided.

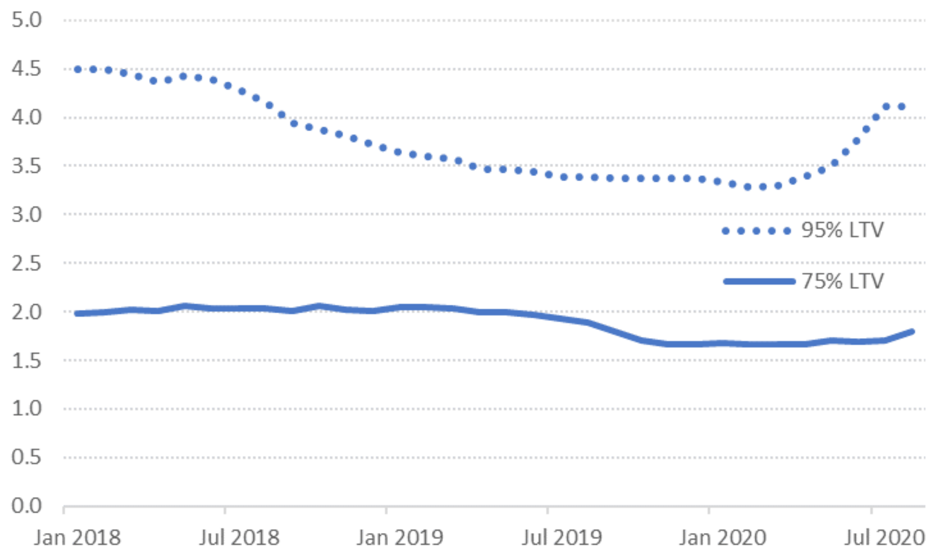
Mortgage lenders have been actively managing their new lending pipelines over recent months, initially to cope with the challenges of setting up payment holidays and a shift to working from home and more recently to address a sharp increase in borrower demand.

Risk appetites have also altered, in anticipation of a more challenging economic environment and nervousness about the jobs fall-out when the Government's furlough and self-employed schemes end in October and the future evolution of house prices.

The overall effect since March has been one of less lending at higher LTVs or to borrowers with gifted deposits, or to those who are self-employed or who have been furloughed.

By way of example, the availability of 90% LTV loans has shrunk materially since March, whilst 95% LTV products have almost disappeared. Meanwhile (see Chart 5), Bank of England data shows that the pricing of new 90% and 95% mortgages has firmed considerably – by about 70 bps - since March

Chart 5: Quoted mortgage rates, 5-year fixes, %



Source: Bank of England

The availability and pricing of higher-risk mortgage products has also become very fluid, with individual lenders dipping in and out of the space, in part reflecting concerns about maintaining service standards in the face of high customer demand.

These more conservative lending policies have limited the ability of some borrowers to purchase, and so helped to keep the housing market on a sensible footing. This, together with low interest rates and ongoing forbearance measures, should help ensure an orderly transition to a more sedate market to some extent.

That said, as things currently stand, there is a risk that any slowdown may be reinforced from next Spring when cuts to stamp duty are reversed and less generous Help to Buy arrangements kick in.

First-time buyers

Several factors have made life more difficult for first-time buyers recently. This fits anecdotal reports that home-mover activity has revived more sharply post-lockdown than first-time buyers (although there is no evidence for this in UK Finance figures through to July).

Younger households are more likely to have experienced some loss of income during the pandemic, so limiting their ability to save or causing them to draw on past savings. The negative ramifications for putting together a deposit will be amplified by the stronger house prices being seen across most of the UK.

In recent years, as affordability pressures have intensified, nearly two-fifths of first-time buyers have come to rely on higher LTV products to get onto the housing ladder. So, greater caution on the part of mortgage lenders in offering products at or above 90% LTV, and their higher pricing, will particularly affect first-time buyers. Given the importance of Bank of Mum and Dad, the decision by some lenders to narrow the scope for parental assistance will also be unwelcome.

Meanwhile, the temporary cut in stamp duty does little to help the majority of first-time buyers, who already enjoyed first-time buyer relief, and by making the concession available to all purchasers (except in Wales) it has potentially increased the competition from investors and those looking for second-homes.

The 2-month extension in the deadline for the current Help to Buy regime will ease the problems associated with delays in construction because of social distancing, but some first-time buyers will be affected when regional price caps kick in from next April.

On a more positive note, the Government has just announced a revamp of its shared ownership model, that will see lower up-front deposit requirements, repair and maintenance costs covered for the first 10 years and more flexible staircasing options. These changes, due to take effect from 2021-22 onwards, as part of the Government's £12 billion Affordable Homes Programme (AHP) to provide 180,000 new homes, should broaden the appeal of shared ownership for first-time buyers. The AHP should also herald the delivery of First Homes, offering first-time buyers a 30% discount against market value.

Elsewhere, proposed reforms of England's planning system, set out in the Government's *Planning for the Future* white paper, are proving controversial and face uncertainty.

Buy to Let

Pre-Covid, landlords had begun expanding cautiously for the first time in several years.

The temporary cut to stamp duty has provided a rare piece of positive news for landlords, and should prompt some purchase activity, although the extent of fresh investment may be tempered by nervousness about struggling tenants.

Numerous studies confirm that incomes of private renters have been disproportionately affected during pandemic. While most tenants have kept up their rental payments, about 10% have agreed lower payments with their landlord or moved into arrears. Shelter estimates that in England 170,000 households renting privately have fallen into arrears since March. The National Residential Landlords Association estimates that 22% of private landlords in England have lost rental income because of the pandemic.

The Government has extended the ban on possession actions – the majority of which are tenant evictions - until 20 September, but there is no clear longer-term strategy as yet. Whereas Scotland and Wales have announced hardship loan schemes to support renters, this is not the case for England, where much of the financial burden still rests with private landlords. Landlords in England & Wales must now give six months' notice of their intention to regain possession of properties, except where significant arrears have built up or in cases of anti-social behaviour, domestic abuse or where there is no right to rent, and it remains unclear how quickly courts will be able to hear cases.

Existing mortgage borrowers

Government measures have not fully insulated households from the adverse effects of dealing with coronavirus. Numerous studies confirm that such effects have been unevenly distributed.

Broadly speaking, those on lower incomes have been less able to curb their spending in line with their reduced incomes and have had to rely on drawing down their savings and/or borrowing more. Other groups have much larger discretionary spending activities, and social distancing restrictions have meant an increase in savings levels.

Payment deferral schemes, aka "payment holidays", have extended forbearance to a wide array of borrowers, by allowing a temporary freeze on mortgage or other loan repayments.

The number of mortgage holidays taken out peaked at 1.8 million in early June. A significant proportion of households will have made use of such holidays for precautionary reasons, rather than because they were at risk of loss of income or financial stress. Many borrowers have since re-started their mortgage payments – UK Finance reports 731,000 still using mortgage deferral at mid-August - prompted by stronger messaging to the effect that this would be in their best longer-term interests.

That said, UK Finance has reported that higher-risk borrowers (those with higher LTVs or income multiples) are more likely to have opted to defer their mortgage payments, and surveys indicate that a minority cohort of households using payment holidays are struggling or will do so when the furlough scheme ends and debt payments resume (see, for example, *Emerging from Lockdown*). A recent analysis by the Institute for Fiscal Studies notes the key role that SEISS has played in helping the self-employed resume mortgage payments, so it may be worth paying close attention to the performance of the self-employed post-October.

The latest FCA/PRA guidance, expecting firms to offer pro-active and tailored help, very much chimes with the approach already being widely adopted across the mortgage industry.

As well as payment deferral, lenders have also supported their borrowers by ensuring that product transfers (PTs) have been available to all those on payment deferral or furlough. PTs actually rose by 2% in the second quarter and accounted for an unusually high 77% of all refinancing. With Bank of England figures showing remortgages still languishing far below year-earlier levels in July, this preference for PTs may well persist.

Prospects

The UK housing market finds itself at an interesting juncture, as a post-lockdown surge in demand and activity meets the reality of a weakened economy.

Once the furlough scheme and other support measures end, there is likely to be a housing market slowdown of sorts over the closing months of this year and into 2021. A key question is whether this will be gentle or not.

From a macro-prudential standpoint, the authorities will be pleased to see that the mortgage lending industry is acting cautiously in its new lending, not least because this improves the odds of a soft landing.

The end of the furlough and self-employed support schemes from the end of October will inevitably expose those households who are struggling with their finances. But their numbers should be limited by the more restrictive lending policies put in place following the global financial crisis and continuing low interest rates, whilst lender forbearance will help borrowers facing short-term difficulties.

The lack of public financial support for tenants in England whose incomes have been hit during the Covid-19 pandemic continues to pose risks for private landlords and remains an area worth monitoring.

As we have said before, the UK is navigating uncharted waters and the economic risks are skewed heavily on the downside.

The Autumn Budget – likely to be in November – provides an opportunity for Rishi Sunak to implement housing measures or intervene to help steer the UK economy through the challenging period ahead.

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