Market Commentary

Neal Hudson, Residential Analysts, Neal@Resi-Analysts.com

The past will be revised. The present is confused by COVID-19. And the unprecedented effects of the lockdown cast enormous uncertainty over the future of the housing market. None of this has curbed the enthusiasm estate agents have for publishing house price forecasts.

True, there's a huge need for guidance in these troubled times. But putting definitive numbers on where the housing market is heading seems, at the moment, pointless. So, in our first UK housing market commentary we will start by admitting that there's little that can be said with certainty. Therefore, this note will focus on what we know, what we'd like to know, and the risks we see in coming weeks, months, and even years.

Most market commentary involves speculation and projection based on recent trends, if only because lags in the data demand it. In times of sudden change, like now, the past trajectory is often of little consequence. So the post-election "Boris Bounce", if it existed, is now irrelevant. But recent data does reveal clues to deeper underlying trends that may help us as we strive to understand life in a post-lockdown housing market.

Revisiting The Past

To understand the immediate past, we need to address the "Boris Bounce". It became a catchall phrase for a range of positive post-election data releases that seemed to support the view of market relief at avoiding a Corbyn-led government and the prospect of "getting Brexit done". The mood may have improved, but this could only ever partially explain the bounce. Technical factors also played a part. House price growth would have been lifted anyway as a period of falling prices during 2018 dropped out of the annual growth calculations. The eagerness to project optimism into the housing market saw spikes in transactions attributed to the bounce that were later revised away due to data collection issues. Importantly, ONS data suggests the uplift in house price growth predates the election by some months.

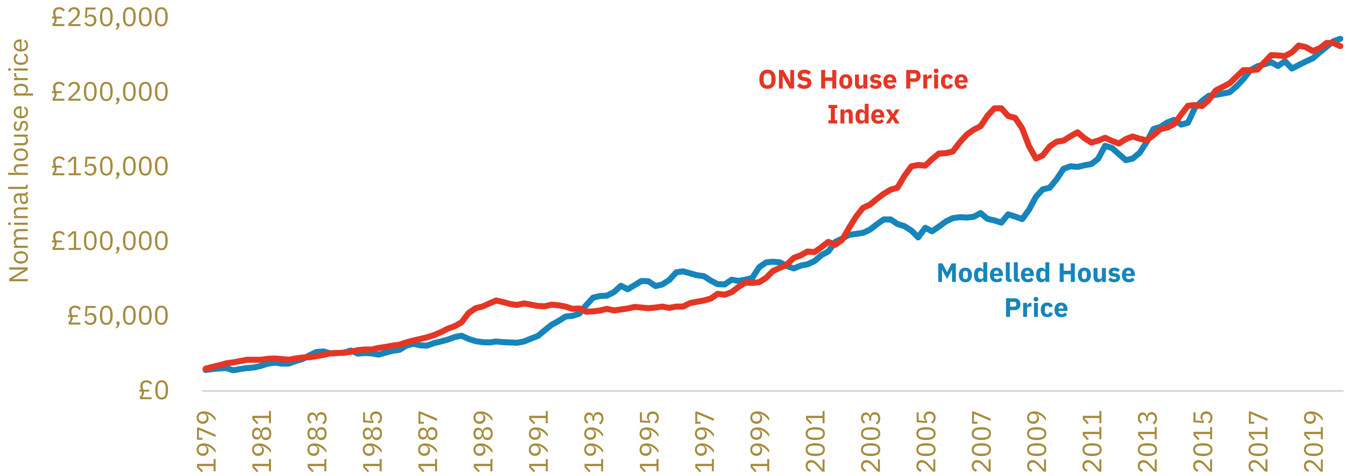
Whatever the reasons, there were signs that housing market activity had increased and the government's dual priorities of home-ownership and housing supply were also increasing. For example, leading housing supply indicators suggested that net additions to dwellings in England had reached 250,000 by the end of 2019. However, the structural issues facing the housing market remained – house prices were still unaffordable to many renters and potential home movers, the London market remained stagnant, housing quality was poor, the private rented sector was insecure and expensive, and the rate of delivery of affordable housing was still slow.

Despite these structural issues, at a national level houses were priced sensibly relative to earnings and prevailing mortgage lending conditions (see Figure 1 below). Some areas of the market may have looked risky but national house prices were not in a bubble as the nation entered the lockdown. Importantly, as we are inevitably heading for recession, it appears that those buying their first home in recent years were typically far better financially positioned than those in the late 1980s and mid-2000s.

There is some comfort in how little evidence there is of a national housing bubble primed to pop. However, the speed and scale of the economic downturn we face is expected to be unparalleled in recent history (NIESR, Capital Economics, EY Item Club). So, whatever the recent past, the risks to the housing market are substantial.

Figure 1: Actual Versus Modelled House Prices, UK

Source: ONS, Bank of England, UK Finance. Model using average earnings, mortgage rate and 75% LTV to calculate price



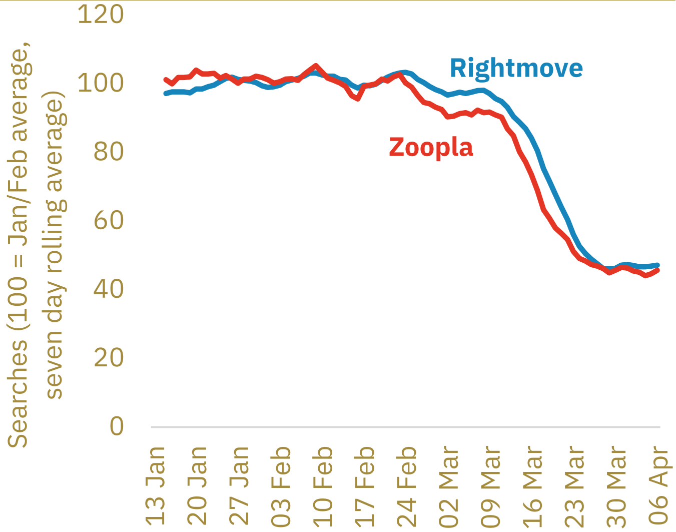
Current confusion

Every day brings small pieces of information about how the housing market is reacting to the lockdown. The situation is in rapid flux and the lag in publicly available data makes it difficult to say definitively what is happening. The most immediate impact of the lockdown was the ban on agents, surveyors, and the public from entering homes. Sales collapsed. Zoopla data shows housing demand down by around 70%, Google Trends data (Figure 2) shows searches for property portals down 50%, and the March RICS sentiment survey reports a net balance of -92% for near term sales expectations. Transactions look set to continue downward over the coming months, possibly taking the annual total below the historic low seen in Q2 2009 (Figure 3). There will still be sales taking place in coming months including some agreed prior to the lockdown and possibly an unfortunate increase in probate sales. Much rests on how long the lockdown lasts and how quickly the market rebounds when it ends.

Technology may help the industry deal with the lockdown better than in the past, but very few people are likely to make the single biggest financial purchase of their life without visiting the home they are buying – assuming they are prepared to buy at all during an economic downturn. Additionally, when relying on desktop valuations, mortgage lenders will lend only at lower loan-to-value ratios, if at all. While we may see a smattering of new listings coming to the market (along with an uptick in amusing amateur photos), it appears likely that the only buyers in the market will be those with ready access to cash and a willingness to buy the property sight unseen with an appropriate price discount for the risk. Willing sellers are likely to be dominated by those who need to sell quickly.

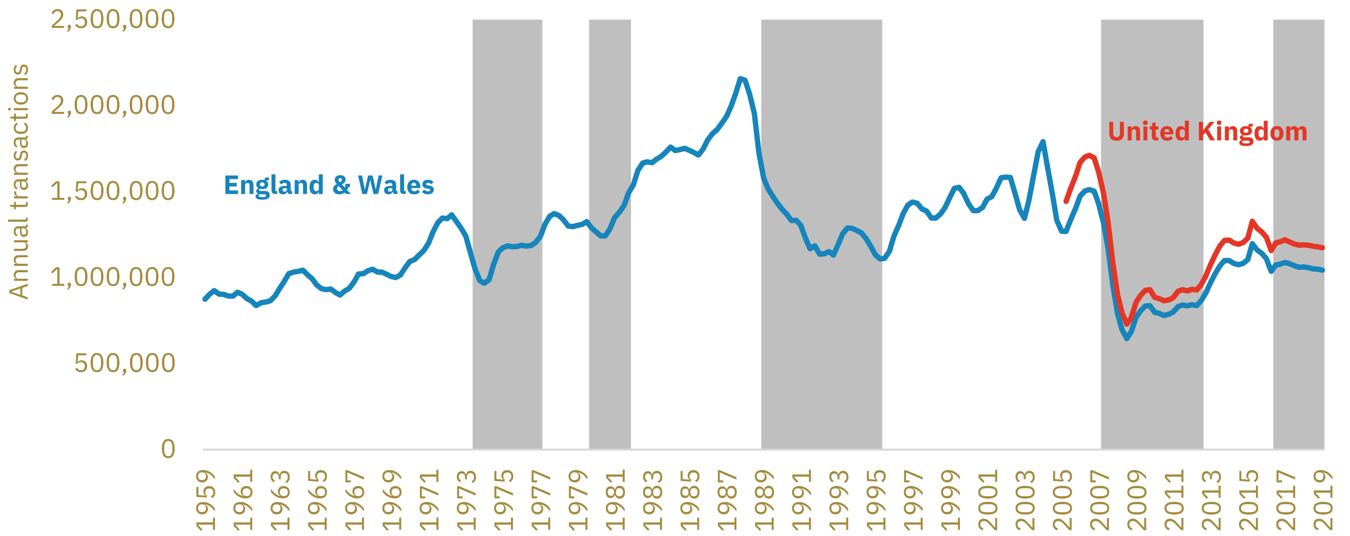
The very low levels of transactions we should expect over coming months will make it difficult to measure house prices accurately, so we might expect the temporary suspension of some house price indices.

Figure 2: Searches for Property Portals
Source: Google Trends



There is the additional challenge that any transactions during the affected period will not be representative, reflecting unique circumstances bringing buyers and sellers to transact. We could, if data is still published, see some substantial price falls (10% or more) reflecting the stressed position of any sellers and the risk appetite of the buyers active during this period. However, these transactions would not necessarily be representative of pricing when activity recovers. Mortgage payment holidays and recommendations that lenders should avoid repossession will help limit distressed sales and any negative impact on house prices. But a very low level of transactions inevitably means a very small number of distressed sellers could have an outsized effect, particularly if they are concentrated in specific locations.

Figure 3: Annual Residential Transactions & Real House Price Downturns
Source: HMRC, ONS



An Uncertain Future

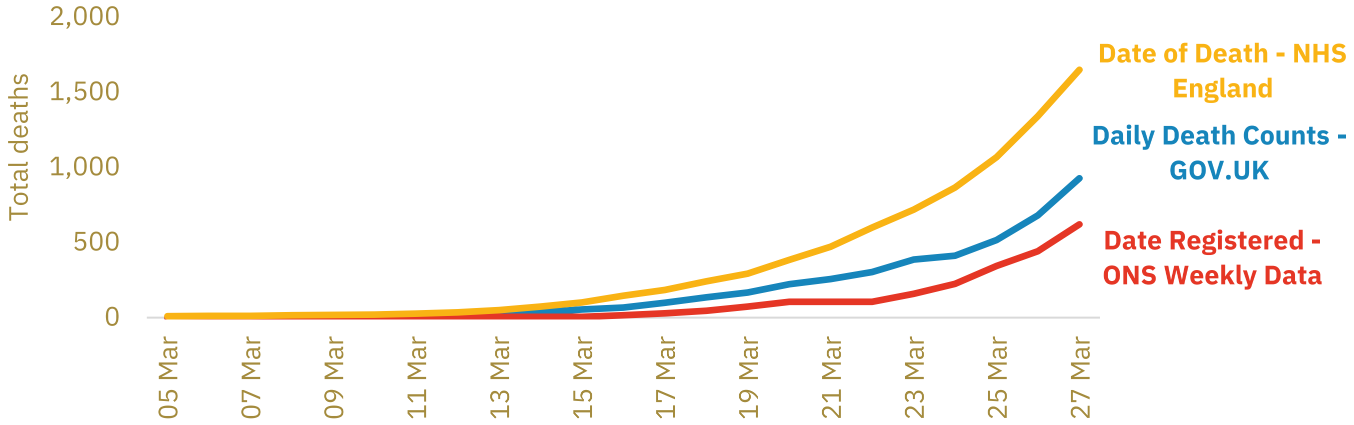
For possibly the first time in recent history, the UK's housing market is not responsible for or directly linked to an economic downturn. Instead, it is the lockdown (a forced suppression of the economy) and the resultant economic crisis that will hit the housing market. Though if the housing market downturn is deep and extended it will impact on consumer sentiment and spending, further depressing the economy. Therefore, an assessment of the likely impact on the housing market relies on knowing the likely length of the lockdown, the path we will take when the lockdown ends (or more likely is eased), and the economic costs that arise during this period.

No one currently knows the answers to these three questions, though there are plenty of forecasts, some better than others. While we can assess the likely trajectory by comparing ourselves to countries where the pandemic hit earlier, even the data available in this country make it difficult to accurately assess the impact of COVID-19. That's before we start comparing ourselves with other countries where testing rates, levels of lockdown, population size and density, and the assessment of cause of death can be very different.

The horror of the situation we are in can only partly be understood through numbers but the reality is the number of people dying during this pandemic highlight both the difficulties is assessing where we are and give us clues as to the responses we might take. The difficulties are highlighted by a comparison of sources on deaths in England involving COVID-19 released by ONS on the 7th April. Some are highlighted in Figure 2 below. The immediate lesson from the data is that the number of deaths published daily are far from a full and timely measure of even deaths in hospital. Meanwhile, the more comprehensive data published weekly by ONS measures the date of registration which can lag the actual date of death by several days or more. This makes judging any peak in the pandemic difficult with the potential to get it wrong in both directions. Therefore, there is still considerable uncertainty about when the lockdown will end and what that end (or more likely easing) will look like. That uncertainty means any economic and housing market forecasts should be treated with a considerable caution.

Figure 4: Comparison of Sources for Deaths Involving COVID-19, England

Source: ONS



Inevitably there is a lot of debate about the likely shape of the economic downturn. Will it be V, U, W or L? A short sharp V-shape is the more optimistic scenario, reflecting the economy (and the housing market) rapidly returning to previous levels of activity following the end of the lockdown. However, this scenario is heavily dependent on the success of government schemes to support jobs and income along with the avoidance of any repeat infections. It seems unlikely that we'll end the lockdown with an immediate return to previous levels of social interaction and hence economic activity. A V-shaped outcome would probably require a vaccine or mass testing programme and so, in the meantime, there will almost certainly be further outbreaks that require some containment measures that reduce economic activity and therefore reduce the likelihood of a V-shaped recovery.

In addition to the more temporary effects on the economy caused by the length of the lockdown and uncertainty about how it will be ended or eased, we have already seen permanent damage to the economy. We are already seeing large numbers of people lose income, savings, and their jobs despite heavy government support. We are already seeing businesses folding. Whatever the shape of the overall economic recovery, for these people the downturn is likely to feel more U-shaped or possibly even L-shaped for the worst affected. The losses they are sustaining will affect their ability to service a mortgage or pay their rent, let alone buy a new home. Meanwhile, there will be others who have seen little or no impact on their financial circumstances. They will be able to afford the same price to buy or rent a home as before the lockdown, though for many buyers this will also depend on the mortgage market recovering to its pre-lockdown state.

It is possible, probably likely, that this crisis will further reinforce pre-existing inequalities within the housing market. Those lucky enough to have the savings and income to buy benefit from secure and affordable home-ownership while the number of those that don't is larger than before the pandemic. They will be stuck in the insecure, unaffordable, often poor quality and over-crowded private rented sector or in homes they own but are too small or inappropriate for their changing needs. If this situation were to occur in the absence of large house price falls then transactions could be permanently lower than even the levels seen in recent years (2014-19 UK average = 1.2million p.a.) and the pre-existing problems in housing magnified.

National house prices were where you'd expect them to be given average earnings and mortgage lending conditions (Figure 1) and, unlike previous downturns, there is no bubble to be popped unless you believe low interest rates are the bubble. However, there is the prospect of much lower earnings and weaker buyer sentiment putting downward pressure on house prices as we exit from the lockdown while much will depend on the scale and timing of the recovery in the mortgage market. Unfortunately, there is a lot that can go wrong during this period and forced sales are always a risk. Looking beyond any temporary adjustments in pricing and transactions during the lockdown period, we'd expect transactions to adjust more than/rather than house prices. However, there is still a very high risk of large price falls due to weaker sentiment, job losses, and lower incomes and available savings. This risk will increase if unemployment remains high, incomes fail to recover, or the lockdown is extended and the economic collapse is deeper. It is also possible that HM Treasury will look much closer at the estimated £5-7trillion of property wealth owned by households when the focus shifts back towards repairing the public finances. The future of the UK's housing market is far from certain.

Market Risks

Looking beyond the broader impact on prices and transactions and there are several areas where the downside risks are more apparent. These are found in the private rented market and the development market where dependence on cashflow will likely be the single biggest common factor amongst those most at risk.

The Rental Market - The problems faced by landlords in the short-term and holiday lettings markets are well documented in the news. Most landlords in the wider private rented sector do not have high levels of debt and this is likely true for many in the short-term lettings market. However, it appears some people are facing difficulties but, in the first instance, they are likely to be geographically concentrated and could lead to higher supply in the local rental market and downwards pressure on rents. A small but welcome relief for renters, a group who are expected to be more heavily impacted by the economic shock.

Given the uncertainty around when the lockdown will end and the global spread of the pandemic, it is unknown when and to what scale international travel will recover. A reduced lockdown in the UK but constraints on international travel could lead to a reversal in fortunes for many short-term lettings landlords with a boom in domestic holidays. However, this would not help the universities and purpose-built student accommodation sector that are very dependent on international students to pay high fees and high rents.

The Development Market – The lockdown will inevitably affect all developers but the impact will vary and be dependent on a range of factors. For smaller housebuilders, much will depend on their luck in where they are in the development cycle, their financial resilience, and their relationships with lenders/investors. Meanwhile, the volume housebuilders should be able to weather this storm with their finances looking robust pre-lockdown while their large margins and the low cost of land should allow them to cope with any minor adjustment in house prices. Their stock market price may suffer, but survival seems reasonably assured for most of the majors at least. The shutdown will inevitably cost them, but their priority will be preserving their labour and material supplies for the eventual recovery. This is why the prevailing model among the major house builders is to build the homes as they sell them. They could also benefit from any government interventions to get the housing market up and running, with the potential for increased investment in sub-market housing tenures to make up for any delay or shortfall in market activity. It seems increasingly likely that the Help to Buy equity loan scheme, or an equivalent, will continue beyond the planned end date.

Of greater immediate concern are those developers focussed on higher-density urban development that require greater initial investment. This includes some housing associations as well as those developers focussed on selling overseas. The debate about whether this pandemic reverses the trend for migration towards urban areas is for another day, but many developers (and their lenders) with schemes currently underway will be keeping a close eye on their existing off-plan sales and any failure to hit agreed timetables. Recent years have shown that the rental market is a useful way to de-risk or quickly exit this market, but the risks discussed above suggest it may not be so easy in the near future. Unsurprisingly, it is highly likely that housing supply will fall well short of government aspirations.