United Kingdom – 2020 Review

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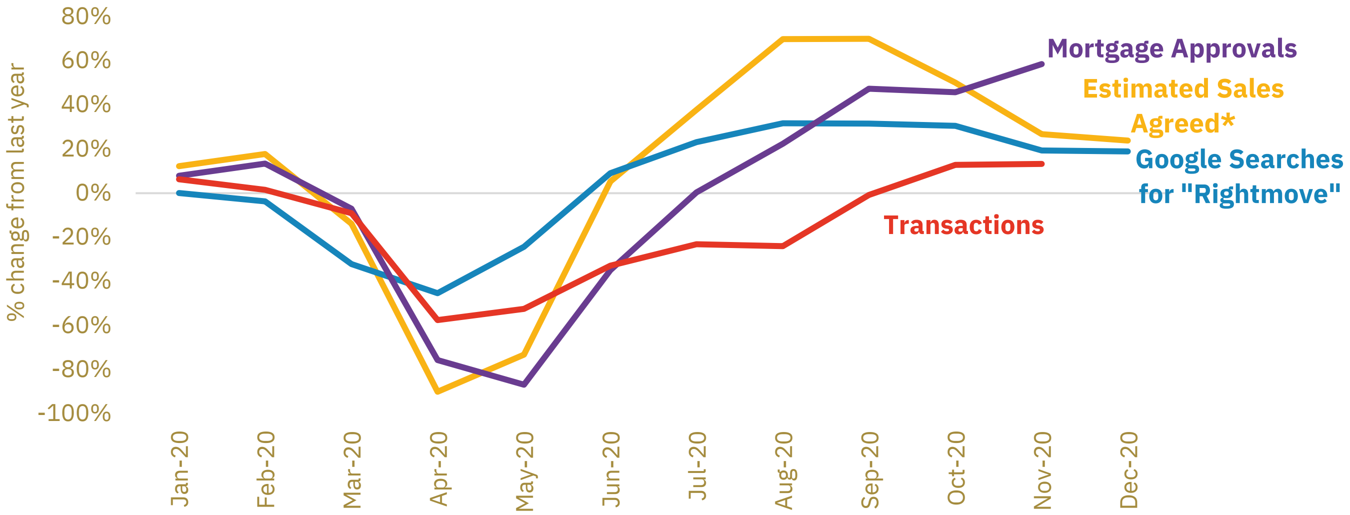
The housing market ended 2020 as it had started, with a boom in activity and prices. However, the rest of the year was rather more volatile thanks to the pandemic, but the much predicted bust never appeared. As we approach the end of the stamp duty holiday in March, there is considerable uncertainty about what happens later in the year. This note provides a brief review of the housing market in 2020 and looks ahead to what could happen next.

Fig 1: UK Housing Market Activity

*Source: Google, Rightmove, Zoopla, Bank of England, HMRC (*based on data reported by both Zoopla & Rightmove)*



The Boris Bounce

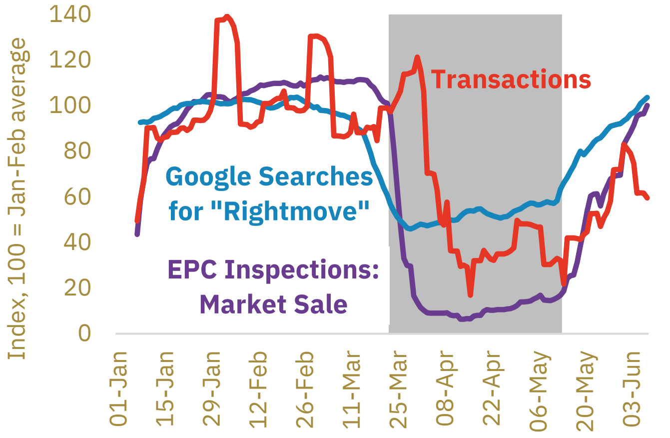
2020 started with tentative signs of a housing boom. After several years of a stagnant housing market, especially in London and the south of England, Boris Johnson's general election victory and promise that Brexit was done had apparently reignited the market. Early indicators of market activity including sales agreed and mortgage approvals for house purchase were higher in February than previous years (Fig 1). The increase in activity was also replicated in house prices, with indices reporting faster growth in March (Fig 3) than seen in recent years. However, the rise in house prices was also reported by the ONS index which is completion based. This suggests the boom had started prior to the general election and so perhaps it couldn't all be thanks to one person.

Lockdown

The housing market boom looked set to continue into the spring despite the weakness of the wider economy, but growing concerns about the pandemic began to have an effect. The lockdown was announced on the 23rd of March and activity levels collapsed as the housing market was shutdown. For example, Fig 2 opposite shows the collapse in Energy Performance Certificate (EPC) inspections. However, there were signs that buyer interest and activity had fallen in the week or two before the official announcement as public concerns about the pandemic rose. Despite the lockdown some activity continued, with transactions agreed prior to lockdown still reaching completion, but this period marked the first time the housing market had effectively been closed for business in recent memory.

Fig 2: Weekly Market Activity

Source: Google, MHCLG, HM Land Registry



Market Commentary

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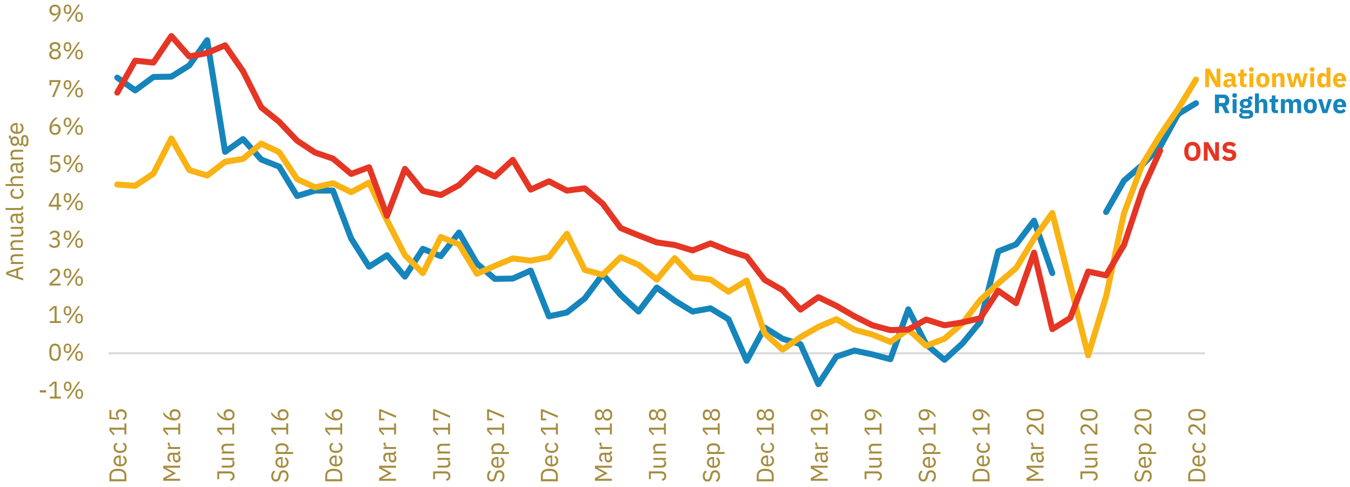
Market Reopening

The housing market in England reopened for business on the 13th of May. The reopening caught many unaware, including MHCLG. They had intended to announce it the following day but were undone by the publication of amendments to legislation allowing the market to restart. An announcement was rushed through that evening and the issue was soon forgotten as the market bounced back. In the weeks following the reopening, there were clear signs of strong interest as activity on property portals increased and estate agents reported rising buyer numbers.

Despite the strong interest from potential buyers, it was not immediately clear where pricing would resume when the market reopened. Some house price indices had been suspended during lockdown though the Nationwide index continued to publish data suggesting weak sentiment amongst their valuers, with the annual change in prices eventually falling negative in June (Fig 3). There had been some market chatter suggesting large discounts had been achieved during lockdown from forced sellers and there was also an ongoing credit crunch primarily affecting higher loan-to-value mortgages, which was unsurprising given the challenges in undertaking a physical valuation during lockdown and the potential risks still facing the housing market. Meanwhile, large parts of the economy remained locked down with many people still furloughed. In the end, many of those looking for a bargain will have been disappointed as the market rebounded faster and stronger than had been expected.

Fig 3: Annual Change in UK House Prices

Source: ONS, Nationwide, Rightmove



The Crash That Never Happened

The housing market was widely expected to crash when the pandemic hit but confounded many forecasters by refusing to do so. As the economic impact of the lockdown became clearer and the scale of the recession was realised, there was considerable concern and numerous forecasts for a house price crash. However, as we noted in April, for perhaps the first time in the last fifty years the housing market wasn't directly responsible for, or implicated in, the recession. Unlike previous recessions, national house prices were appropriately priced when considering average wages and mortgage rates. Tighter regulation of mortgage lending meant there were few of the signs of stretched borrowing amongst recent buyers that are typically seen before a crash. Although some parts of the housing market did look risky, there was no house price bubble ready to pop. However, the market still faced considerable risks from the economic fallout of the pandemic but was supported by government policies such as furlough and mortgage payment holidays.

Housing Inequality

Another contributing factor to the lack of a house price crash is the widespread inequalities in housing. As we have repeatedly warned, the pandemic has further reinforced the existing inequalities in the housing market. The evidence that has emerged since the beginning of the pandemic shows that younger and lower income people have been most affected by the economic consequences. Unfortunately, the housing market only works for those that are able (and willing) to transact in it, and many of those most affected by the economic fallout are the ones unable to access the current market. Some of them are stuck in the insecure, unaffordable, often poor quality and over-crowded private rented sector, and this includes large numbers of prospective first-time buyers due to the ongoing credit crunch. Meanwhile, others are stuck in homes they own but are too small, inappropriate for their changing needs, or unable to sell due to cladding or leasehold issues. Many other households have been financially unaffected by the pandemic and even seen their savings increase thanks to less spending (see Fig 5). These are the people that have kept the housing market moving in 2020 and could do so in 2021.

Market Commentary

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Stamp Duty Holiday

The strong rebound in the housing market following its reopening was already apparent in multiple data sources when the Chancellor announced a stamp duty holiday for properties up to £500,000 on the 8th of July. The Chancellor referenced the fall in house prices reported by Nationwide in June and low transaction numbers in May when highlighting the need to "catalyse the housing market and boost confidence". However, by the time of his announcement, these data points were out of date and both Rightmove and Zoopla had already reported the number of sales agreed were back to normal levels and house prices were still rising. Not only was the timing of the announcement somewhat strange but its approach was too. It was broadly targeted at increasing all activity and narrowed the difference in the stamp duty payable between prospective first-time buyers and investors. There are some suggestions that HM Treasury was forced into announcing the stamp duty holiday thanks to a leak to the press by Number 10, as delaying the announcement would've been disastrous for the market. With the added fuel of a stamp duty holiday, the housing market was now running hotter than a typical British summer.

The Race For Space

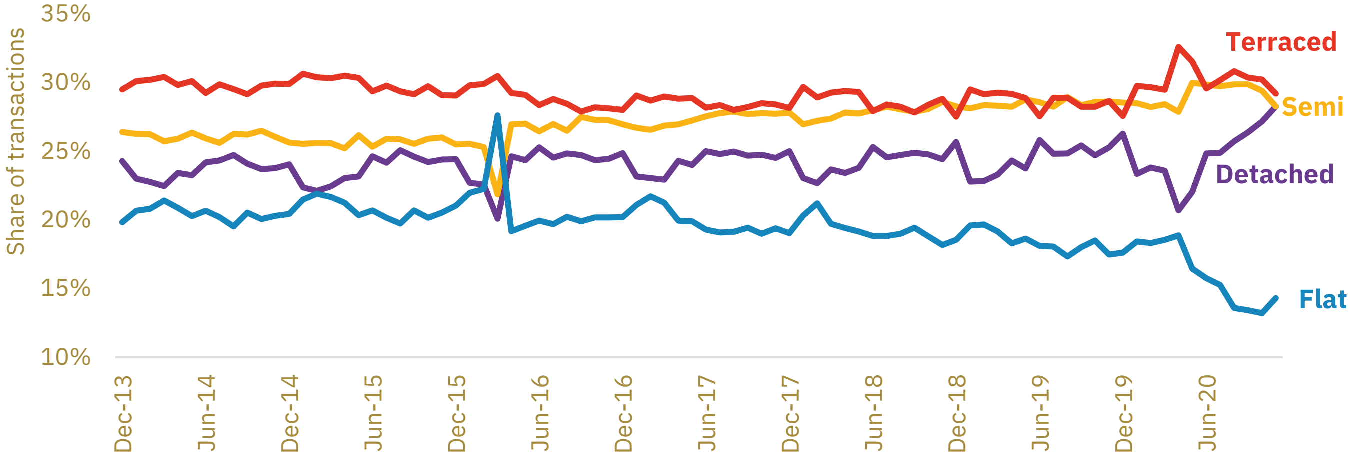
As the summer progressed, it became clear that there were very large numbers of people looking to move house, with several possible reasons for why they were doing so. The first reason was the backlog of demand that had been suppressed while the housing market was closed. As noted earlier, the market had started 2020 with higher levels of activity than seen in previous years, When the market closed in March, there were many frustrated buyers, some with transactions already underway. As the market reopened, some of these transactions resumed and buyers returned to the market. It is possible that the entire market bounce since the summer is just the backlog in demand, as most activity measures (Fig 1) suggest total numbers across 2020 were similar to 2019.

The backlog in demand could explain the high levels of market activity since the summer but, despite the poor timing, it is clear that the stamp duty holiday has helped to increase activity. There have been reports suggesting higher levels of activity around the £500,000 threshold and investors taking advantage of the reduced tax (though they're still liable for the 3% additional rate). The impact of the holiday should be clearer as we approach and pass the deadline for its end. We've previously looked at what happened to historic tax booms and cliff edges.

There is another reason why market activity has been so strong since the market reopened: "the race for space". The pandemic and its repeated lockdowns have led to a mass re-evaluation of housing. People stuck at home during lockdown have realised their existing home does not meet their needs and so have decided to move (possibly incentivised by the stamp duty holiday). For example, those without outside space have been disadvantaged during lockdowns and so, for those able to afford it, interest in properties with gardens has increased while interest in properties without has decreased (see the fall in market share of flats in Fig 4 below).

Fig 4: Share of Transactions by Property Type, England & Wales

Source: HM Land Registry (the three most recent months may be subject to large revisions)



For many people during lockdown, their home has also had to evolve to cope with rapidly changing needs. It is no longer just a home but a place for work and education. That has led to a reassessment of the space a home offers and the value of that space. A spare room or shed that can be used as an office is no longer an added extra but a necessity. The pandemic has also lead to a reassessment of location, especially where commuter access to employment centres was a key driver of value. Working from home, at least for some of the week, is now a reality for many more people than before the pandemic. Lots of these people are now willing and able to live further from their place of work. It is not yet clear how many of these changes will be permanent but the housing market could see diverging paths for places and homes where people want to live compared to those where people have to live.

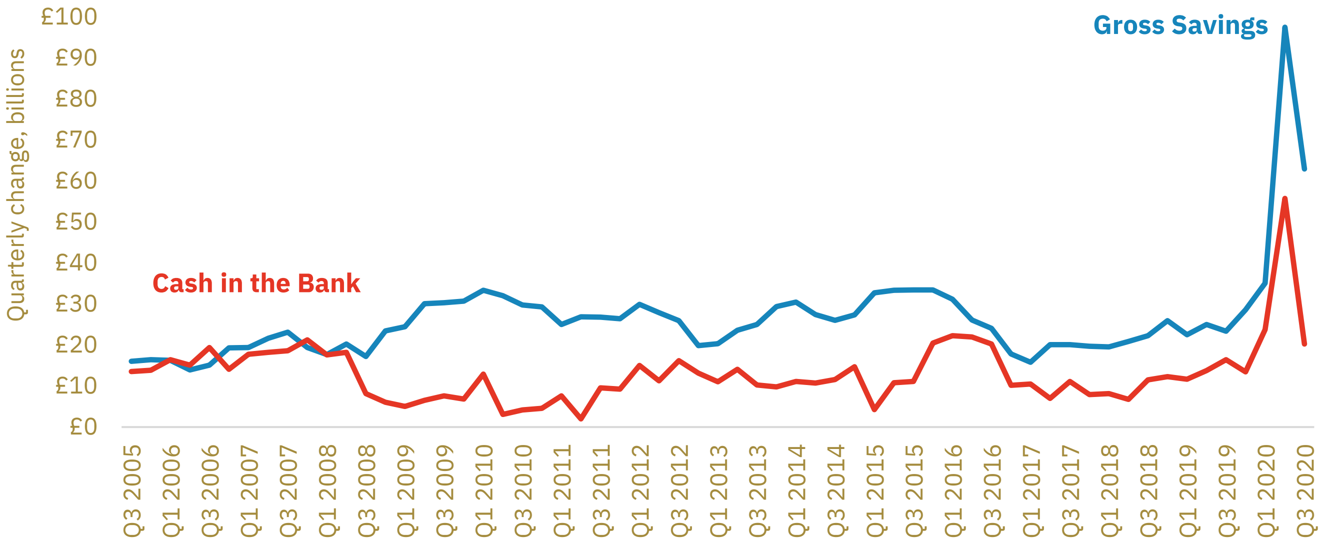
What Happens Next

The housing market in the first quarter of 2021 looks set to continue on from 2020 but there is considerable uncertainty about what happens from April. The end of the stamp duty holiday; changes to the Help-to-Buy equity loan scheme; the 2% surcharge on overseas buyers; the ongoing credit crunch; the continued pandemic and repeated lockdowns; the end of government support for the economy; and the impact of Brexit all point to considerable downside risk for the housing market in 2021. However, there are some potential drivers of a continued boom with the potential for the race for space to continue beyond March and the prospect of some return to normality thanks to the vaccination programme.

Perhaps the biggest unknown in the housing market is that we still do not know the relative balance between the different drivers of the higher demand seen since the summer. It is clear that both the backlog in demand created during the first lockdown and the stamp duty holiday have played a part in driving both activity and prices higher but it appears the race for space has also been significant. With a large pipeline of sales trying to complete before the end of the stamp duty holiday, it appears likely that many transactions will miss the deadline. What happens to those sales following the end of the holiday could provide some clarity on which of the drivers of demand is more significant and hence what happens to the housing market during the rest of 2021.

The end of the stamp duty holiday will inevitably lead to a spike in completions in March that falls away in April but it is worth noting that average house prices have now risen by more than the value of the tax cut. Although the tax will have to be paid from equity unlike rising prices which can be paid for with debt, it's possible that many prospective buyers that do not complete during the holiday will choose to press ahead with their transaction rather than return to the market. Meanwhile, data from the ONS and Bank of England on household savings (Fig 5) highlights the aggregate scale of savings during the pandemic, and Resolution Foundation research shows that higher income households are more likely to have increased their savings since February 2020. These households could continue to support the higher levels of activity and prices seen since the housing market reopened in May despite a higher tax rate and other challenges facing the market.

Fig 5: Quarterly Change in Household Savings
Source: ONS, Bank of England



The future of the housing market in 2021 is far from certain and the range of possible outcomes is perhaps the widest it has been in over a decade. There are considerable downside risks and so this year could be when we see the crash widely predicted last year. However, there's an equally likely probability that we see the boom continue through to the end of the year and prices end up hitting new highs thanks to the race for space and increased demand from higher income buyers. Or perhaps the market will remain at lower levels of activity following the end of the stamp duty holiday with prices stagnating. Any honest forecast for what might happen this year should include a number of scenarios but perhaps the most likely outcome is a combination of all three. Locations and property types that appeal to buyers with wealth and the ability to live and work where they choose continue to experience a boom. Meanwhile, those locations and property types that have seen a collapse in demand due to falling incomes and rising unemployment see a price correction driven by falling rents. And a range of outcomes for all the other locations somewhere in between the two.