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Cash in retreat?

by Bob Pannell, Economic Adviser to IMLA

For several years, the amount of house purchases funded by cash has served as a useful inverse proxy for the health of mortgage lending.

The surge in cash to about a third of housing transactions following the global financial crisis echoed the efforts by firms at the time to rein back their mortgage lending. Subsequently, from about 2014 onwards, the reliance on cash has nudged lower, which fits with the progressive recovery in lenders' risk appetites and more intense competition for business.

But the popularity of cash has fallen sharply over the past two years. And this presents something of a puzzle.

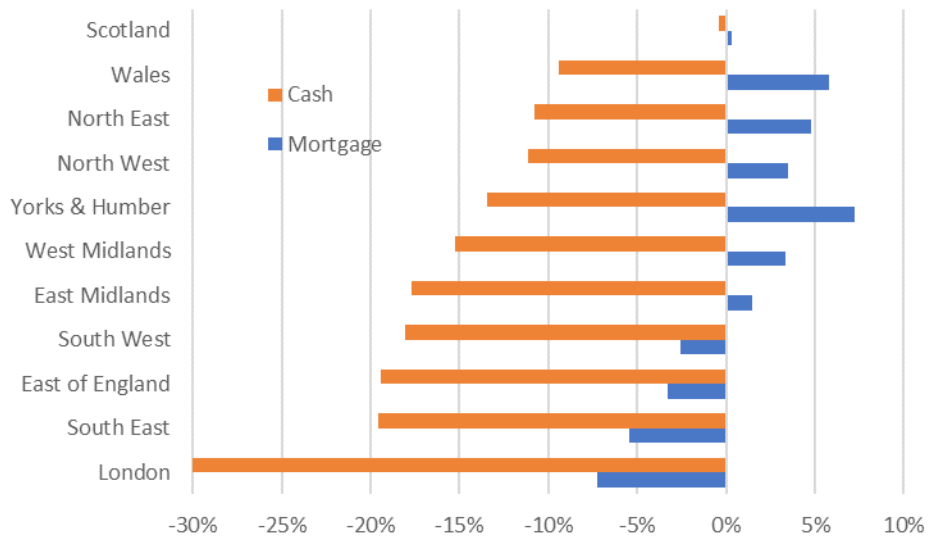
At this juncture, I should point out that we don't really know very much about cash buyers – who comprise an eclectic mix of investors, those buying second homes or holiday homes and (mainly) older households downsizing to smaller or at least cheaper homes. This means that there is an important gap in our understanding of the wider housing market.

One of the things we do know is that the geography of cash is really interesting. The South West accounts for the largest share of cash purchases (perhaps reflecting its attractiveness as a holiday destination). Meanwhile, London has the smallest proportion of cash buyers. If this seems a little surprising, the explanation lies in the large and diverse nature of the capital – about half of purchases in prime London are cash-based (reflecting the narrow focus of many overseas buyers), but interest falls away significantly elsewhere and barely a tenth of purchases in Barking & Dagenham are cash-based.

Back to that recent sharp decline in the popularity of cash.

This is not a case of mortgage firms regaining further market share from cash. Loans for house purchase have more or less stagnated, whilst the absolute volume of cash purchases has fallen away sharply – by nearly a fifth - over the past two years.

Chart: How cash and mortgage transactions have changed



Source: Office for National Statistics
Note: Figures based on purchases in 12 months ended July 2019 compared with two years earlier

As can be seen from the chart, cash's retreat appears to be confined to England and Wales but applies across all its regions. That being said, London has seen by far the steepest decline – about 30% - followed by the rest of southern England and the Midlands.

It is clear that some of the decline reflects a more general softness in activity associated with intense affordability pressures and high transaction costs in the south of the country. Over and above such effects, price falls in and around the capital may have limited opportunities to extract housing equity or discouraged owners from selling/trading down and investors from buying.

So, what of the future?

We have to be careful when interpreting the most recent monthly official figures, because there can be significant lags in the reporting of transactions.

At a broad level, cash-funded activity echoes the performance of the buy-to-let sector, where tax and regulatory changes have depressed purchase activity for some time. Landlords may have seen the worst of the hit from such changes, with both IMLA and UK Finance anticipating a steadier market this year and next.

London may also serve as a useful bellwether for cash-based purchases. Over recent months there have been definite signs of buyer interest stirring for home ownership and private rental.

While it makes sense to see the details of the March Budget before calling the market, the ingredients appear to be falling into place for a modest 2020 upturn in both cash transactions and the wider housing market.