Market briefing: December 2020

Key developments in the housing and mortgage markets

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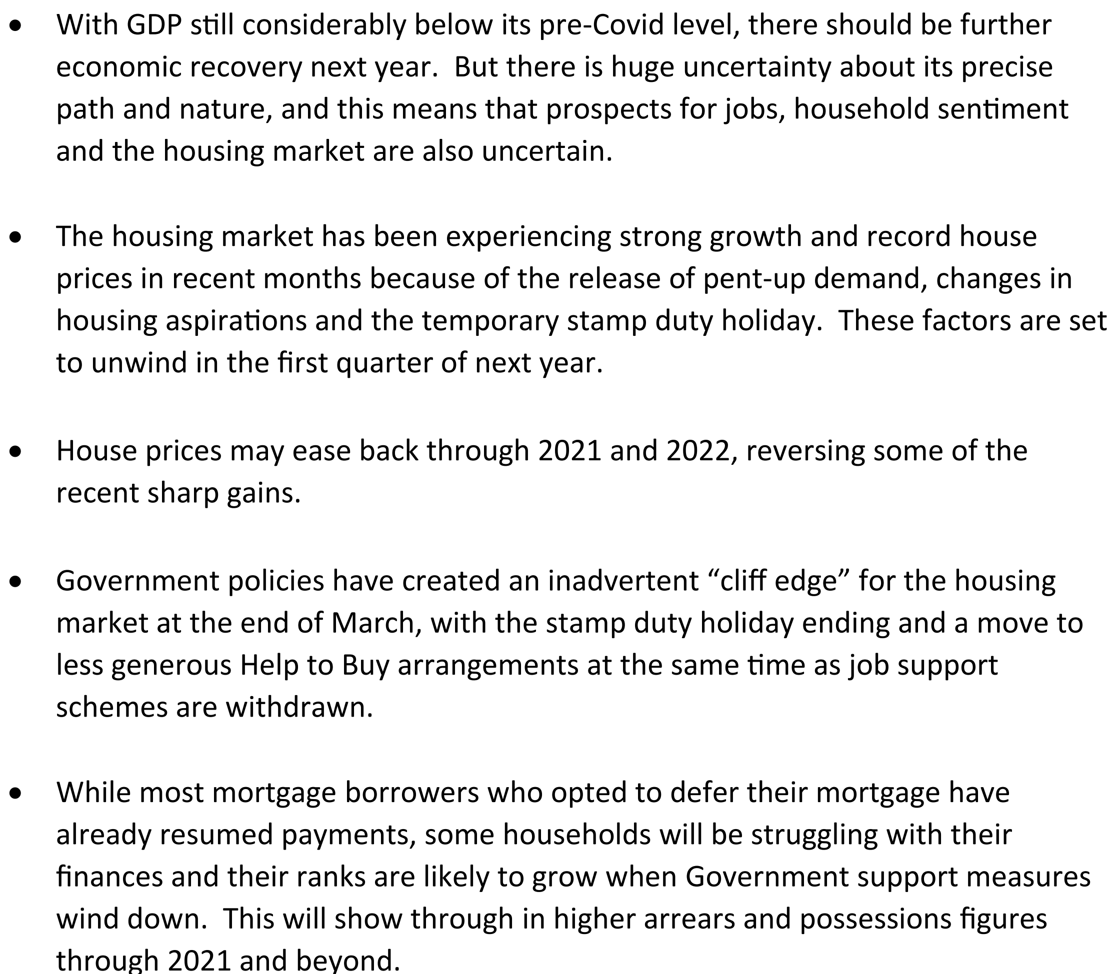
Executive Summary



- With GDP still considerably below its pre-Covid level, there should be further economic recovery next year. But there is huge uncertainty about its precise path and nature, and this means that prospects for jobs, household sentiment and the housing market are also uncertain.

- The housing market has been experiencing strong growth and record house prices in recent months because of the release of pent-up demand, changes in housing aspirations and the temporary stamp duty holiday. These factors are set to unwind in the first quarter of next year.

- House prices may ease back through 2021 and 2022, reversing some of the recent sharp gains.

- Government policies have created an inadvertent “cliff edge” for the housing market at the end of March, with the stamp duty holiday ending and a move to less generous Help to Buy arrangements at the same time as job support schemes are withdrawn.

- While most mortgage borrowers who opted to defer their mortgage have already resumed payments, some households will be struggling with their finances and their ranks are likely to grow when Government support measures wind down. This will show through in higher arrears and possessions figures through 2021 and beyond.

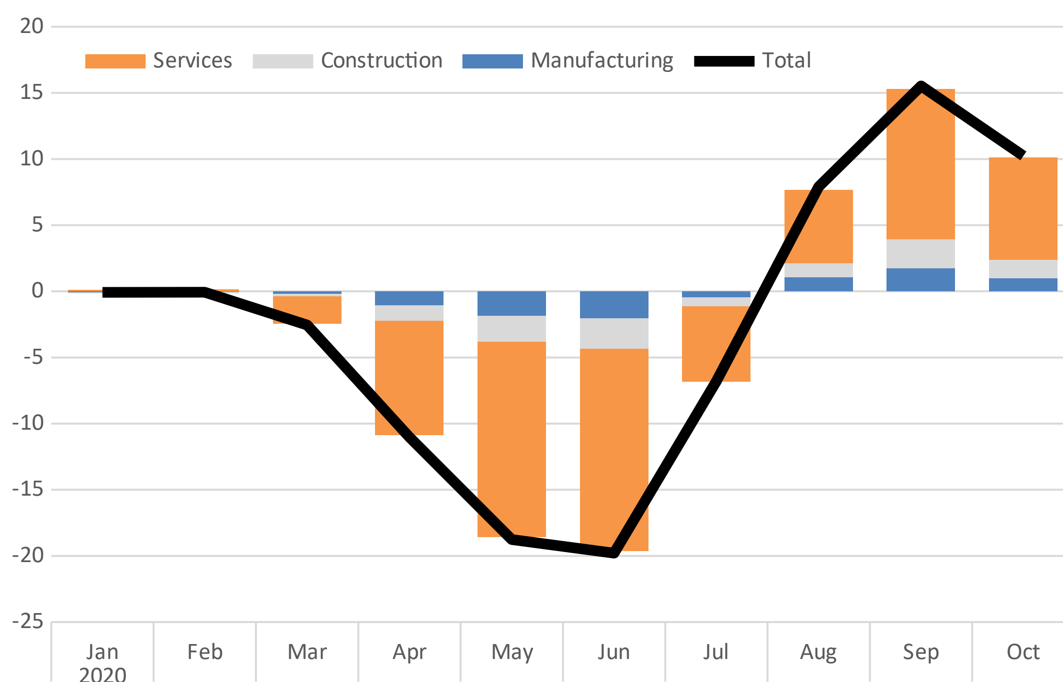
The Economy

The UK economy faces strong headwinds, because of the ongoing Covid-19 pandemic and EU trade uncertainties.

With our recovery from the first Covid-19 wave already showing signs of faltering, it is no surprise that the latest ONS figures confirm that this autumn's second wave has derailed progress further.

Monthly GDP grew by 0.4% in October 2020 – the sixth consecutive monthly increase but also the weakest, raising fears that the economy may be broadly flat or weaken a little during the fourth quarter.

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

There is no disguising that this is a disappointing performance. Output has not fully recovered from the record falls seen across March and April 2020 and is still 7.9% below the levels seen in February 2020, before the full impact of the pandemic. No surprise then that 2020 will be one of the worst years on record.

That said, until recently, there has been progress in slowing the upward trend in Covid-19 infections at the national level during this second wave and we have also seen huge strides made in developing vaccines and other treatments.

This suggests that we can look forwards with a degree of optimism that economic activity will rebound relatively sharply through 2021 and beyond.

The precise path and nature of that recovery will, of course, be key to prospects for jobs and the housing market.

While the consensus view of private sector economists is for growth of about 6% next year, it is worth noting that there is considerable uncertainty ahead. The Office for Budget Responsibility (OBR) itself has three growth scenarios for 2021, ranging from about 2% to 11%, together with a caveat that up to 2% might be trimmed off prospects should Brexit negotiations end without a deal.

Government action

Government policy continues to be at the mercy of Covid-19.

In late September, Rishi Sunak outlined plans in his *Winter Economy Plan* to move away from blanket support policies to less generous work subsidy arrangements. Such plans quickly lost relevance as lockdown measures intensified across the country, giving the Chancellor little option but to make an eleventh-hour U-turn with respect to ending the Coronavirus Job Retention Scheme (CJRS) and Self-Employment Income Support Scheme (SEISS) from the end of October.

CJRS will now run until the end of March with employees receiving 80% of their current salary for hours not worked (although employers will have to cover National Insurance and pension contributions). The CJRS extension will be reviewed in January to examine whether the economic circumstances are improving enough for employers to be asked to increase contributions. The Job Retention Bonus (JRB), the purpose of which had been to encourage employers to keep people in work until the end of January will not now be paid in February.

Similarly, support for millions more workers through SEISS will continue, with a third grant covering November to January calculated at 80% of average trading profits, up to a maximum of £7,500, and a further grant to follow covering February to April.

These measures provide much-needed support for many households and businesses over the coming months, but a critical issue will be how the UK copes with their planned unwinding from the end of March. It seems likely that some less generous and/or more targeted job support measures will persist beyond then, but much will

depend upon whether we see fresh waves of Covid-19 and how quickly vaccination programmes allow the UK to normalise.

Government largesse does not come cheap. The extension of the furlough and self-employed schemes through to next spring itself cost more than £25 billion!

The latest central forecast from the Office for Budget Responsibility (OBR) is for a public sector deficit this year of £394 billion (19 % of GDP), its highest level since the Second World War.

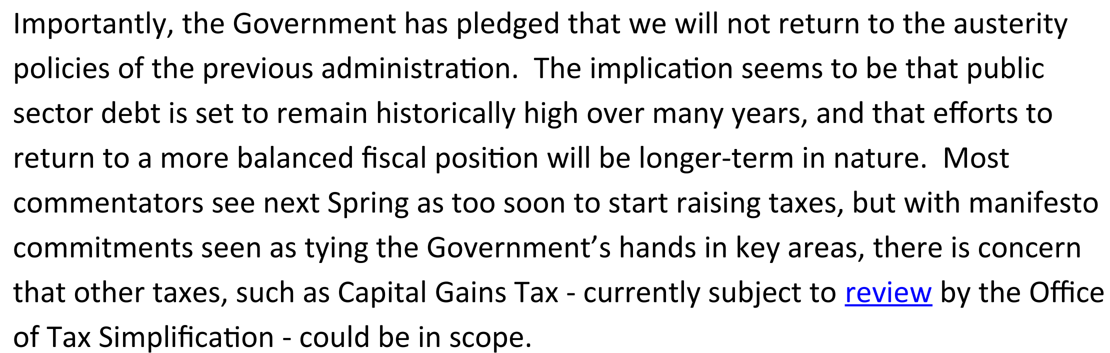
Spending Review 2020: housing measures

Review confirms nearly £20 billion in multi-year capital investment to underpin the government's long-term housing strategy. This includes £7.1 billion over the next four years for the National Home Building Fund and £12.2 billion for the Affordable Homes Programme.

New money seems to have been limited to an additional £100 million in 2021-22 to support housing delivery and regeneration, including unlocking brownfield sites, regenerating estates and releasing public sector land for self and custom builders. This adds to the £400 million Brownfield Fund announced in the March Budget.

Green Homes Grant voucher scheme – under which homeowners can apply for up to £5,000 to make their homes greener - extended with £320m allocated for 2021-22.

Local Housing Allowance, which helps tenants on benefits pay their rent, to be frozen in cash terms from next year. Rate had been increased in April 2020 to help renters whose incomes had been affected by the pandemic cover the lowest 30% of local market rents, but will fall back below this threshold over time.



Importantly, the Government has pledged that we will not return to the austerity policies of the previous administration. The implication seems to be that public sector debt is set to remain historically high over many years, and that efforts to return to a more balanced fiscal position will be longer-term in nature. Most commentators see next Spring as too soon to start raising taxes, but with manifesto commitments seen as tying the Government's hands in key areas, there is concern that other taxes, such as Capital Gains Tax - currently subject to review by the Office of Tax Simplification - could be in scope.

November's Spending Review proved to be a watered-down single year settlement. Although it made references to the Government's levelling up and climate change agenda, the review mainly served to highlight the economic damage that Covid-19 has wrought. A few housing-related take-aways are shown in the boxed section.

The Bank of England continues with a range of strong actions to limit the economic fallout from the coronavirus crisis. It announced a further £150 billion of quantitative easing (QE) in early November. This means that total QE is eventually set to reach £895 billion. Most recently, it has extended the Term Funding Scheme with additional incentives for SMEs - its cheap short-term funding for banks – by a further six months.

Total QE actions post-Covid amount to £460 billion, comfortably matching the expansion of public sector spending. This provides a significant benefit to the Government with respect to its short-term debt-servicing costs but does introduce concerns about the monetary financing of deficits and the potential longer-term risk to price stability.

With much of its immediate firepower spent, the Bank is reviewing the scope for negative policy rates, as used by the European Central Bank and in a small number of countries including Denmark, Sweden, Japan and Switzerland. This is an area to watch, although unlikely to directly impact the retail sector.

Households

With knee-jerk tax measures to repair the fiscal black hole seemingly ruled out by the Government, a key issue for household sentiment is the state of the jobs market and what happens when furlough and other support arrangements end in March.

Consumer confidence has been badly buffeted and brought to a low ebb by measures to address Covid, and by the two national lockdowns. GFK's consumer confidence index dropped to its lowest level since the spring after the government imposed a month-long lockdown in England in November. While recent positive news about vaccines should have lifted the national mood, unease about a possible third wave and the economic and personal financial situation is likely to persist into the spring.

Labour market conditions have deteriorated over the course of the Covid pandemic.

But the headline unemployment rate - now 4.9% - by no means tells the full story, because these figures are flattered by generous Government support schemes and higher numbers not actively seeking work (for example, because of poor health or caring responsibilities).

Payroll numbers provide a clearer labour market indicator and are 819,000 less than before the pandemic. Redundancies, meanwhile, have hit a new record high of 370,000, partly in the expectation that the furlough scheme would close at the end of October.

It is not all bad news, however. Vacancy rates, hours worked and rates of pay have all picked up noticeably from their early-mid year lows.

Housing market

Activity and prices

Two factors have fundamentally shaped the housing market this year: Covid-19 and the stamp duty holiday announced in July (see table)

Stamp duty holiday summary

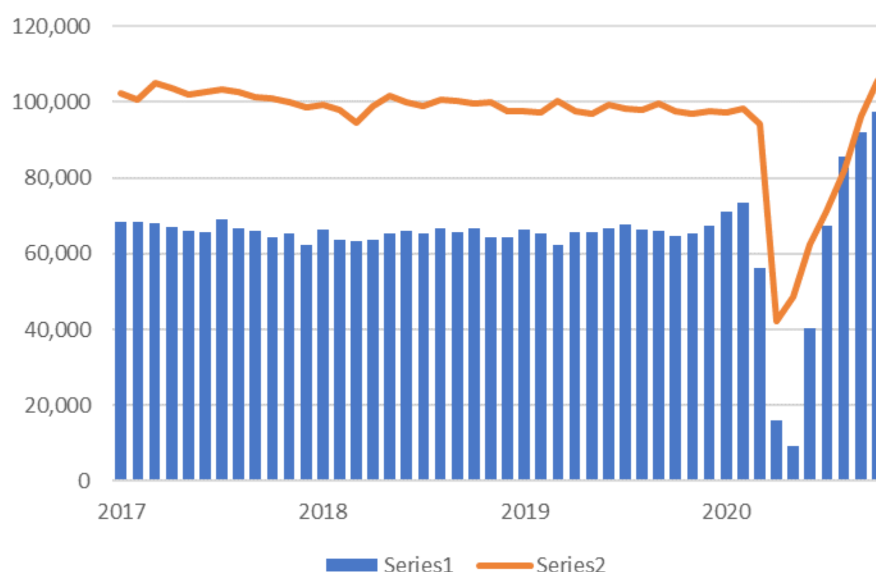
	England	Wales	Scotland	Northern Ireland
	Stamp Duty Land Tax	Land Transaction Tax	Land & Buildings principal Transaction Tax	Stamp Duty Land Tax
Nil rate band, up to:	£125,000	£180,000	£145,000, (£175,000 for FTBs)	£125,000
Temporary increase in nil rate band, up to:	£500,000	£250,000	£250,000	£500,000
Maximum saving	£15,000	£2,450	£2,100 (£1,500 for FTBs)	£15,000
Eligibility	All purchasers	Main home purchase only	All purchasers	All purchasers
Median house price, 2020	£247,000	£162,000	£160,000	

Source: HMRC; Scottish and Welsh governments; Acadata Limited (median house prices)

Demand has surged following the re-opening of national housing markets from mid- to late-May, reflecting both the release of pent-up demand and a reappraisal of housing needs because of lockdown. The temporary cuts in residential stamp duty until the end of March 2021, also appear to have been an important catalyst, especially in England, where the greatest potential savings is to be made and where all purchasers, including landlord investors and those buying second homes, are eligible.

Stronger demand since mid-year has now begun to feed through into a greater volume of mortgage offers and higher sales.

Chart 2: Housing sales and loan approvals, UK, seasonally adjusted



Source: HM Revenue & Customs, Bank of England

Residential transactions rose 8.1% year-on-year to 105,630 in October, figures from HMRC show. This was the highest number completed this year and the strongest performance since March 2016 (another month affected by stamp duty changes). It was also the first time since January that all nations of the UK have posted year-on-year increases in activity.

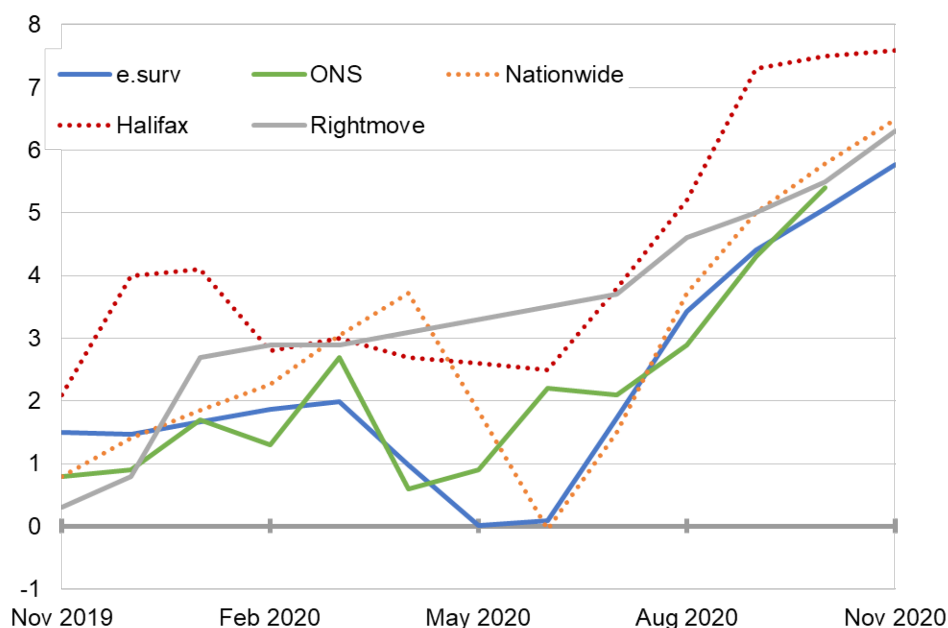
The year-to-date total is still nearly a fifth lower than the same period a year ago so, even with strong figures for November and December, overall sales for 2020 are unlikely to match those in 2019.

With something of a "mini boom" since the housing market re-opened, higher, indeed record, house prices have been reported during the second half. Although regularly published metrics report prices at different stages of the home-buying process and with varying lags, the broad consensus appears to be that UK house price inflation will peak in the 7%-8% range.

With early signs that demand may be easing, a key question for the industry is whether this pick-up in prices – the strongest in more than four years - will ebb away gently or in more dramatic fashion.

A sharp correction cannot be fully discounted, not least because several negative factors are set to come together to create something of a "cliff edge" for the housing market at the end of March.

Chart 3: Comparison of house price metrics



Note: Figures for e.surv are for England & Wales only

Stamp duty measures always tend to be associated with market disruption, as people bring forward purchases ahead of unfavourable tax changes or, as in this case, the end of a tax holiday (so-called “forestalling”). Back in the summer, the OBR estimated that the current stamp duty holiday would 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. The impact may turn out to be larger than this, given subsequent buying behaviour.

The end of March is also when the new and more restrictive Help to Buy Equity Loan Scheme kicks in, and this is widely expected to halve such sales going forwards.

Even more importantly, the Government’s furlough and self-employed schemes are scheduled to end, as well as the opportunity to defer mortgage payments. The risk then is that valuable market props are taken away, precisely when the labour market and household confidence weaken.

Another issue is that an exceptionally large number of potential buyers are in the pipeline, while surveyors, conveyancers, local authorities, mortgage lenders and other firms involved with home-buying are still operating with restricted capacity because of lockdown and tiering arrangements. Bottlenecks and delays seem inevitable for some, and there is a growing risk that some purchasers will not be able to complete by end-March.

The Government has been lobbied on this point, but so far appears unwilling to show flexibility with respect to the stamp duty deadline.

Consequently, market sentiment may become progressively less positive during the first quarter, as the chances of agreeing and concluding a sale by the end of March fall away sharply, housing chains break down or would-be purchasers seek to negotiate price reductions with vendors. This in turn could reinforce a developing trend amongst valuers to down-value properties.

The central view of the OBR is for house prices to fall back by 8% next year, driven by end of the stamp duty holiday and the hit to household incomes from the labour market adjustment that it assumes will follow the end of Government support schemes. While we would not attach too much weight to specific numbers, given current uncertainties, it does seem plausible that house prices could weaken through much of 2021 and 2022, reversing at least some of the sharp gains seen over recent months.

Mortgages

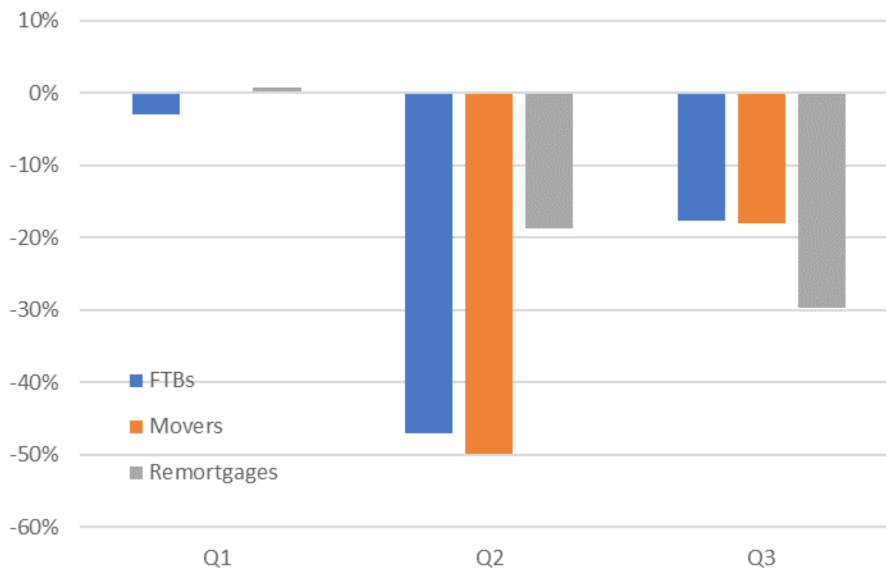
Mortgage lending activity has reflected the wider fortunes of the housing market, with nearly all types of lending adversely impacted by the Covid-19 pandemic. Product transfers have been the exception, with volumes closely matching year-earlier levels and the value of business on course to nudge higher than last year's £169 billion.

House purchase approvals have recovered strongly from their record low in May, exceeding 90,000 in September and October for the first time since 2007. There were 97,532 mortgage approvals in October 2020, 50% higher than a year ago and the first time the value has topped £20 billion.

Despite remortgage activity falling away sharply in the third quarter – in part because of the ongoing shift towards product transfers - gross mortgage lending has picked up noticeably in recent months and is back to year-earlier levels. The rolling 12-month total has bottomed out at about £240 billion but is likely to have built on this over November and December to end the year just 6-7% below 2019.

Total mortgage lending including product transfers looks set to end 2020 only about 4% lower than last year, a remarkable achievement in such a tumultuous year.

Chart 4: Number of mortgages, % change year-on-year



Source: UK Finance

First-time buyers

There has been considerable media comment on the difficulties facing would-be first-time buyers, because of the dearth of low deposit mortgages and rising house prices.

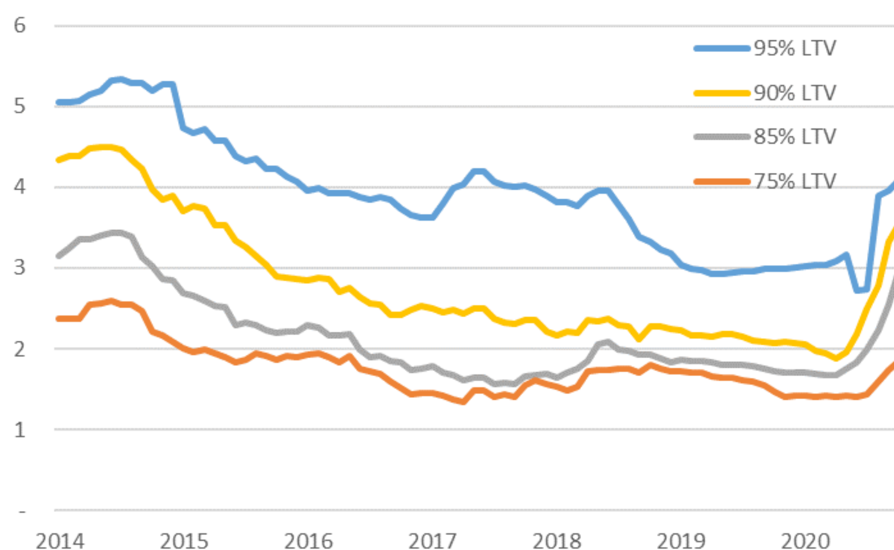
So, it is interesting to note that first-time buyer and mover numbers have pretty much moved in lockstep this year.

After collapsing by half in the wake of the first lockdown, first-time buyer numbers have recovered strongly in recent months. For the UK, volumes had almost returned to year-earlier levels by September, according to UK Finance. Momentum suggests that a further recovery seems likely through Q4.

What is happening here?

Affordability pressures have certainly intensified. Low deposit borrowers have faced higher rates over several months, according to the Bank of England's mortgage rate data. Taking 2-year fixed rates as an example, borrowers with a 15% or 10% deposit faced rates of 3.02% and 3.67% at the end of November the highest levels for six years.

Chart 5: Quoted rates, 2-year fixed rate mortgages



Source: Bank of England

Moneyfacts reports an increase in the number of mortgage deals, including for 85% and 90% LTV mortgages, although this does not yet appear to have fed through into better rates. Going forwards, any improvement because of better lender capacity may be tempered by credit risk perceptions relating to house prices and unemployment.

With fewer low deposit mortgages available post-Covid over recent months, average LTVs have shrunk back a little. This has contributed to a material increase in deposit size to new record highs, with the average first-time buyer deposit now exceeding £60,000.

What squares the circle is the fact that buyer income has grown in recent months across all nations and regions, implying that purchases are becoming more concentrated amongst those with relatively higher incomes. This has been a feature of the housing market for several years (see, for example, *First-time buyers: how do they finance their purchases and what's changed?*).

The Covid-19 pandemic appears to have intensified such trends, with households that have substantial income, savings or housing equity accounting for a larger share of housing market activity more generally.

Buy to Let

Buy to let lending has held up relatively well, with purchases accounting for a slightly higher percentage of total transactions and remortgage lending – 13% lower in Q3 compared with a year ago - more resilient than in the owner-occupied sector. Buy to let has also accounted for a higher proportion of industry net lending.

The private sector has seen a two-tier market emerge, with rents falling by 4-5% year-on-year in London but increasing by 2-3% elsewhere. In most parts of the UK, affordability pressures mean that more younger households are staying in the PRS for longer, pushing up rents. In London, Covid-19 has meant a shift in working and commuting patterns, whilst the hit to tourism has seen former Airbnb properties switch from short to long lets, pushing up supply which is only being absorbed slowly. Downward pressures are at their most acute in central London, with outer boroughs and wider commuter belt around London seeing some benefit from the preference for bigger homes and greener surroundings.

The unsatisfactory position, in which landlords are expected to absorb rent arrears, persists, with government further extending the ban on evictions in England until at least 11th January 2021. Landlords must also give six months' notice of their intention to regain possession of properties, a provision that will remain in place until at least the end of March.

The absence of a longer-term strategy for helping tenants is disappointing. As a recent report from the Resolution Foundation makes clear, tenants have borne the brunt of recent job losses and income shocks and are likely to be disproportionately affected when Government support measures are eventually unwound. Even now, more than a fifth of private tenants report that they have cut back on other spending, used their savings or borrowed to cover their housing costs.

The Spending Review decision to freeze Local Housing Allowances in cash terms from next year may suggest that the Government does not see landlords as a worthy cause.

Forbearance

Following the announcement of a second national lockdown, the FCA confirmed an extension to the mortgage payment deferral scheme until 31 July 2021, by when all payment holidays must end. Borrowers may access payment deferrals up to a maximum of six months and have until 31 March 2021 to apply for an initial or a further payment deferral.

Of the 1.8 million borrowers who took advantage of mortgage deferral, 127,000 mortgage payment deferrals remained in place by mid-November, UK Finance data shows.

While UK Finance is probably right in asserting that additional take-up of deferral arrangements is likely to be modest, there will be some borrowers who have been unable to resume their mortgage payments and who will therefore become subject to lenders' usual forbearance measures. UK Finance has indicated that 89% of customers whose payment holidays have come to an end are now making repayments. Allowing for timing delays, this suggests that an additional 100,000 or so borrowers may start to feature in the trade body's arrears reporting. Roughly speaking, this would represent a doubling of UK Finance totals, albeit from historically low levels.

Mortgage prisoners

Several lenders have now started to adopt the modified affordability assessments facilitated by the FCA last year to allow lenders to support mortgage prisoners trapped with inactive or unregulated lenders.

A research report on mortgage prisoners, published by the London School of Economics and Political Science and commissioned by MoneySavingExpert, asserts that the FCA has gone about as far as it can within its current powers but that its measures will only help a small minority of mortgage prisoners.

It goes on to discuss a range of possible remedies for the Government to explore fully. These include equity loans, delinking the secured and unsecured elements of Together loans, loan write-offs, mortgage rescue and bringing all owners of closed books within the FCA's regulatory perimeter as in Ireland. LTV caps also get a mention, although the authors note the risk of creating harm in other parts of the market and acknowledge that the benefits are anyway likely to be limited.

Prospects

Mortgage lenders face challenging market conditions in 2021, with the economic risks skewed on the downside.

The early months of the year will see massive scrambling to complete sales and the need to manage expectations in cases where delays give rise to frustrations and housing chains unwinding.

Government policies have inadvertently created something of a "cliff edge" at the end of March, when some key pillars supporting the UK housing market are due to be withdrawn at precisely the same time as job support measures. This can only undermine market confidence.

The end of the furlough and self-employed support schemes from the end of March will be negative for jobs, household sentiment and the wider economy. The Spring Budget - which will presumably take place in early-mid March – provides an opportunity for the Chancellor Rishi Sunak to mitigate some of these adverse effects.

As Government support measures wind down and the mortgage deferral scheme ends, this will expose those households who are struggling with their finances. Arrears are almost certain to rise materially from their historic lows. Lender forbearance will help borrowers facing short-term difficulties, but there will be higher possessions.

A disproportionate number of struggling households are likely to be tenants. 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 their finances.

Finally, it is worth noting that the Financial Policy Committee (FPC) has announced that it is reviewing its housing market rules around stress rates and higher income multiple lending, and will report its conclusions in 2021. IMLA sees the current macro-prudential stance as unnecessarily onerous for first-time buyers and is one of several organisations that has argued for a shift of policy. Any relaxation of the housing rules would mainly benefit purchasers in London and the South East. It is hard to gauge the "mood music" around the FPC's current review and worth bearing in mind that its previous review in 2019 actually led to more stringent policy.

20 December 2020