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Coronavirus and the UK housing market

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A short, sharp shock?

The coronavirus pandemic will affect all aspects of the UK housing market. In this note we consider the impact it is likely to have on residential transactions, values, rents, and development.

The scenarios set out in this note reflect a set of economic forecasts produced in a period of significant uncertainty. As a result, they are liable to change as circumstances unfold.

In general, we can expect the pandemic to affect the housing market in a number of ways:

- General uncertainty will weigh on consumer sentiment;
- Restrictions on people's ability to go about their day-to-day business will impede normal estate agency, mortgage and conveyancing processes;
- Stock market falls will make people feel less secure about their personal financial situation; and
- A negative impact on earnings, employment and wealth generation.

The UK Government has responded with extensive support for the economy and businesses, including liquidity injections, grants and low-cost loans for the most exposed sectors of the economy and encouraging lenders to take a benevolent approach to those struggling with mortgage payments. This should help reduce some of the pandemic's impact, enable a swift economic recovery and limit the number of households forced to sell.

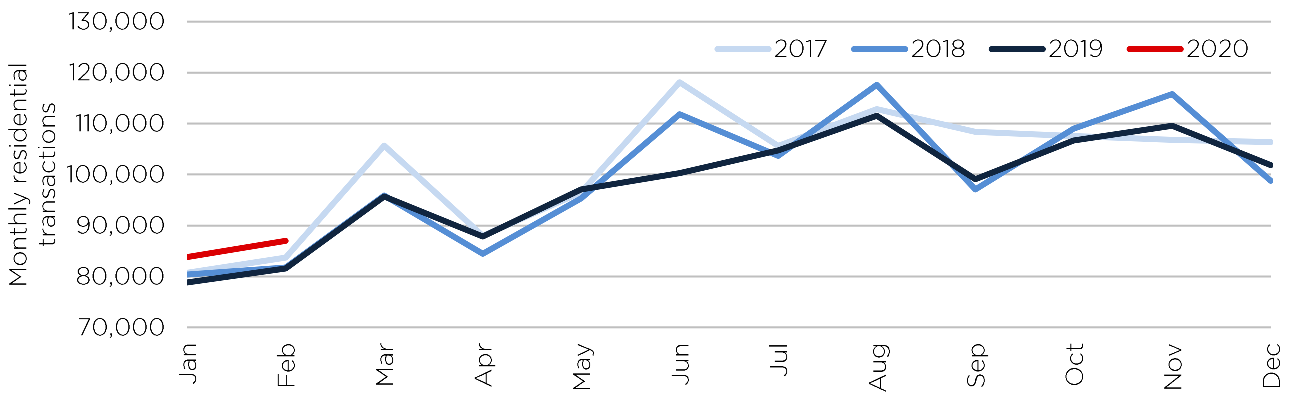
Economic context

The central scenario for most economic forecasters is a sharp, short economic contraction in 2020, particularly in Q2, followed by a rebound in late 2020/early 2021. For example, as at 19th March Oxford Economics was predicting UK GDP will fall -2.5% in 2020 Q2 and rebound +1.8% in Q4.

Current forecasts now account for the base rate cut to 0.1% announced by the Bank of England earlier this month. Oxford Economics predicts rates will remain at this level until Q3 2021 and only reach 1.5% by the end of 2024.

Unemployment is likely to rise slightly in the short term, returning to pre-pandemic levels by Q3 2021.

Figure 1 Monthly UK residential transactions



Source HMRC

Residential transactions

We anticipate transaction levels are likely to be most significantly impacted over the next three months, particularly with restrictions in place limiting people's ability to leave their homes. In China property transactions were at or around zero for the three weeks following movement restrictions and have since (two months later) recovered to 50% of the four year average.

If transaction activity were to fall to between 20% and 40% of the five year average by June and remain there until September, total transactions for 2020 would be between 566,000 and 745,000. This is between 38% and 53% lower than the 1,207,000 transactions we forecast for 2020 in November last year.

Suppressed transaction activity means we expect to see a build-up of latent demand. The experience of working from home for an extended period of time will drive many households to move. If transactions were to recover to between 60% and 80% of normal levels by January 2021 and return to normal levels by May-21, we could see between 1,122,000 and 1,166,000 sales in 2021.

Figure 1 above shows the number of residential transactions recorded by HMRC in each month of the last three years. It shows that sales activity had been relatively strong in the first two months of 2020, supported by greater political certainty after the general election. Any subsequent fall in activity should be interpreted against the context of this strong start to the year.

Mainstream capital values

Based on the pace of the post-recession recovery predicted by Oxford Economics, we would expect the pandemic to have a more limited and shorter-lived impact on house prices than either the early-1990s recession or the Global Financial Crisis. Short-term price falls could be in the order of -5% to -10%, but on very low levels of transactions.

The pace of recovery from that point will depend on the state of the wider economy. Brexit uncertainty may act as a drag on consumer and business confidence and dampen any recovery in house prices and transaction levels from Q4 2020.

On the upside, households whose incomes remain stable and secure will be able to take advantage of historically low interest rates. This should support a return to stronger levels of price growth in the medium term. Assuming long term damage to the economy is contained, we expect the five year outlook for prices to remain similar to our November 2019 forecasts but with a different distribution of growth year to year.

Prime Central London values

Our own index indicates Prime Central London values fell -20.5% between June 2014 and September 2019. For those buying in US Dollars, sterling's weakness presented a discount relative to 2014 in the order of 40%. Our latest index results show annual price falls in PCL continuing to slow and a return to growth in outer Prime London markets.

The coronavirus pandemic is likely to reduce wealth among ultra-high net worth individuals given its impact on global equity markets and the prospect of a global recession.

Were this to result in further price falls, this is likely to represent a significant buying opportunity for those seeking to hold in the long term. A high proportion of purchases in Prime Central London are in cash, which means we would expect to see it lead the post-pandemic recovery.

Private rents

There will be less movement in the rental markets in the next three months as movement restrictions place practical constraints on people's ability to view properties and move.

Government has announced a range of measures to help support those in the private rented sector, namely an moratorium on evictions for three months in England and extending its mortgage payment holiday to mortgaged buy to let landlords whose tenants are in financial difficulty. Government has yet to announce direct support for tenants struggling with rental payments.

There may be modest falls in average private rents paid as some landlords act to help tenants in financial distress. For the majority of households, rental payments will continue as normal with no significant impact on rental values in the short term.

There is a long-established correlation between rental value growth and income growth. We expect this correlation will continue. The coronavirus pandemic is therefore likely to result in slower rental value growth over the next year, with growth accelerating as income growth returns.

Development

Restrictions on people's ability to move and work will present obstacles to housing delivery. Some housebuilders, such as Taylor Wimpey, Barratt, and Persimmon, have already announced that they are suspending construction on their sites; we expect other housebuilders to follow. Inevitably this means there will be a fall in both housing delivery and new build sales this year.

Housebuilders will face particular pressure to restore their sales rates when restrictions on doing business are lifted as they need to maintain cash flow because of their funding commitments. We may therefore see a surge in the use of buyer incentives as activity returns.

If household demand for new build homes is slow to return, we could see housebuilders take other routes to market. We could see an increase in the number of sites converted to affordable housing delivery with additional grant funding, as we observed in the aftermath of the Global Financial Crisis. There will also be continued demand from institutional Build to Rent investors, albeit they may require greater discounts to account for difficulty letting in the coming months.

The consensus among economic forecasters is that the coronavirus disruption will be relatively short-lived. On that basis, we'd anticipate continued demand for residential development sites as housebuilders continue to plan their construction output over the coming years.

However, there is a risk of disruption to land supply where local authorities have diverted resources away from planning. Some local authorities have temporarily suspended registering new planning applications as they adjust to remote working. This will reduce the supply of consented land and could put upward pressure on land values in the medium term.

Table 1 Economic forecasts as at 19th March 2020

Measure		2019	2020	2021	2022	2023	2024
Real GDP growth	Yr Av	1.4%	-1.4%	3.7%	2.2%	1.4%	1.6%
	At Q4	1.1%	-0.7%	3.8%	1.9%	1.3%	1.5%
Average Bank Base	Yr Av	0.75%	0.23%	0.16%	0.59%	1.09%	1.36%
	At Q4	0.75%	0.10%	0.25%	0.75%	1.25%	1.50%
Unemployment	Yr Av	3.18%	3.87%	3.68%	3.43%	3.43%	3.43%
	At Q4	3.40%	4.17%	3.47%	3.42%	3.42%	3.44%

Source Oxford Economics

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