Residential Quarterly | Summer 2020

Research - Market View

Economic Outlook

The outbreak of the COVID-19, declared by the World Health Organisation as a “Global Pandemic” on the 11th March 2020, has significantly impacted global economies. International travel restrictions as well as restrictions on individuals’ behaviour and activity have been implemented by most countries across the world. Market activity was impacted in many sectors, with some sectors, such as leisure, unable to function at all, and others, to include office-based service industries, hampered to a lesser degree with the ability for staff to work from home. As countries slowly start to come out of their lockdowns, more evidence will become available as to how markets, businesses and individuals respond. The world will also await further evidence on the pandemic, and whether countries will have to re-impose restrictions in some form.

Global markets have fallen since the outbreak of COVID-19. The FTSE 100 fell by a significant 25% over Q1 2020, with almost all losses felt after mid-February, effectively reversing the gains achieved over the course of 2019. At the end of Q1 2020, the index was at its lowest level since Q1 2016. Over April 2020, the index recovered slightly by 4%. Over Q2 2020, the index grew at a steady rate by 10%, recovering over a third of the losses felt over Q1. The end of Q2 figure is still 17% down on the value at the start of the year and 16% down YoY, but much improved since last quarter. Globally, economic uncertainty remains a significant factor.

Stepping back from the current global crisis, The Withdrawal Bill was successfully passed on 24th January 2020, following which the United Kingdom formally exited the European Union on 31st January 2020. The country has now entered an 11-month period, known as the ‘Transition’, which keeps the UK bound to the EU’s rules, until such time as a free trade agreement has been established. Trade talks started remotely with the US at the beginning of May.

On the 11th March 2020, the UK Government announced their new Budget. For residential property the main headline was an additional 2% Stamp Duty Land Tax (SDLT) for non-UK residents from April 2021.

The HM Treasury consensus forecast for 2020 (made 15th July 2020) reports a forecast for -9.1%, growth, down significantly from the April 2020 estimate of -5.8%. Current forecasts range from -12.0% to -6.6%. Growth is expected to recover in 2021, with the forecast at an average of 6.6% (ranging from 1.5% to 10.3%), demonstrating that most forecasters expect the fundamentals of the economy to remain strong and for it to be able to return to growth once the current situation has passed.

On 7th May, the Bank of England warned that the UK economy could shrink by 14% in 2020 (the largest annual slump in 300 years) and that unemployment could double to 8%. Forecasts originally included a 15% GDP bounce back in 2021 indicating no expectation of long-term effects. In June 2020, the Bank of England chief economist stated that, whilst unemployment is a major concern, there were signs of a ‘V-shaped’ economic recovery. By contrast, the OBR in May stated that, despite their original ‘V-shaped’ forecast, they now believe that a fast bounce back is less likely than originally thought, warning of scarring effects on the economy inducing a slower recovery. OBR does however, note that the economy was likely at its worst in April 2020.

A worsening global backdrop and the recent financial market performance has pushed the BoE to deliver an emergency rate cut to 0.1% as part of a wider package to mitigate the shock of COVID-19. The BoE believes they have seen a ‘marked deterioration’ in the outlook for UK growth, albeit they are still uncertain about the timeframe. The central banks of the US, Australia, Malaysia and Canada have also cut their interest rates.

The Chancellor has announced an unprecedented package of Government-backed interventions aimed at supporting businesses and individuals through the current situation. This includes: a furlough scheme to pay up to 80% of employees’ wages, intended to minimise job losses; mortgage holidays agreed with lenders; business rates holidays and loan schemes. At its peak (20th April to 3rd May), an estimated 31% of workers were on furlough across all industries. The worst affected industries were accommodation and food service activities (78%), arts entertainment and recreation (65%) and administration and support activities (36%). In the most recent period for which data is available (15th June to 28th June), the all-industry figure for the proportion of workers on furlough had decreased to 22%. On the 4th July, some businesses including food and beverage businesses were able to reopen, and a gradual continued relaxation is planned throughout the summer.

On the 8th July, the Chancellor unveiled further measures to help the economy including, removing SDLT on the first £500,000 of all property sales until 31st March 2021 in England and Northern Ireland; a temporary cut to VAT on food, accommodation and attractions from 20% to 5%, and a new job-retention bonus for employers who bring back furloughed staff. Following this announcement, both Scotland and Wales also announced residential tax property freezes for Land and Buildings Transaction Tax (LBTT) and Land Transaction Tax (LTT) respectively, until 31st March 2021.

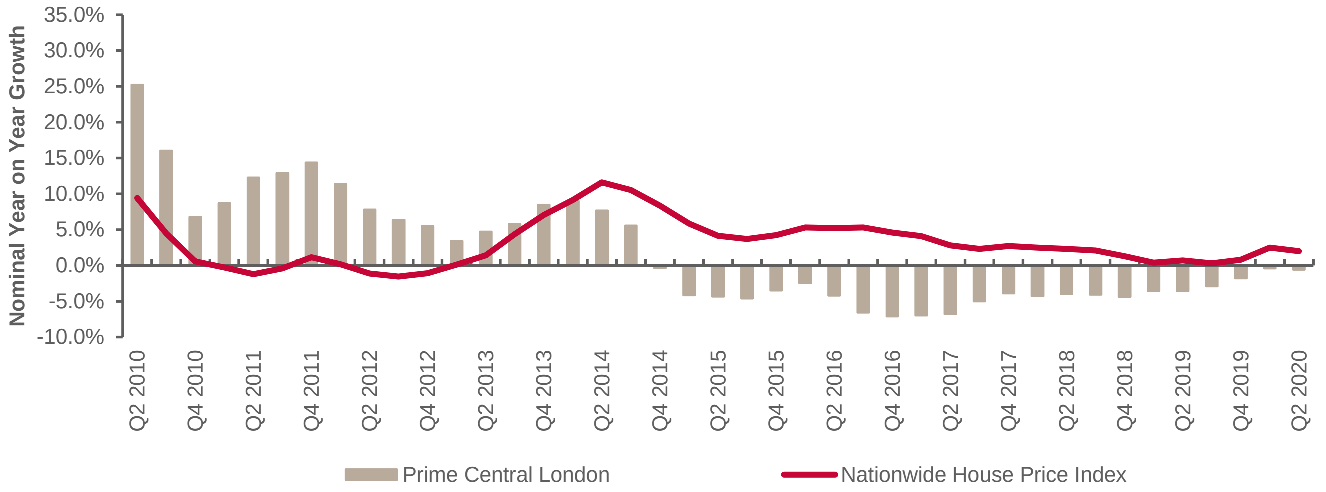
Property market pricing

The Nationwide House Price Index stated that UK property prices grew by 2.0% in the year to Q2 2020; down from the 2.4% in the year to Q1 2020 but 1.3% higher than the same period last year (0.6%). YoY growth over the year to Q2 2020 shows that, on a regional basis, the best performers were the North West (4.9%), Scotland (3.9%) and the South West (2.3%). London growth was at 2.1%; up from 1.7% the previous quarter and recovered from the price falls over the same period last year (-1.6%). Nationwide state that the impact of the pandemic has now started to filter through.

The housing market reopened on the 13th May with house moves and viewings able to resume under social distancing and safety rules in England, with Scotland following suit at the end of June. Despite the ability to trade being improved from complete lockdown, it is likely that pick-up will be cautious given safety concerns. In addition, as businesses adapt to changing government guidance on working practices the speed of conveyancing will be affected. That said, market reports are cautiously optimistic and parts of the country in particular are showing considerable buyer and vendor interest.

Figure 1

UK house price growth vs Prime Central London (PCL)



Source: *Nationwide House Price Index, Volterra*

Regional residential sales transactions

Table 1. Number of registered properties sold for H1 2019 and H1 2020

Region	All Property H1 2019	All Property H1 2020
East Midlands	38,370	11,308
East of England	46,418	14,375
Greater London	44,798	13,892
North East	20,578	6,135
North West	58,670	17,029
South East	66,143	20,734
South West	45,751	13,962
Wales	22,574	7,175
West Midlands	41,855	12,410
Yorkshire and Humber	42,888	12,755

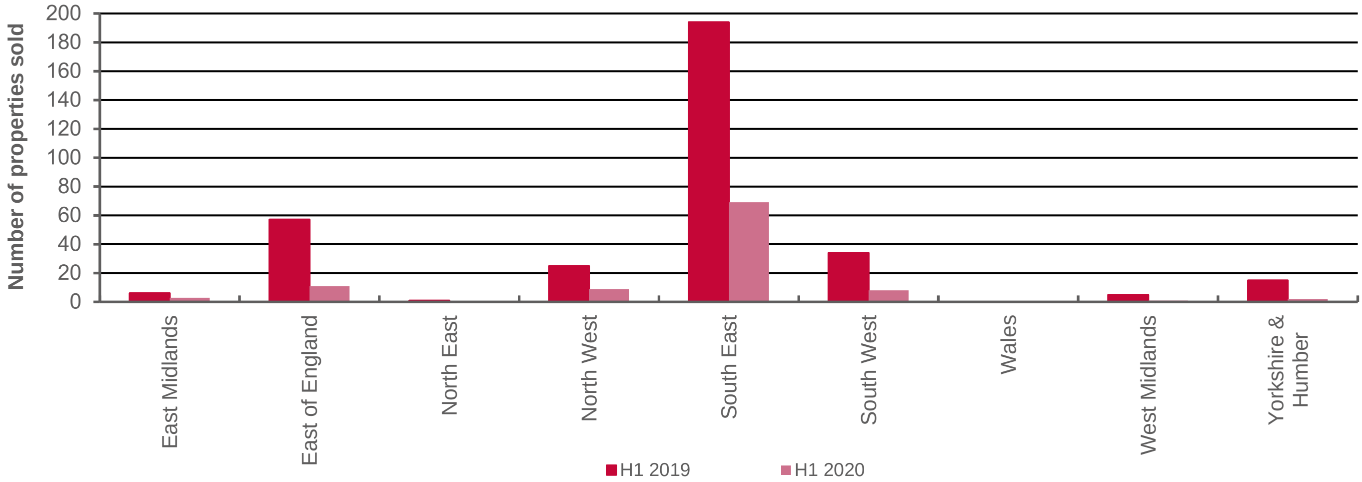
Source: *Dataloft, Land Registry H1 2019 and H1 2020 data as at 15th July 2020, Land Registry data has a reporting data lag which is typically why one will see such a large difference in figures and should not be viewed as a drop in transactions, however the transactional market was paused for a large portion of Q2 due to COVID-19 so it is expected that figures will be even lower than typical for reporting purposes; Registers of Scotland data has been omitted from the report this quarter due to transactional activity being paused during COVID-19.*

Country house highlights

COVID-19 halted all transaction activity during Q2 2020 and this is reflected in the low figures reported for all regions, outside of Greater London in the over £2 million market. The largest numbers of £2 million plus homes that sold continued to be in the South East for H1 2020, however post lockdown viewing activity has increased dramatically in this price band across the UK.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in H1 2019 and H1 2020



Source: *Dataloft, Land Registry H1 2019 and H1 2020 data as at 15th July 2020, Land Registry data has a reporting data lag which is typically why one will see such a large difference in figures and should not be viewed as a drop in transactions, however the transactional market was paused for a large portion of Q2 due to COVID-19 so it is expected that figures will be even lower than typical for reporting purposes.*

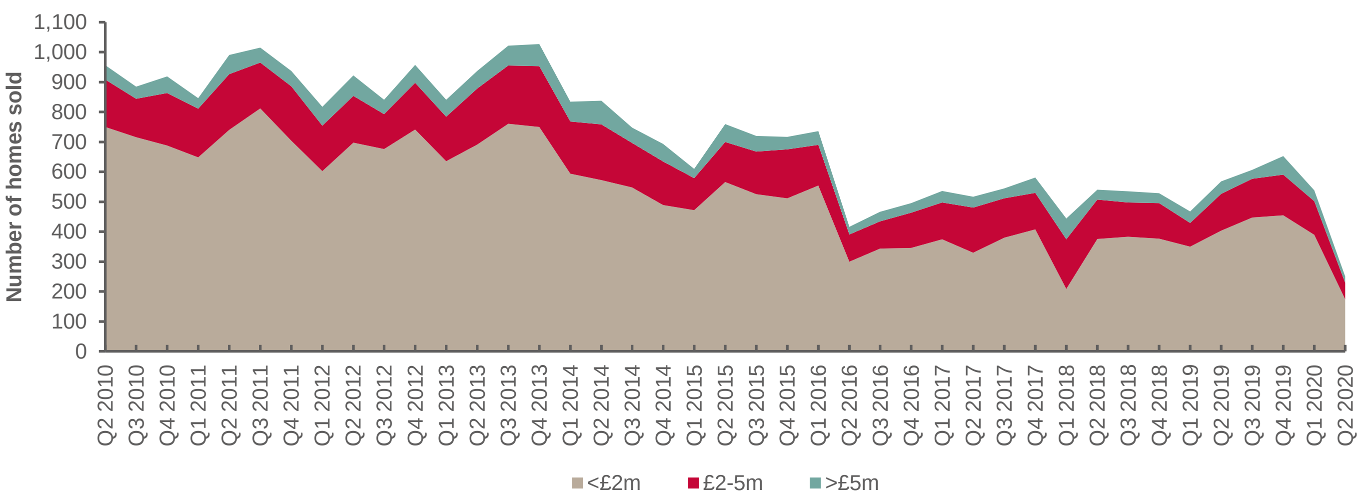
Prime Central London residential sales market

Prime Central London (PCL) sales index data for Q2 2020 reported negative price growth of -1.1%, effectively reversing the growth experienced in Q1 2020 (+0.9%). In the year to Q2 2020, PCL prices have fallen by -0.6%; a larger decrease than the -0.4% in the year to Q1 2020 but smaller than all the YoY price falls between Q1 2015 and Q4 2019. Total transactions in PCL sales fell by -56% compared to Q2 2019 and by -54% compared to the previous quarter. By historic standards, all transaction levels remain low. Total PCL transactions in Q2 2020 were only 24% of the previous peak in Q4 2013.

The six-month holiday on SDLT will likely have a positive impact on transactions although likely felt to a lesser extent in PCL compared to other regions. The RICS is also recommending the removal of material valuation uncertainty clauses from all residential assessments across the country.

Figure 3

Historic number of homes sold in PCL



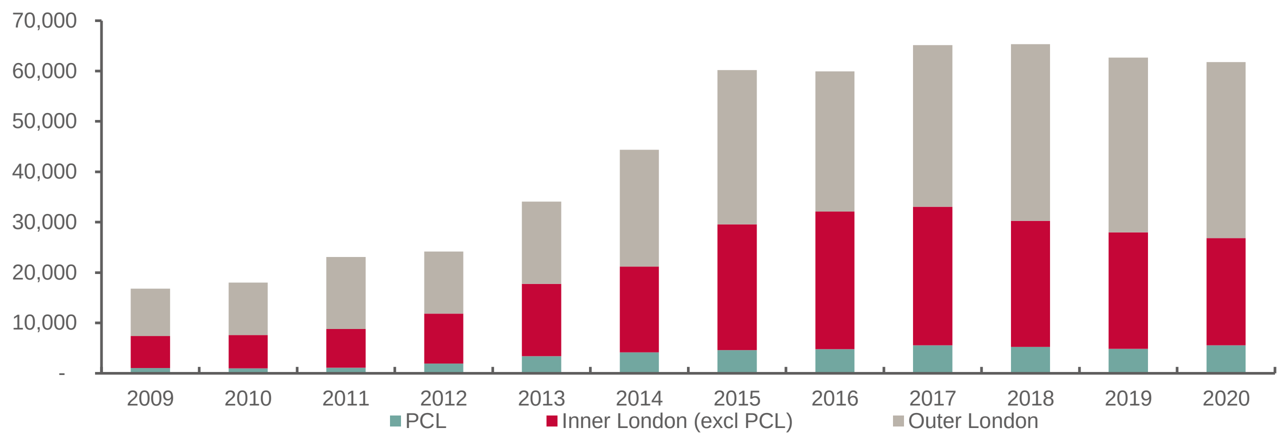
Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th July 2020.*

Greater London residential new homes

Across Greater London, there were nearly 62,000 new build units under construction at the end of Q2 2020, with nearly 4,000 new build for sale units sold across London during Q2 2020, according to Molior. It should be noted that over 30% of the sales activity for this quarter was accounted for by Build to Rent (BTR) use with a further 23% of sales stock switched to affordable product.

Figure 4

Number of private sale units under construction in schemes of 20+ private units in Greater London



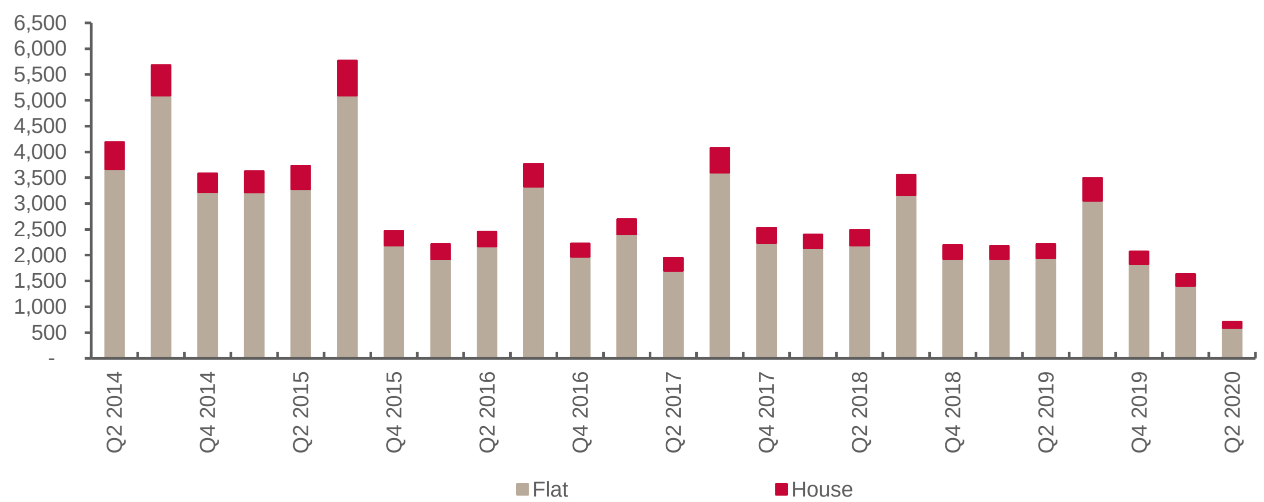
Source: *Molior, Strutt & Parker as at 10th April 2020; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster; Inner London defined as Local Authorities of Camden, City of London, Hackney, Islington, Lambeth, Southwark, Tower Hamlets, Wandsworth; Outer London defined as remaining 22 Greater London boroughs*

Prime Central London lettings market

2019 saw three consecutive quarters of positive QoQ growth (albeit marginal, at 0.1%, 0.3% and 0.1% respectively), and this growth was maintained into Q1 2020 (0.3%). Q1 2020 saw the first positive YoY growth (0.8%) since Q4 2015 (0.3%). All this suggested a stabilising market. However, for Q2 2020, both QoQ and YoY growth were negative at -2.7% and -2.1% respectively. In Q2 2020, lettings transactions equated to just 32% of Q2 2019 transaction levels. Notably, in April 2020, transactions were equivalent to just 5% of Q2 2019 transaction levels, reflective of market pick up towards the latter end of the quarter.

Figure 5

New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th July 2020.*

Outlook & forecast

Overall, the restrictions as a result of the pandemic were felt over the historically busiest three-to-four months of the year, having a huge impact on transactions levels in both lettings and sales. Whilst the market has now reopened, there is still some considerable market uncertainty given the wider economic outlook. An estimated, at least half, of prospective buyers and sellers in prime markets are discretionary – i.e. they do not have to move and can afford to wait and see what happens to the market next year. This is further strengthened by the fact that government intervention schemes such as mortgage holidays and furlough have made it financially viable to wait. Indeed, half of Q2 sales transactions were lost. If this is also the case in Q3 and Q4, this would equate to a worst-case drop in volumes of an estimated 40-50% over the course of 2020.

After the market reopened, agents were reporting cautious optimism, with similar levels of activity compared to this time last year. There have been some pockets of considerable positive activity levels as the pandemic has reinforced or accelerated demand for lifestyle changes; people are looking to move and actively change how they live and work. There have been some price corrections of c. 5-10% in some markets as sellers seek to capitalise on current demand that may not be there tomorrow due to fears of a second wave or Brexit impacts.

In the PCL sales market, agents report that the return to activity has been as good as it could have been. There was an initial flurry of applicant activity after lockdown eased which has since stabilised to levels similar to that seen last year. The high net worth individuals are interested in London again. PCL looks strong, although the PCL periphery is expected to struggle over the next year or two; these peripheral locations are most likely to be affected by the trend towards lifestyle changes, whereas decisive reasons to live in central London persist through this trend. This might mean that London as a whole could soften.

The above reports provide no reason to either upgrade or downgrade forecasts and, as such, the Q1 forecasts are retained. The short-term impact on PCL sales prices may be as much as -10% but felt only in very low trade environments, in specific submarkets, or on properties that have no other option than to transact. Given the expected recovery of the economy, we estimate a best case 0% YoY change to Q4 2020 and a worst case of -5% for PCL sales prices. All economic forecasts anticipate a significant recovery from 2021. Whilst the shape of these recovery projections may vary, none indicate long-lasting impacts of the shock 2020 recession. This translates to a cumulative forecast medium-term impact on PCL prices of between +7% and +33% over the five years to Q4 2024, inclusive of 2020.

Price changes may be more severe at the UK level as economic slowdown could impact some areas more than others. We estimate a best case of -1% and a downside risk of -7% in the year to Q4 2020, with potentially larger shorter-term impacts. However, given the expected recovery in 2021, it is expected that nationwide prices will rise by a cumulative c.+20% in the five years to Q4 2024.

The PCL lettings market has been seeing stock increases due to the collapse of the short-let market which is unlikely to recover fully this year. However, the pipeline remains and there is pent-up demand. Now that people are able to move in, it is expected that transactions will recover (albeit slowly). Renewals are happening at lower rates, and some tenants may need to negotiate rent reductions given job uncertainty. It is expected that rents in the central case will fall by 2% and in the worst case by 10% in the year to Q4 2020. Cumulatively over the next five years we would expect a bounce back, but the scale and speed of this could potentially be more dependent upon longer term behavioural shifts resulting from the current situation. We anticipate the best case outcome for lettings over the next five years would be a cumulative rise of +11%.

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Methodology

As the housing market is seasonal, for the purposes of this report; data is compared year on year, i.e. looking at Q2 2020 in light of changes since Q2 2019. Data may also be compared on a rolling month on month basis. When referring to the PCL market it includes those markets which Strutt & Parker operate in (Knightsbridge, Belgravia, Kensington, Chelsea, Notting Hill & Fulham) and as such is reflective of London's most prime markets. Economic views are attributed to Strutt & Parker's retained economic advisors, Volterra. Registers of Scotland does not have a data lag at end of quarter compared to Land Registry data and therefore transaction figures at end of quarter for Scotland may appear abnormally high in comparison. Additionally, Lonres.com data is used to assess the London sales and lettings market. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.