COVID-19 UPDATE: RESIDENTIAL PROPERTY MARKET

RESIDENTIAL TO HOLD RESILIENT IN THE LONGER TERM

MAY 2020 | JENNET SIEBRITS, HEAD OF RESIDENTIAL RESEARCH

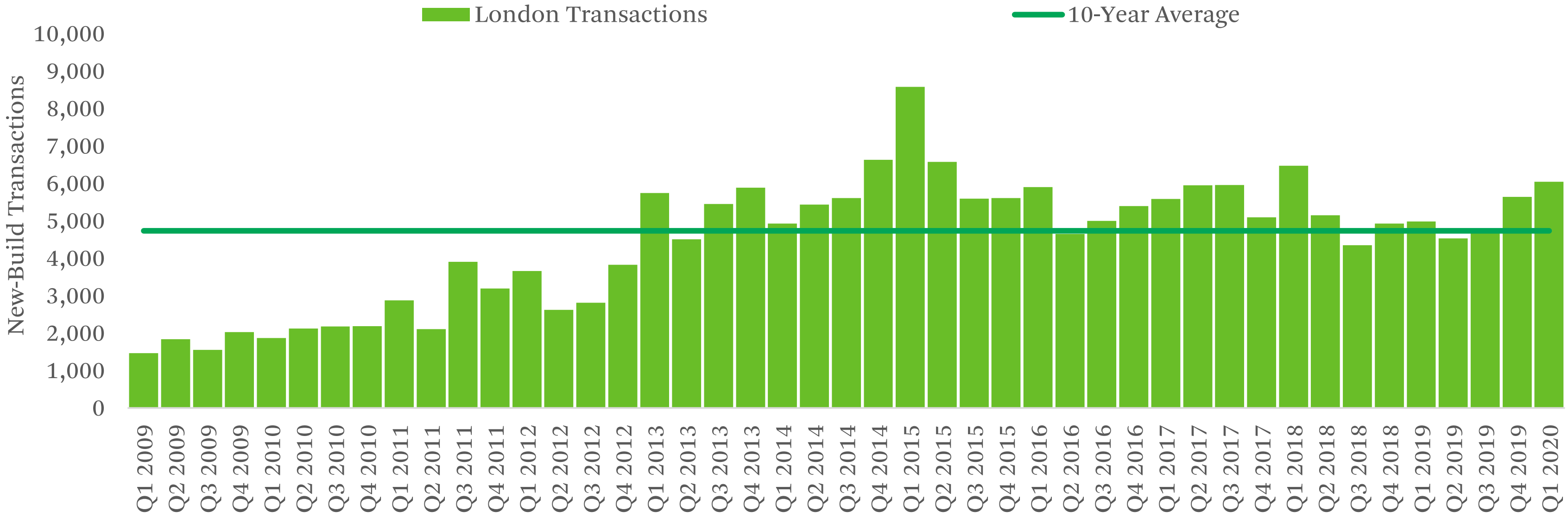
CBRE

EXECUTIVE SUMMARY

A Boris Bounce started the year off positively	• The market commenced 2020 with the highest level of mortgage approvals in February for six years. • This reflected improved confidence after the decisive election win and reduced Brexit uncertainty. • This momentum was expected to continue.
But a Covid-19 Comedown followed	• The Government's lockdown policy has caused the housing market to slow significantly. • RICS sales expectations are much more negative than during the Global Financial Crisis. • During the lockdown only a few sales have progressed, with many deferred. • The post lockdown recovery will depend on consumer confidence and the wider economic outlook.
Expecting a sharp shock to the economy	• CBRE currently forecasts a 5.4% fall in GDP and a rise in unemployment to 5.6% in 2020. • This suggests the GDP decline will be worse than the GFC, but the unemployment impact is lower. • The market is unlikely to return to full strength until 2022, due to the wider economic downturn.
The downturn will negatively impact transactions	• Transactions to fall dramatically, ending the year 40% lower than 2019. • While the percentage decline is less than the GFC, sales are likely to be lower due to a lower base. • Sales should pick up in 2021 and return to trend in 2022 as macro factors return towards trend.
Prices declines expected to be muted	• Initially, low sales volumes will make it difficult to determine the quantum of any price reductions. • Prices are likely to fall in 2020, with a consensus expectation of between 5% and 10%. • In the last two recessions (early-1990s and 2008-09) UK house prices fell by 18% from peak to trough. • With low interest rates and bank/Government support measures, fewer distressed sales are expected.

A POSITIVE START TO 2020…

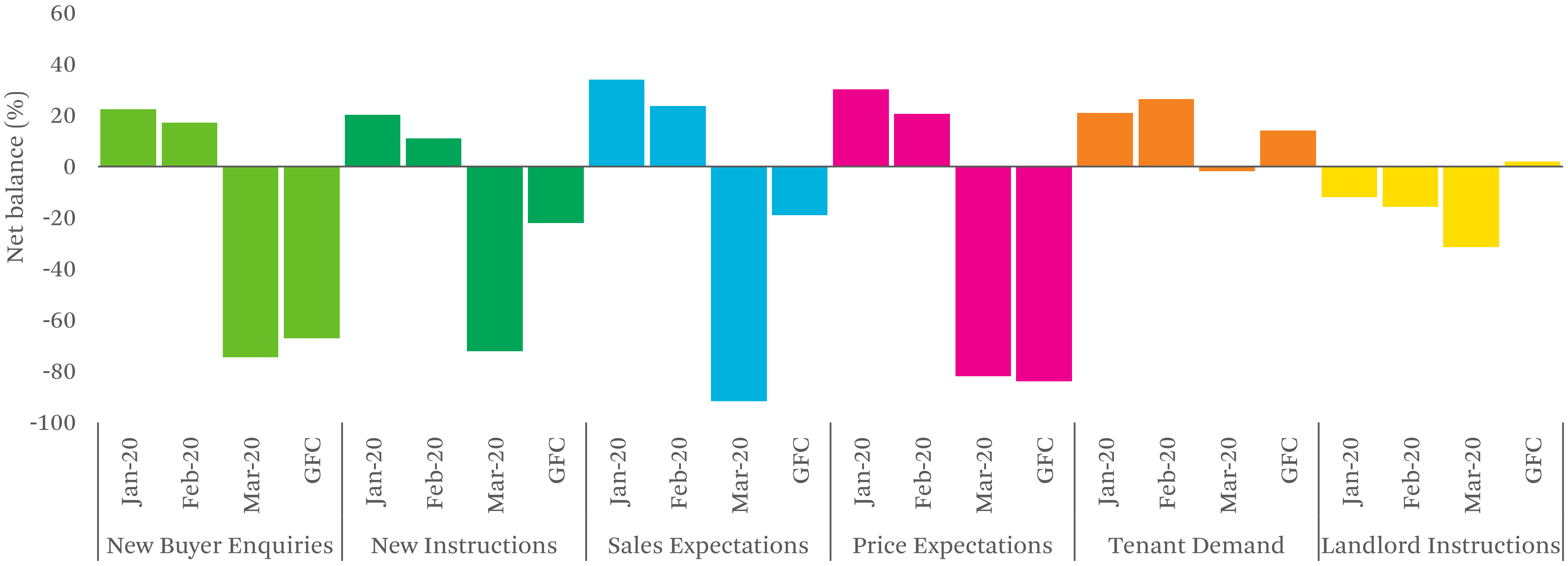
There was a resurgence in the residential property market at the start of 2020. Buoyed by perceived clarity around Brexit and a conclusive Conservative election win, confidence and activity returned with the Bank of England reporting the highest level of mortgage approvals in February for six years. Initial estimates suggest there were c.300,000 sales in Q1. Looking specifically at the London new build market, Molior data showed that sales in Q1 2020 were at their strongest for two years. CBRE's performance mirrored this, with our residential unit sales 70% higher than Q1 2019.



Source: Molior, CBRE Research

…BUT LOCKDOWN LED TO A SHARP SLOWDOWN

The outbreak of Covid-19 and subsequent lockdown policy caused the market to slow significantly. This was reflected in the CBRE Key Client Survey, which showed a 70% fall in the number of new applicants and sales in the last two weeks of March, when compared with the start of 2020. The Royal Institute of Chartered Surveyors (RICS) Residential Survey was similarly negative. RICS Surveyors' sales expectations are much more negative than during the GFC and partly reflects the lockdown period.



Source: RICS

SALES ACTIVITY MAY BE LOWER BUT THERE IS LIGHT AT THE END OF THE TUNNEL

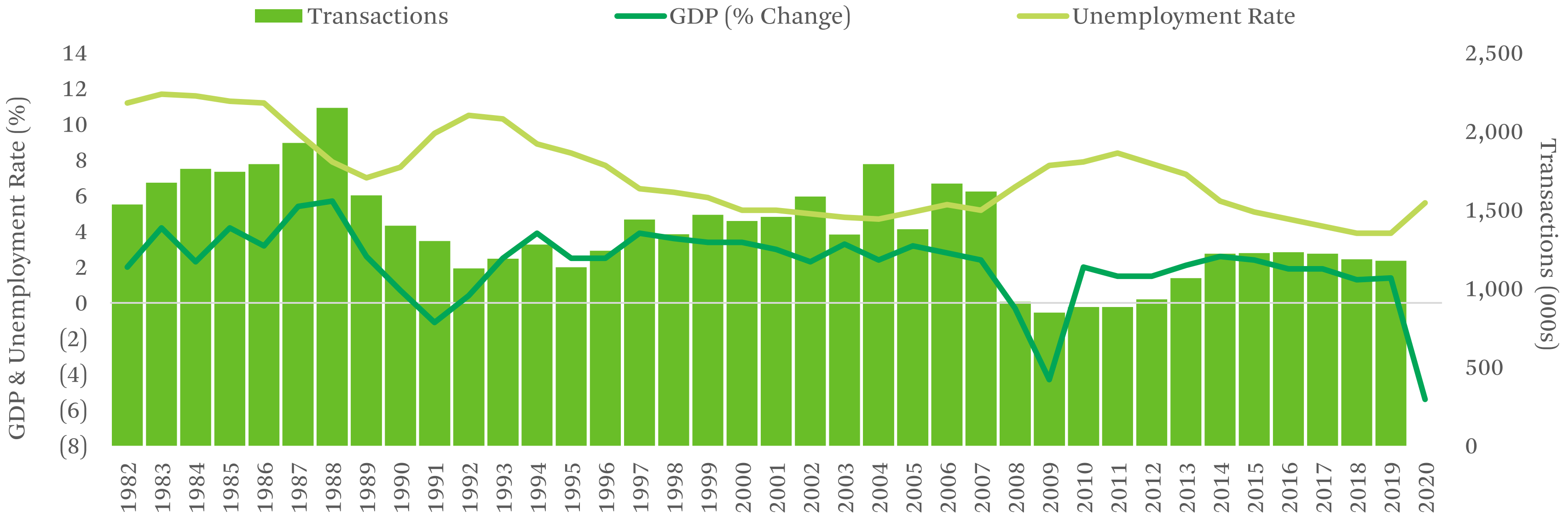
The housing market will go through a number of phases reflecting the Covid-19 restrictions and wider economic backdrop. During the lockdown very few sales are concluding, but as restrictions are relaxed many more in-progress deals should reach completion. In the aftermath, the economic backdrop becomes more influential and demand is likely to moderate. The market is unlikely to return to full strength until 2022.

Tentative Base Case Timeline

	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5	Phase 6	Phase 7
	Jan - Feb	Mar – mid Apr	Mid Apr- May	Jun – Sept	Oct – Dec	H1 2021	H2 2021
Covid-19	Pre-lockdown period in the UK	Lockdown	Lockdown	Restrictions steadily relaxed	Lockdown lifted	Covid-19 contained, social distancing relaxed	Post Covid-19 period
Economic	Unemployment at a record low	Collapse in consumer confidence	Employees furloughed	Sharp fall in GDP in Q2	Economic growth improving, but unemployment may still rise Brexit	Economy continues to grow Unemployment peaks	Economy back to full strength
Housing Market	Strong market and positive start to the year	Very few sales able to progress Zoopla estimate 370,000 on hold	Lenders adapting, desk-based valuations Applicant levels picking up	Some sales put on hold during lockdown will now progress Viewings/listings permitted	Needs driven demand arrives to the market	Activity picks up with more sales progressing	Sales return to trend

THE POST LOCKDOWN RECOVERY DEPENDS ON ECONOMIC RECOVERY

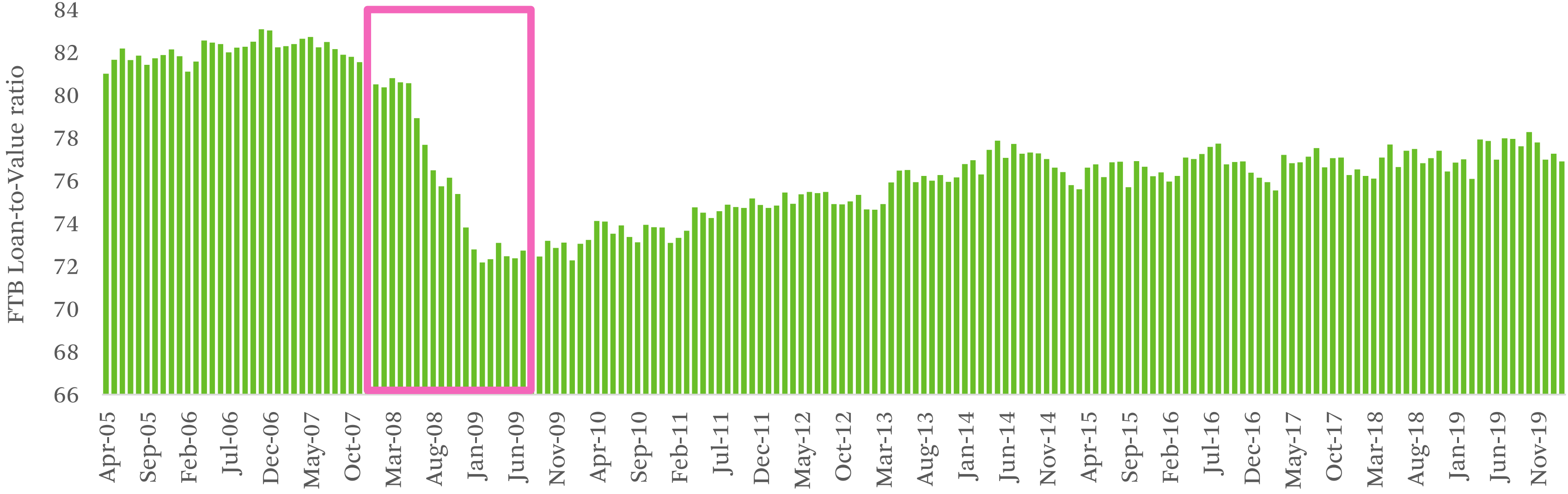
We can look back at previous recessions to illustrate how the housing market might react during this downturn. In both the nineties recession and during the Global Financial Crisis (GFC), property sales halved. In the current downturn, CBRE expects a larger fall in GDP (5.4%) than in previous recessions. With this in mind, one might expect a larger fall in sales of c.60%. However, this is unlikely for three reasons: 1) the rise in unemployment is expected to be lower, 2) in both previous downturns the housing market had been booming, which isn't the case now, and 3) declining sales during past recessions were exacerbated by external factors (i.e. MIRAS removal in 1990s) but dampened in the current crisis by Government and bank support measures.



Source: HMRC, ONS, CBRE Research

TIGHTER LENDING POST-GFC LED TO LOWER LOAN-TO-VALUE RATIOS

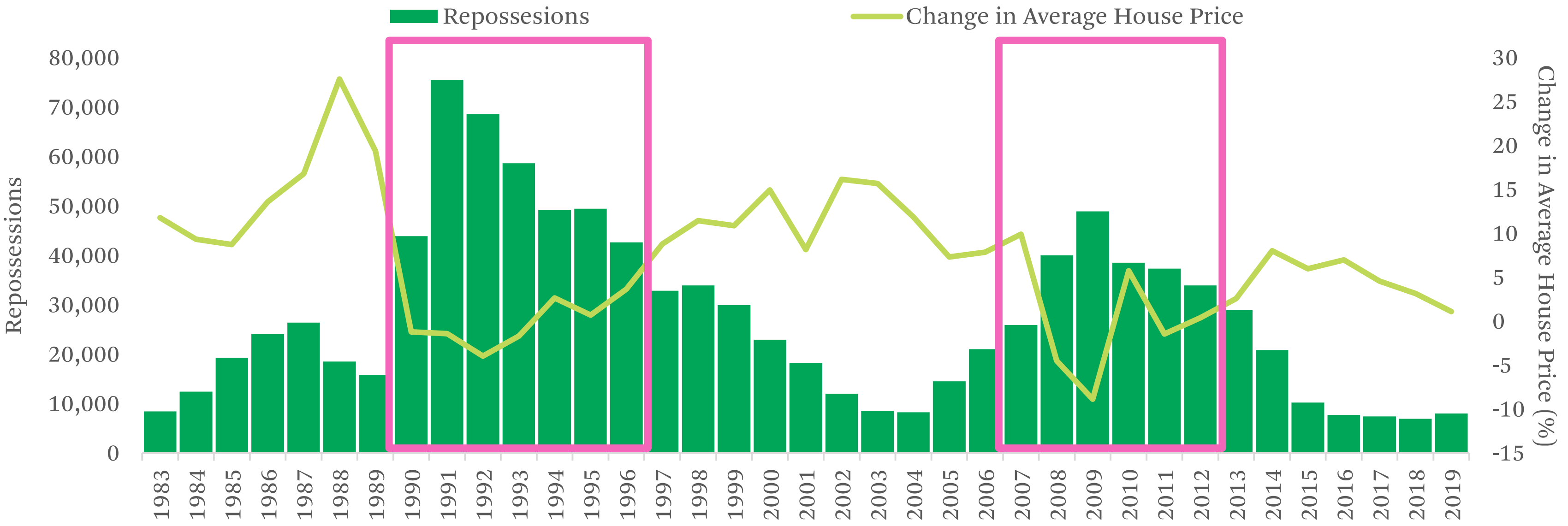
Before the GFC, average first-time buyer (FTB) loan-to-values (LTVs) were over 80%, and 95% mortgages were common. However, conservative lending saw LTVs fall to c.70% in 2009. This reduced the ability for many to buy, resulting in a marked fall in sales. In the decade pre-GFC, sales averaged 1.5m p.a., this has since reduced to c.1.1m. In the immediate lockdown period, lending standards tightened, but appear to have relaxed slightly. Still, tighter lending criteria are likely to slow sales activity.



Source: UK Finance

SHARP DOWNTURNS DON'T NECESSARILY EQUAL DEEP DISTRESS

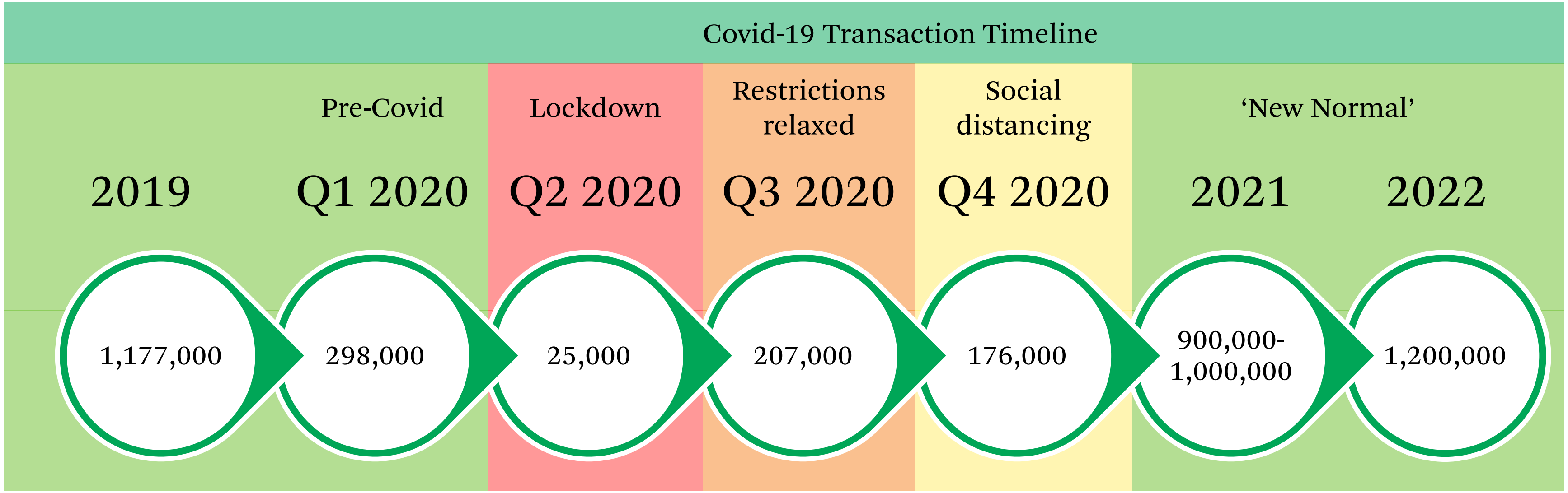
During the GFC, the Government encouraged lenders to be more forbearing and increased support for at-risk households. As a result, repossessions at 36,000 p.a. were modest compared with 54,000 p.a. during the 1990s downturn. We entered the current crisis with relatively good affordability, due to lower interest rates and LTVs. The swift support measures announced for at-risk households through mortgage payment holidays (used by 1.6m borrowers) is likely to once again limit the scale of repossessions. Lower supply of distressed properties, and therefore price declines, appears likely despite a sharp economic downturn.



Source: UK Finance, ONS, Land Registry, CBRE Research

AT C.700,000 TRANSACTIONS, FORECAST SALES WILL BE 40% LOWER

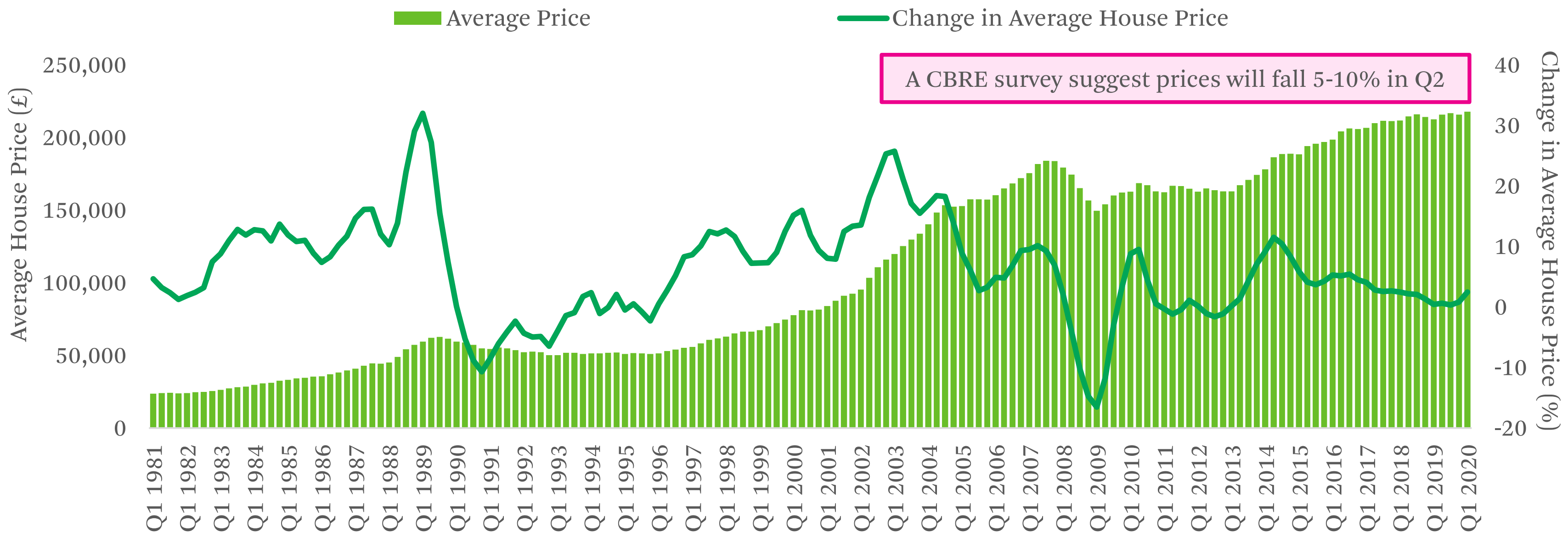
With a promising start, 2020 sales volumes were expected to be slightly higher than in 2019. In addition, there were around 370,000 transactions in the pipeline. Covid-19 restrictions mean the only sales to complete in Q2 are those that had previously exchanged. As restrictions start to lift, some stalled sales will resume and progress to completion in Q3, however, not all will progress. Past experience suggests around 40% will remain on hold. Sales volumes in Q4 are likely to reflect wider economic concerns and estimated to be 40% lower. Compared with the GFC, this is a lower percentage fall in sales, but the actual number of sales is likely to dip below the 2009 trough. Assuming no secondary infection and double-dip economic downturn, sales should begin to pick up steadily in 2021 before returning to trend levels in 2022.



Source: ONS, Land Registry, Molior, Zoopla, CBRE Research

EXPECTING MODEST PRICE DECLINES IN 2020

The previous two downturns had been preceded by several years of double-digit house price growth. In both cases, peak to trough declines were c.18%; the 1990s descent was spread over five years, while it took only 18 months in the GFC. The current economic decline will clearly put downward pressure on prices. Post lockdown, it is likely vendors will resume marketing at ‘pre-Covid prices’, at this point the market will be tested. The low sales environment and a lack of distressed sales may keep a floor under prices, but price declines of 10% cannot be ruled out.



Source: Nationwide

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