Residential Quarterly | Spring 2020

Research - Market View

Economic Outlook

The outbreak of the Novel Coronavirus (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 is being 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 other 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 retain restrictions in some form for longer periods of time. Boris Johnson’s announcement on 10th May stated that now is not the time to be coming out of lockdown. The speech used highly conditional language with regards to primary schools and some hospitality businesses returning to operation no earlier than the 1st June. The housing market was reopened in England on the 13th May with house moves and viewings able to resume under social distancing and safety rules.

Stepping back from the current global crisis, the majority win by the Conservatives in the UK General Election at the end of 2019 means that there is now more surety in the Government, particularly in respect of Brexit, than there has been for over three years. The Withdrawal Bill was successfully passed on 24th January 2020, following which the United Kingdom formally exited the European Union on 31st January 2020.

Markets responded positively to Conservative majority, with the FTSE 100 jumping 4% in the five days after the General Election, and subsequently closing the year strongly up 12% from the beginning of the year. However, global markets have fallen since the outbreak of COVID-19 and its expected effect on economic growth. 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%. Globally, economic uncertainty remains a significant factor.

The ONS recorded that the UK economy grew by 0.5% in Q3 2019 with 0% growth in Q4 2019. This small growth meant forecasts for 2020 had been cautiously optimistic, for the early part of the year, but have been recently revised down considerably to reflect the uncertainty and concerns surrounding the current unprecedented situation.

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%. However, the forecasts also include a 15% GDP bounce back in 2021, indicating no expectation of long-term effects. However, on 17th May the OBR 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 do, however, note that the economy was likely at its worst in April 2020.

The latest figures from the ONS show that inflation (CPI) as of March 2020 is 1.5%, down from 1.8% in January 2020. This is 0.5% below the 2.0% target, which has not been hit since July 2019. The March 2020 inflation rate was slightly below the year before (1.8% in March 2019) and on par with the 1.4% in December 2019.

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 (new Term Funding Scheme financed by the issuance of central-bank reserves and a cut back of the countercyclical capital buffer to 0%) to mitigate the shock of COVID-19. The BoE believes they have seen a ‘marked deterioration’ in the outlook for UK growth, albeit still uncertain about the timeframe.

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; loan schemes, and relaxation of planning rules to enable food businesses to offer takeaways.

Despite the very negative economic outlook and likely assessment of business confidence, the economic interventions announced by the Government should minimise the rate of unemployment, and cushion some businesses, enabling them to return to productivity once the current restrictions are lifted. The extent of the slowdown and the speed of the recovery will depend crucially on when lockdown is able to be lifted and which continued restrictions have to remain in place and for how long. As a result, considerable uncertainty remains.

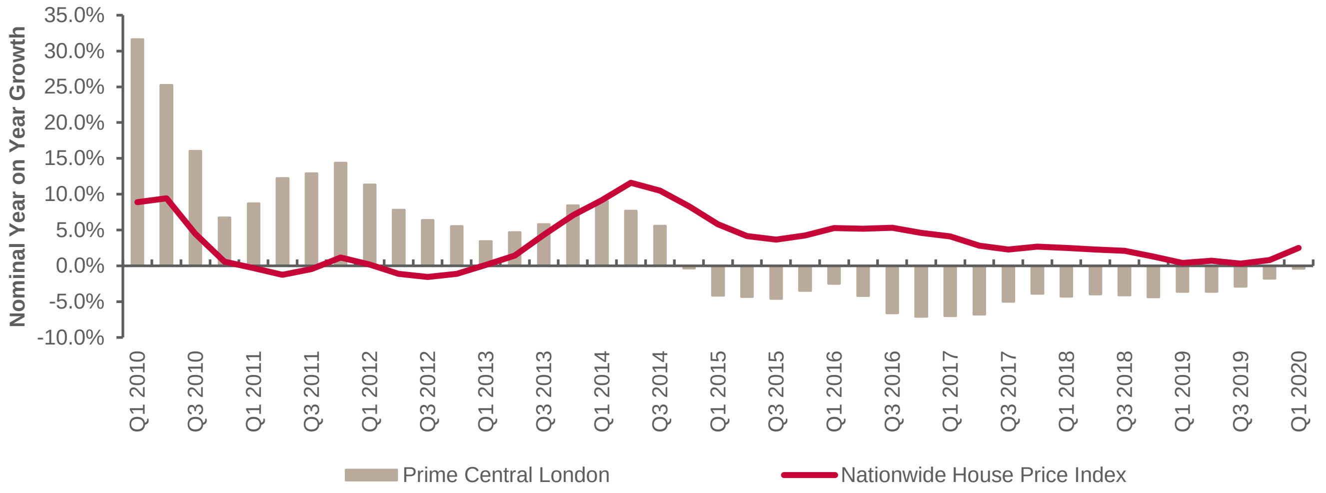
Property market pricing

UK property prices grew by 2.5% in the year to Q1 2020, which represents a 2.1% gain on the same period last year (0.4%), according to the Nationwide House Price Index. YoY growth over the year to Q1 2020 shows that, on a regional basis, the best performers were Wales (6.4%), Yorkshire and the Humber (4.3%) and the North West (4.1%). London and the Outer South East both recovered from the previous quarter's annual price falls (-1.8% and -1.0% respectively) to 1.0% and 1.7% respectively. In April 2020 (the latest press release), house prices grew 3.7% YoY; up from 3.0% the previous month and the strongest since February 2017. Nationwide state however that the impact of the pandemic will not be captured in April data.

The housing market reopened on the 13th May with house moves and viewings able to resume under social distancing and safety rules in England. Despite the ability to trade being improved from complete lockdown, it is likely that pick-up will be cautious given safety concerns, alongside the advice to still remain indoors (applicable to everyone) for Scotland, Wales and Northern Ireland.

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 Q1 2019 and Q1 2020

Region	All Property Q1 2019	All Property Q1 2020
East Midlands	18,061	9,121
East of England	22,178	11,770
Greater London	21,736	11,204
North East	9,682	5,022
North West	27,724	13,712
Scotland	19,451	18,337
South East	31,374	16,793
South West	21,748	11,447
Wales	10,580	5,770
West Midlands	20,037	10,162
Yorkshire and Humber	20,352	10,374

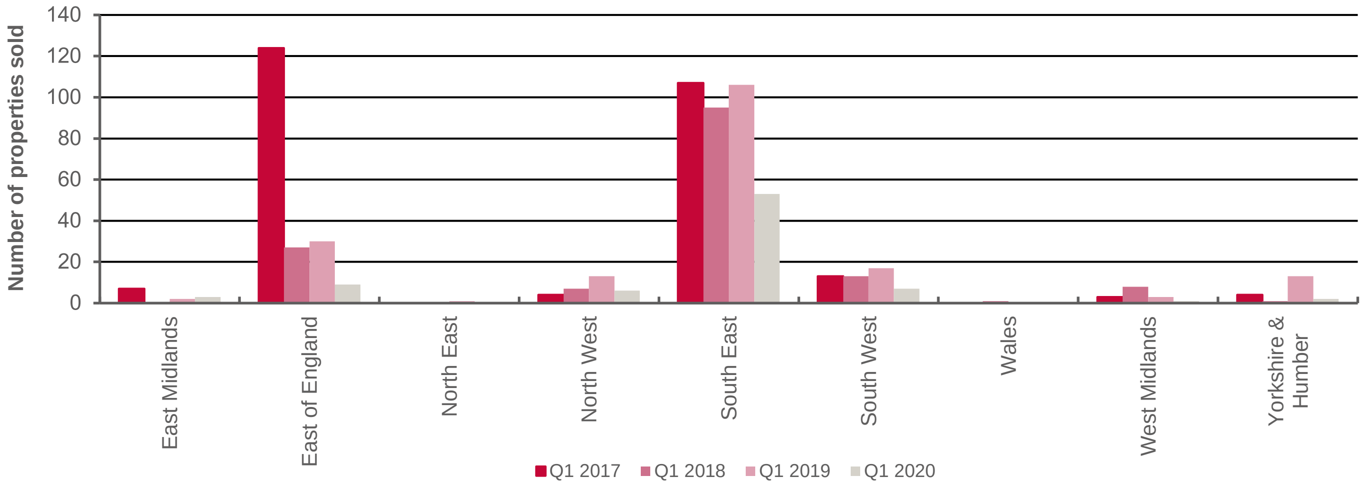
Source: *Dataloft, Land Registry Q1 2019 and Q1 2020 data as at 18th May 2020, Land Registry data has a reporting data lag which is why one will see such a large difference in figures and should not be viewed as a drop in transactions; Registers of Scotland 2019 and 2020 data as at 1st May 2020.*

Country house highlights

All regions, outside of Greater London saw transactions activity in the over £2 million market, however, the largest numbers of £2 million plus homes that sold continued to be in the South East for Q1 2020. With East of England, South West rounding out the top three regions for the largest number of transactions in this price point.

Figure 2

Number of recorded properties sold over £2M in England & Wales excluding London in Q1 of 2017, 2018, 2019 and 2020



Source: *Dataloft, Land Registry 2017 data as at 9th January 2018, 2018 data as at 18th January 2019, 2019 and 2020 data as at 18th May 2020; Please note Land Registry data has a data lag which is why we compare equivalent registered data for the same period.*

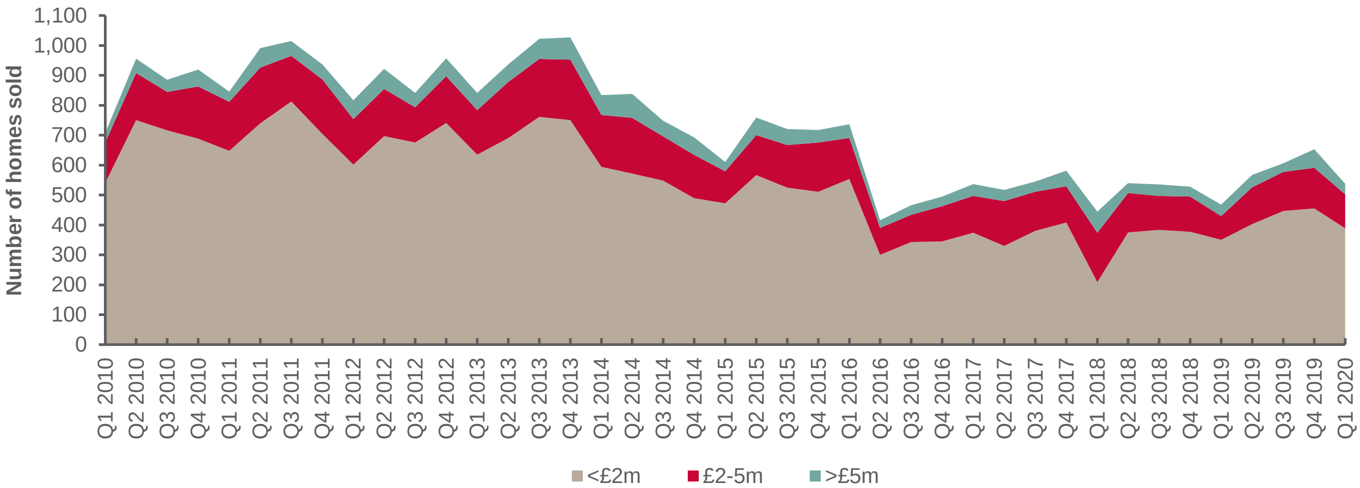
Prime Central London residential sales market

Prime Central London (PCL) sales index data for Q1 2020 reported that QoQ prices grew slightly (0.9%), after Q4 2019 (0.0%) growth brought an end to 17 consecutive quarters (commencing Q3 2015) of falling prices in the PCL market. The growth of Q1 2020 marks the first QoQ increase since Q2 2015 (+0.2%). In the year to Q1 2020, PCL prices have fallen by -0.4% which, although negative, is the smallest YoY reduction in PCL prices since Q4 2014 (also -0.4%).

Total transactions in PCL rose by 24% compared to Q1 2019, although there was a dip in activity levels compared to the previous quarter (-11%). This YoY increase has been driven by positive growth in all three price brackets, and in particular the £2-5m bracket, where transaction levels increased by 56%. By historic standards, however, all transaction levels still remain low. Total PCL transactions in Q1 2020 remain only at 56% of the previous peak in Q4 2013.

Figure 3

Historic number of homes sold in PCL

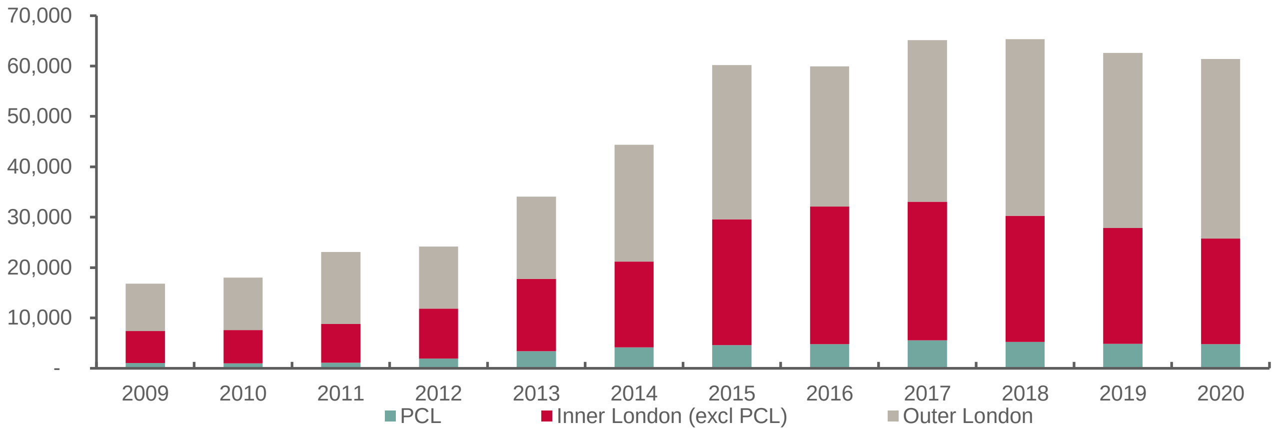


Source: *Dataloft, Lonres.com, Strutt & Parker as at 15th May 2020.*

Greater London residential new homes

Across Greater London, there were 61,400 new build units under construction at the end of Q1 2020, with just over 6,000 new build for sale units sold during Q1 2020 (up 22% compared to Q1 2019), according to Molior. It should be noted that a majority of the sales activity was during the first ten weeks of 2020 and does not capture the decline in activity due to COVID-19.

Figure 4
Number of private sale units under construction in schemes of 20+ private units in Greater London

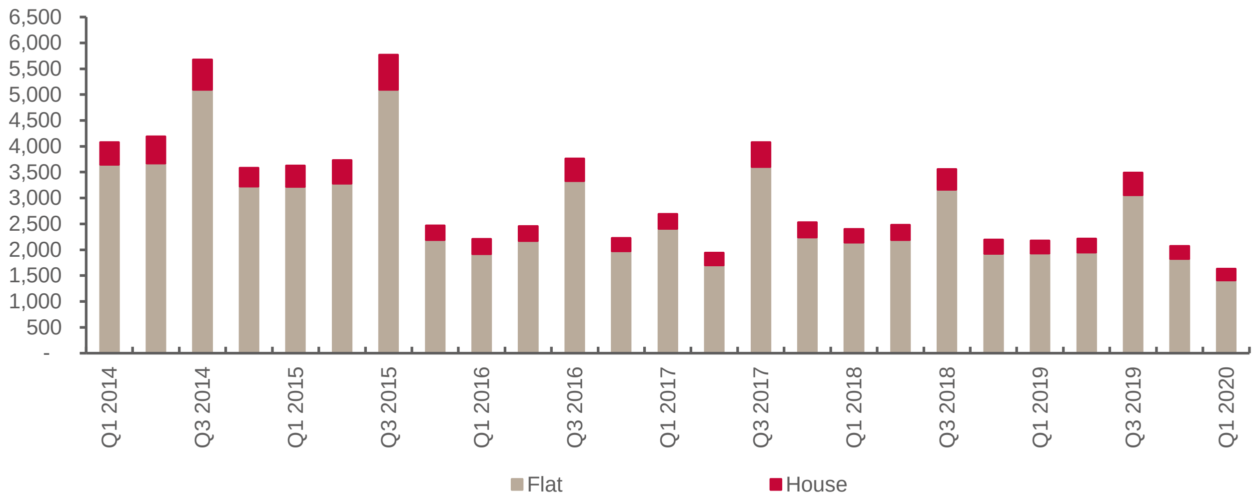


Source: *Molior, Strutt & Parker as at 10th April 2020; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster; Inner London defined as Local Authorities of Camden, City of London, Hackney, Islington, Lambeth, Southwark, Tower Hamlets, Wandsworth; Outer London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

Prime Central London lettings market

The take-up of new rental tenancies across PCL was 25.0% down from Q1 2019 (2,073 homes) which was mainly driven by the decline in the house market versus flats. This decline can be attributed to the market slowing down for the sub £1,500 per week market in March due to COVID-19. However, 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 and now that people are able to move in, it is expected that transactions will recover.

Figure 5
New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 18th May 2020.*

Outlook & forecast

The impact of the restrictions as a result of the pandemic will be felt over the historically busiest three-to-four months of the year. As agents are able to start trading more fully and freely again in June for the entire UK, an estimated 250k transactions will have been lost. This is almost half the quarterly level of transactions and c. 10% overall impact on the year's volumes. This points to a significant short-term direct impact. Furthermore, whilst transactions will be able to resume in some form, there will be considerable market uncertainty given the wider economic outlook. It is estimated that at least half of all prospective buyers and sellers in prime markets are discretionary – i.e. they don't 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 has made it financially viable to wait. If they do so, and half of Q2 to Q4 is lost, this would equate to a worst-case drop-in volumes of an estimated 40-50% over the course of 2020.

Despite the negative impact on transaction levels, given the PCL market had only just bottomed out, agents report little appetite from sellers to change price (preferring to instead wait if they can). Many PCL sellers are outright owners and not part of the demographic that is most at risk of unemployment during the crisis, so they will not come onto the market because they have to. The short-term impact on PCL prices may be as much as -10% but felt only in a very low trade environment, and in specific submarkets or on properties which 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 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.

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. 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 Q3 2019 in light of changes since Q3 2018. 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 behavioural data is collected from our activity in PCL markets: our proprietary "behavioural data" is not representative of the UK as a whole. The global economy remains volatile and therefore there is risk that any market commentary provided will become out-dated within a very short timescale.