Residential Quarterly | Winter 2020/21

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 was impacted in many sectors, with some sectors, such as leisure, unable to function at all, and others, including 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. In 2021, some countries (including the UK) had to reimpose further lockdowns as the spread of the virus increased.

Throughout 2020 the UK experienced varying degrees of lockdown tiers, resulting in the housing market being unable to operate for parts of the year. Across the UK subsequent increases in case numbers during the winter months has resulted in the imposition of a third, national lockdown which was announced on 4th January 2021. It is currently unclear as to when the third national lockdown will end, but it is understood that new legislation governing the lockdown runs until 31st March 2021. It is thought that this will allow for a gradual easing of restrictions prior to then. In any event, the housing market will stay open throughout this lockdown, with safety measures in place to reduce the spread of COVID-19.

Moving away from Coronavirus, the Brexit Transition period ended on 31st December 2020. On the 24th December 2020, the negotiators from the EU and UK reached an agreement on a new partnership which sets out the rules that apply between the EU and the UK as of 1st January 2021. This agreement has been approved by the EU member states and the UK Parliament and provisional application of the agreement took effect on 1st January 2021. In response to the deal, the FTSE 100 rallied on the first day back of trading after the Christmas break. However, the deficiencies of the deal are still causing concern for the markets.

The ONS recorded that the UK economy shrank by 3% in Q1 2020; the sharpest quarterly decline in more than 40 years. However, over Q2 2020, the UK economy shrank by a staggering -19%; the biggest quarterly fall on record. In Q3, QoQ growth was 16%, bouncing back considerably from the Q2 falls experienced.

In the OBR's latest forecast (made in November 2020), the central scenario assumes restrictions equivalent to Tier 3 remain until the spring and an effective vaccine becomes available in H2 2021. In this scenario, UK GDP is expected to fall by 11.3% in 2020 with growth of 5.5% in 2021. This is congruent with the December 2020 HM consensus Treasury forecasts (-11.1% for 2020, 5.4% for 2021). However, the January 2021 HM consensus Treasury forecasts have an average of -10.6% for 2020 and recovery in 2021 at 4.4% growth. The downgrade in 2021 estimates is reflective of the third lockdown. The recovery predicted for 2021 demonstrates 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.

The latest figures from the ONS show that inflation (CPI) as of December 2020 is 0.8%. This is 1.2 percentage points below the 2.0% target, which has not been hit since July 2019. The December 2020 inflation rate was well below the year before (1.4% in December 2019).

A worsening global backdrop and the performance of the financial markets has pushed the Bank of England (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 central banks of the US, Australia, Malaysia and Canada have also cut their interest rates.

The Chancellor throughout 2020 has announced an unprecedented package of Government-backed interventions aimed at supporting businesses and individuals through the current situation, including a furlough scheme to pay up to 80% of employees' wages; mortgage holidays agreed with lenders; business rates holidays and loan schemes; increasing the starting threshold of Stamp Duty to £500,000 until 31st March 2021 (in England and Northern Ireland, with similar measures announced in Scotland and Wales).

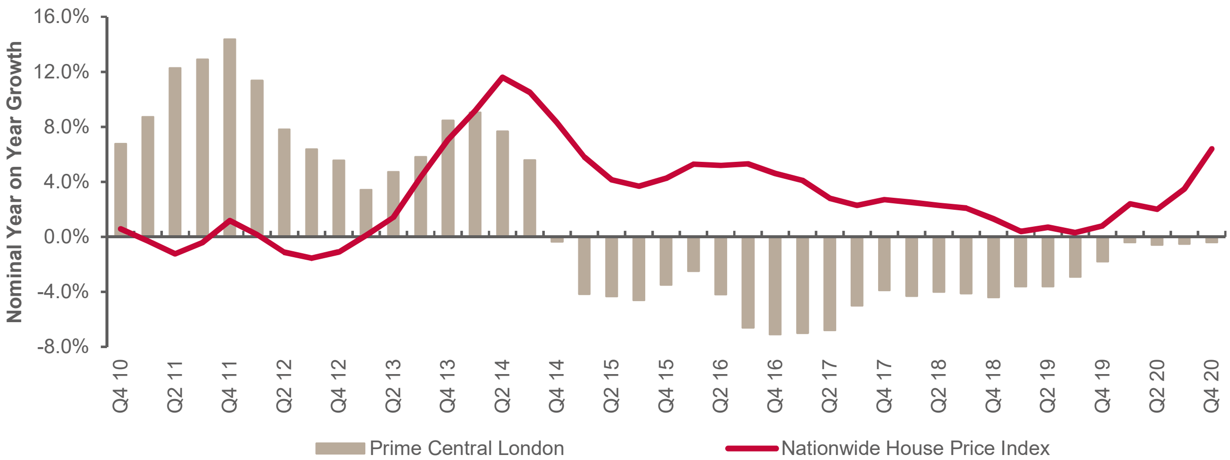
Despite the negative economic outlook, the economic interventions announced by the Government should minimise the rate of unemployment and cushion some businesses. The speed of the recovery will depend upon latent stressors in the economy, which will not be fully realised until all temporary measures (furlough, trading restrictions) are lifted. As a result, considerable uncertainty remains.

Property market pricing

The Nationwide House Price Index stated that UK property prices grew by 6.4% in the year to Q4 2020; the highest YoY growth since the year to Q4 2014. YoY growth over the year to Q4 2020 shows that, on a regional basis, the best performers were the East Midlands (8.6%), outer S East (8.0%) and the North West (8.0%). Scotland saw the lowest positive growth at 3.2% and no regions saw negative growth. London growth was at 6.2%, up from 4.4% the previous quarter.

In their August 2020 report, the Bank of England notes that "housing market activity appears to have returned to close to normal levels, despite signs of a tightening in credit supply for some households". The housing market is due to stay open throughout the third lockdown, which is encouraging for the industry. The November 2020 Bank of England report states: "housing market activity remained strong in most parts of the UK, but contacts reported a modest softening in areas where tighter social distancing rules had been introduced." Given the changing nature of the crisis, the outlook remains varied and hard to predict.

Figure 1
UK house price growth vs Prime Central London (PCL)

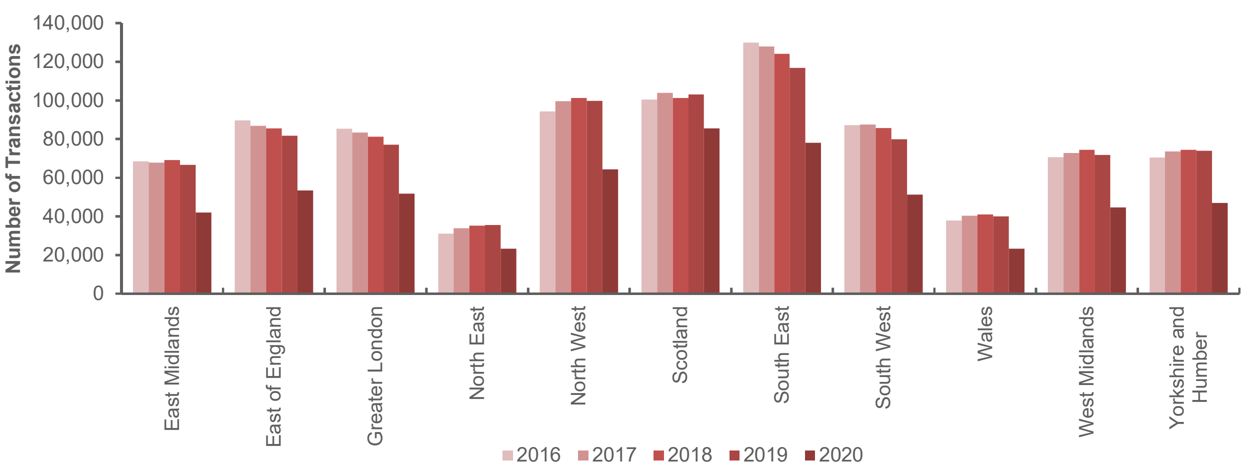


Source: *Nationwide House Price Index, Volterra*

Regional residential sales transactions

COVID-19 halted all transaction activity during Q2 2020, however activity resumed quickly in Q3 2020 as individuals re-evaluated their housing during the first lockdown. Scotland experienced the lowest overall decline in transactions compared to 2019 at -17% followed by the South East and Greater London both seeing a decline of 33% in overall activity compared to the previous year.

Figure 2
Number of recorded properties sold in England & Wales and Scotland during 2016 through 2020



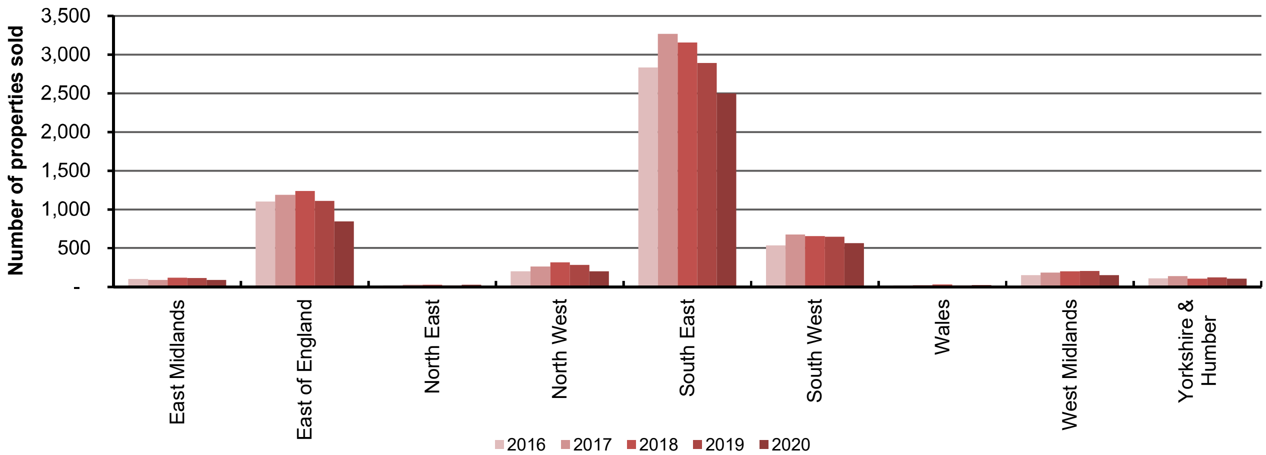
Source: *Dataloft, Land Registry 2016 data as at 20th January 2017, 2017 data as at 9th January 2018, 2018 data as at 18th January 2019, 2019 data as at 20th January 2020 and 2020 data as at 7th January 2021; Land Registry data has a reporting data lag which is typically why one will see such a large 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 is complete as at 5th February 2020.*

Country house highlights

The first lockdown which paused the housing market for most of the second quarter, resulted in an average overall decline in transaction activity of 9% for 2020 compared to 2019 for property over £2M outside of Greater London. The North East and Wales both experienced more transaction activity than in 2019 albeit at low figures, with the South East having the highest amount of overall transactions over £2M, seeing a decline of 14% compared to 2019.

Figure 3

Number of recorded properties sold over £2M in England & Wales excluding London between 2016 and 2020



Source: *Dataloft, Land Registry 2016 data as at 20th January 2017, 2017 data as at 9th January 2018, 2018 data as at 18th January 2019, 2019 data as at 20th January 2020 and 2020 data as at 7th January 2021; 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 is not available for transactions above £2M.*

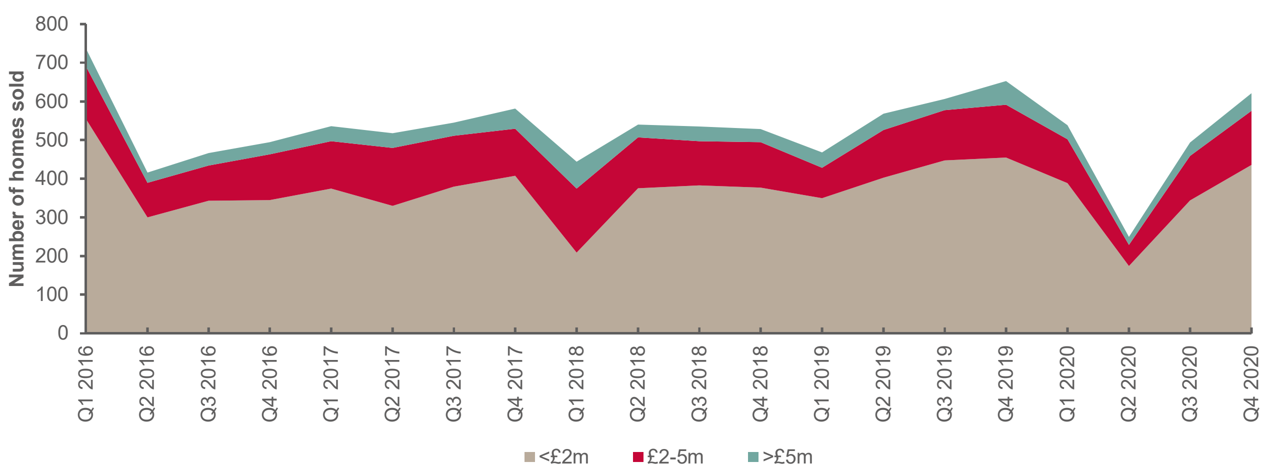
Prime Central London residential sales market

Q1 2020 had been the first quarter of positive house price growth after 17 consecutive quarters of falling prices in the PCL market (commencing Q3 2015 and ending Q4 2019). However, with slight QoQ price falls in both Q2 and Q3, over the year to Q4 2020, PCL prices fell by -0.4%.

Total sales transactions in PCL fell by 5% compared to Q4 2019 but increased by 26% compared to the previous quarter. By historic standards, all transaction levels remain low. In the PCL market, agents report good activity, with deals going through at very strong prices. There has been an increase in refinancing activity. Before the first group of restrictions, the PCL market had only just bottomed out, but is now in slight negative growth. 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.

Figure 4

Historic number of homes sold in PCL



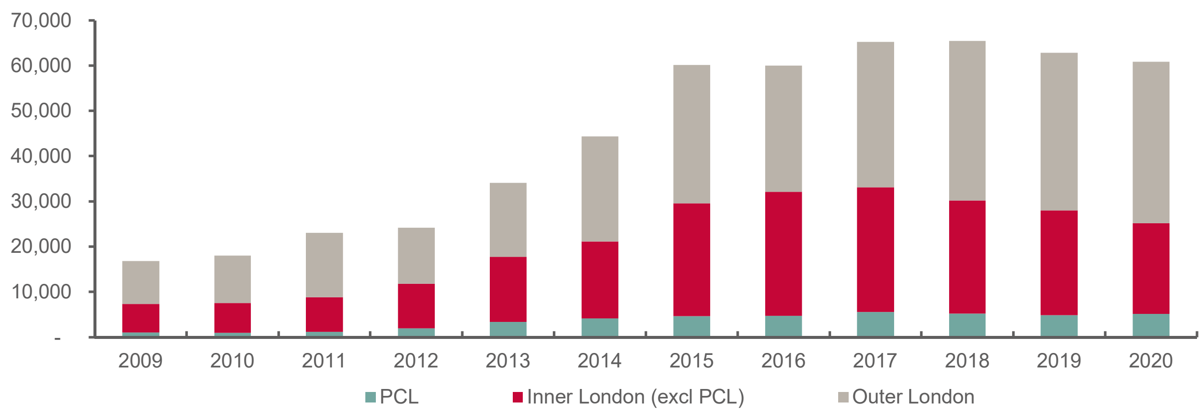
Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th January 2021.*

Greater London residential new homes

Across Greater London, there was just over 60,000 new build units under construction at the end of 2020, with just over 20,000 new build units sold across London during the year, according to Molior. Build to Rent (BTR) represented nearly a third of all transactions sold in 2020. However, BTR purchase activity was concentrated in Q1 2020 as the pandemic impacted the rental market and appetite for this product reduced over the course of the year. The Stamp Duty Land Tax (SDLT) holiday along with the Help to Buy (HTB) programme were drivers for sales transactions during Q3 2020 but saw surprisingly lower than anticipated sales levels in Q4 2020 as both incentives draw to a close at the end of March 2021.

Figure 5

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



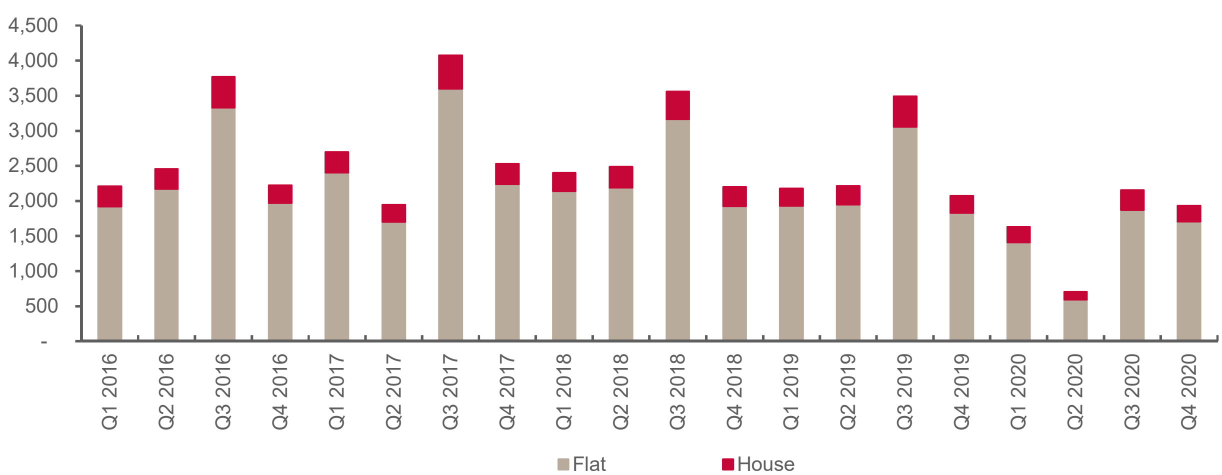
Source: *Molior, Strutt & Parker as at 8th February 2020; PCL defined as Local Authorities of Hammersmith & Fulham, Kensington & Chelsea and Westminster; Inner London defined as Local Authorities of Camden, City of London, Hackney, Islington, Lambeth, Southwark, Tower Hamlets, Wandsworth; Outer London defined as remaining 22 Greater London boroughs.*

Prime Central London lettings market

With regards to PCL lettings, Q1 2020 saw the first positive YoY growth (0.8%) since Q4 2015 (0.3%) which suggested a stabilising market. However, for Q2 2020, both QoQ and YoY growth were negative at -2.7% and -2.1% respectively. The QoQ growth over Q3 2020 improved slightly to -2.4%, but the YoY growth over Q3 2020 worsened to -4.7%. Over Q4 2020, QoQ growth was still negative at -2.0% and YoY growth was -6.7%. The outlook for PCL lettings remains negative as market activity has been low, and supply of stock has risen, making it a very competitive market where price rises are unlikely in the near term.

Figure 6

New rental tenancies in PCL by house type



Source: *Dataloft, Lonres.com, Strutt & Parker as at 7th January 2021.*

Outlook & forecast

Last year, price changes at the UK level were expected to be more severe, with the economic slowdown having the potential to impact some areas more than others. However, UK wide house price growth was stronger than the best-case scenario. Continued good performance at the UK level is anticipated in 2021, with a forecast of between 0% and 5% growth in the year to Q4 2021. All economic forecasts anticipate a significant recovery from 2021 onwards. 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 UK prices of between +15% and +25% over the five years to Q4 2025.

In the PCL market, prices did not move much in 2020, but finished close to the best-case forecast. Moderate growth is expected in 2021. Given the expected recovery of the economy, it is estimated that price growth will be between 0% and 5% in the year to Q4 2021. Given the expected recovery from 2021, it is expected that PCL prices will rise by a cumulative c.+15% to +35% in the five years to Q4 2025.

In Q3 2020, the PCL lettings market saw strong quarterly recovery with transactions 200% above Q2 2020. However, this was still just 62% that of Q3 2019. In the year to Q4 2020, prices fell by 6.7%. Given muted demand and increased supply, the outlook for lettings is for further declines. 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 2021. 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 outcome for lettings over the next five years would be a cumulative rise of c.+7% to +12%.

Table 1. Residential House Priced Forecast

	2021		5 Years to 2025 (inclusive)
	Best Case	Downside Risk	
	Sales		
Prime Central London	5.0%	0.0%	15.0% to 35.0%
UK	5.0%	0.0%	15.0% to 25.0%
	Lettings		
Prime Central London	-2.0%	-10.0%	7.0% to 12.0%

Source: *Volterra, Strutt & Parker*

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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 2020 in light of changes since Q3 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.