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MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the October 2019 edition of the Mortgage and Property Report. In this issue, we look at how the UK property market has performed in recent years. We compare the different ways house price changes are measured and explain why we often see very different headlines in relation to the same period or region. We also examine the impact of the UK's vote to leave the European Union on the housing market to date, and what this means for mortgage lenders.

Key Highlights

- There are a range of different house price indices, which sometimes contradict each other, due largely to differences in methodology and/or coverage
- Since the referendum vote to leave the EU, housing transactions and house prices have declined noticeably in the UK, but the impact is region-specific with London most impacted
- Compared to previous downturns, this one is still benign, largely due to strong fundamentals

Introduction

Headlines about the UK housing market are published on a daily basis, and it is one of the most closely watched and most easily understood indicators of the country's economy. Every move, whether up or down, is made out to be particularly significant. However on any given day, reports about the market and changes in house prices can vary wildly, and are sometimes contradictory, even in reference to the same region or time period. This has been particularly true in recent years, with the reported impact of Brexit being very inconsistent. The reason for the discrepancies is the wide range of house price indices which are commonly published and referenced in the UK, all of which use slightly different methodologies, and measure different aspects of the market; e.g. for July 2019, Halifax reported an annual change in house prices of 4.1%[1], UK House Price Index (UK HPI) reported a change of 0.7%, and Rightmove of -0.2%.

These numbers paint very different pictures. In order to fully understand what is happening in the market, we start by comparing the different ways that house prices are measured, noting the merits and downfalls of each index. We then look at how activity in the property market has actually been impacted in the years since the referendum vote and consider why the market is performing so differently across different regions within the UK and how this compares to prior downturns.

Conflicting Headlines

Figure 1 provides a comparison of the key house prices indices published in the UK. As can be seen, the basis for the data differs significantly across indices: UK HPI, LSL, and Rightmove are all based on whole of market data and cover 80-100K transactions per month, while Halifax and Nationwide are based only on their own transactions for owner occupied mortgages, and thus cover only a fraction of the market. UK HPI and LSL both take into account only actual registered transactions, while Rightmove data is based on listings. Beyond just a difference in methodology, this often means there is a large time lag between the two data points, as the full process from advertising a property through to selling it and the sale being registered at the Land Registry can be upwards of 6 months. Furthermore, the difference between listed and realised sale price has increased significantly in

Figure 1: Comparison of Different UK House Price Indices

Index	Geographic Coverage	Number of Transactions	Timing	Data Included			
				Owner Occupied?	Buy-to-Let?	Cash Purchase?	Mortgage Purchase?
UK HPI	All UK	c. 100K / month	Sold Price	x	x	x	x
LSL	E&W	c. 80K/ month	Sold Pride	x	x	x	x
Halifax	All UK	c. 15K/ month	Valuation	x			x
Nationwide	All UK	c. 12K/ month	Valuation	x			x
Rightmove	All of UK (as of Jan-18)	c. 100K/month	Asking Price	x	x	x	x

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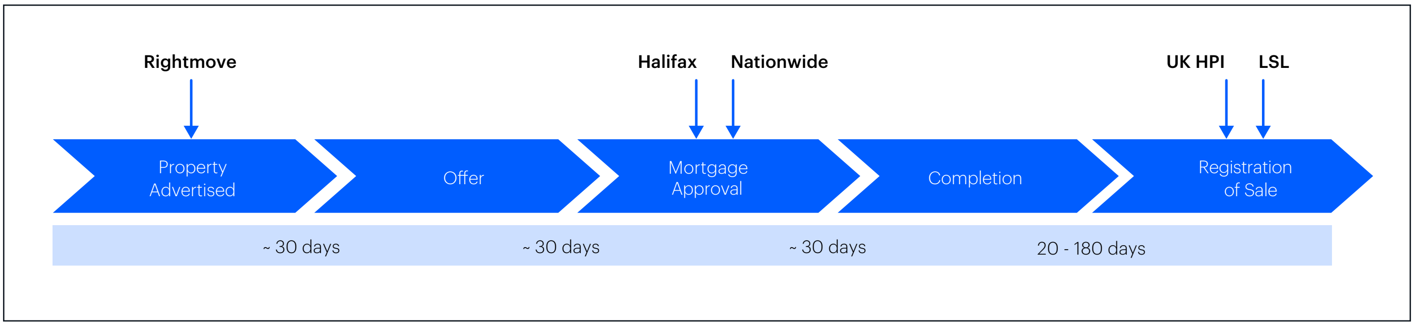
Please contact Alex Maddox +44 (0)20 7532 9845 alex.maddox@kensingtonmortgages.co.uk
Jasmine Heinen +44 (0)20 7532 9005 jasmine.heinen@kensingtonmortgages.co.uk
www.kensingtonmortgages.co.uk

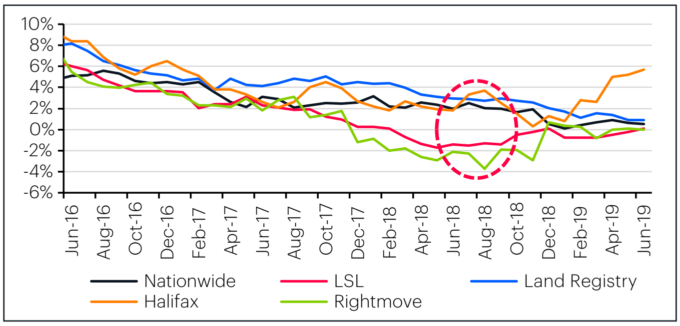
Figure 2: Estimated Average Time for Each Step in the Property Buying Process



the last few years, with sellers increasingly accepting higher discounts to achieve a sale.

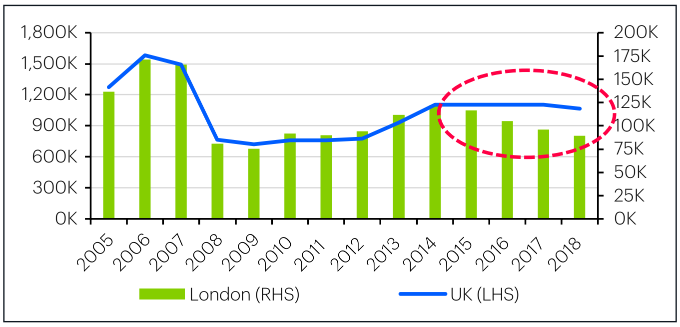
A further important distinction is between indices based on mortgage approval data, and registered sale data. Nationwide and Halifax, which are two commonly-quoted indices, are both solely based on their own mortgage approvals, and exclude buy-to-let transactions. They also don't account for cash transactions, which made up 30% of all property sales in the England last year. This leads to greater discrepancies in regional coverage, as only 21% of sales in London were cash-financed, while that number stands at 36% for the South West.

Fig. 3: Comparison of House Price Indices over 3 Years - YoY Change



While, when examined through time, the indices all reassuringly follow very similar high level trends, when we look at a shorter time period, as in Figure 3, it is evident there are wide variances; e.g. in Summer 2018, the year on year change varies from a 4% price decrease to a 4% price increase, depending on which index is used. It is therefore important to be very clear on what exactly the index used is measuring and what underlying data it relies on when drawing conclusions from these reports. As UK HPI has the widest coverage, it is the one we use in our assessment of the market.

Fig. 4: Number of Residential Property Transactions[4]



What has the actual Impact of Brexit been on the Housing Market?

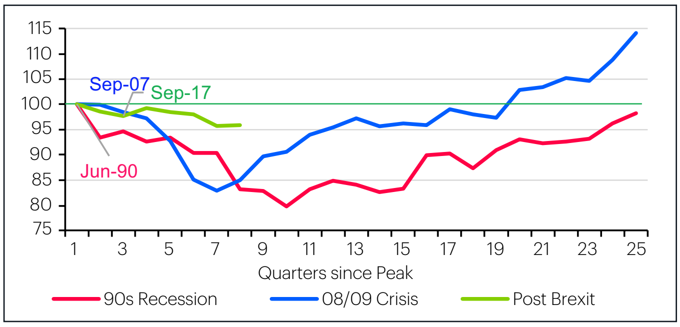
Despite the range of reported impacts, it is clear the referendum vote and the ensuing uncertainty around if, when and under what terms the UK will leave the EU has led to a slowdown of the property market overall. Based on Land Registry data, property transactions in the UK, (Figure 4) which had been trending upwards for a few years, have since levelled off and recently even declined, with only 210K transaction in the first quarter of 2019, the lowest quarterly number since 2013. The effect has been more pronounced in London, where a clear downward trend can be observed from 2016 onwards (despite the large one-off increase in March 2016 due to stamp duty changes). Annual transactions in London fell below 90K in 2018 for the first time since 2009. Along with a decrease in transaction volumes, based on land registry data (Figure 5), house prices have clearly also been impacted negatively. Starting in 2016, a notable decrease in UK house price inflation can be observed, with London house prices actually starting to decrease from 2018 onwards. London has since seen a c. 2% monthly decrease in 2019. The more expensive parts of the city are expectedly feeling the brunt of the impact - those areas also previously experienced greater increases, and thus now face greater corrections.

Fig. 5: Annual Change in House Prices (UKHPI)

Nonetheless, we have observed some differences in the current situation vs. previous downturns. When we compare the house price crash in 08/09 in London with the impact post-referendum (Figure 6), it is clear that the 08/09 drop was quicker and sharper, but that the market was subsequently also relatively fast to recover. A key difference is that in 2008 the UK economy went into recession because of its exposure to the global economy – confidence in London itself was still stable. Brexit has created a very different situation, with the uncertainty coming from within the UK, and any exit from the EU (disorderly or otherwise) is expected to impact the capital in an outsized way. Risk-averse businesses have already pre-emptively moved parts of their operations abroad, and both prospective buyers and sellers seem to be standing on the side lines until there is greater clarity on the future.

Please contact Alex Maddox +44 (0)20 7532 9845 alex.maddox@kensingtonmortgages.co.uk
Jasmine Heinen +44 (0)20 7532 9005 jasmine.heinen@kensingtonmortgages.co.uk
www.kensingtonmortgages.co.uk

Fig. 6: Past London Property Downturns vs. Brexit Impact (rebased to 100 at each peak)[4]

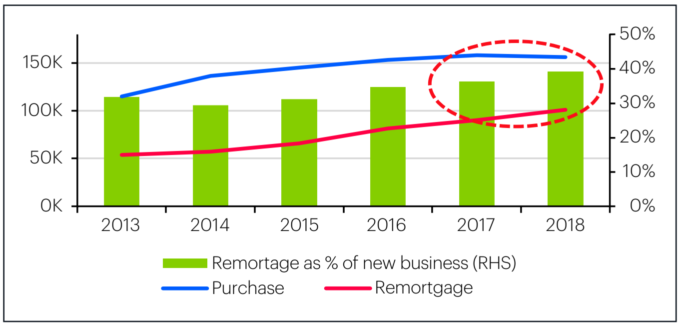


Even so, record low interest rates have to some extent balanced this out, as borrowers have been able to take advantage of cheap mortgage rates, which give them greater affordability and lower repayments. This reassuringly differs significantly from the other major downturn experienced in the UK - the early 90s recession, in which falling prices were coupled with rising inflation and very high interest rates. The combination led to the highest repossession rates seen in the UK to date – in 1991, 0.77% of mortgaged properties were taken into possession – the peak in 2009 was 0.43%[2]. The UK, and the capital, were slow to recover from that crash.

What does this mean for Lenders?

Whether and how the UK will leave the UK will be a key determinant of the future of the housing market, and currently every outcome, from No Deal to No Brexit (and everything in between) is on the table. To date, the UK, and London specifically, has been hurt by the ongoing uncertainty but low unemployment, relatively low inflation, and record low rates mean the actual impact has been benign. So far, lenders have also been able to keep their business fairly flat as low rates have encouraged greater remortgage business even as purchase business continues to level off (Figure 7). With new mortgages underwritten in accordance with more stringent lending criteria, recently originated loans are also expected to be able to better withstand a more severe downturn than in the past. Still, a deep and prolonged slump would have notable consequences on some lenders, particularly those with back books with concentrations of historic interest only loans which could dip into negative equity. Monitoring developments in the market and responding appropriately will be key.

Fig. 7: New Mortgages by Purpose of Loan[3]



References:

[1] Halifax. Data revised according to new methodology in September
[2] UK Finance AP4
[3] BOE
[4] UK HPI and Land Registry data

Please contact Alex Maddox +44 (0)20 7532 9845 alex.maddox@kensingtonmortgages.co.uk
Jasmine Heinen +44 (0)20 7532 9005 jasmine.heinen@kensingtonmortgages.co.uk
www.kensingtonmortgages.co.uk

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