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Hearthstone Investments – UK housing market in light of Coronavirus

The General Election in mid-December resulted in a much-improved sentiment for the UK housing market. Many potential buyers and sellers who had put their plans on hold temporarily returned to the market. The government's intention for investments across the UK and significant infrastructure improvements was positive news for anticipated house building and tenant demand across the UK, in particular in the Midlands and the North West.

As a result, annual house price growth for England and Wales improved from a low of 0.2% in August 2019 to 1% by February 2020 (Source: LSL Acadata), with further improvements expected throughout 2020.

Over recent weeks, we have seen the Coronavirus coming to dominate the political and economic agenda, and wreaking havoc on financial markets. What has been the impact on UK housing and what is our outlook?

First, as you know the UK housing market is not as excitable as other markets. So far, indications from Estate Agents haven't yet shown a significant drop in prospective buyer and seller activity, but it seems inevitable over the coming weeks. The question then is how this would impact house price growth.

A structural rerating of house prices seems unlikely at this point. For that to happen, one would need to assume a prolonged recession as opposed to a temporary shock, and a housing market susceptible to macroeconomic risks. Coordinated global action by central banks and governments is designed to ensure that the likely virus-related recession is short-lived. In that context we are closely monitoring economic activity in China where new cases have been levelling off over the past weeks.

It is also worth pointing out that the UK housing market is in better shape than in 2007/08. Interest rates are low, mortgage lenders have been more prudent over the past decade, the housing market is less leveraged than 12-15 years ago and although jobs are threatened by the current crisis, employment is at record highs.

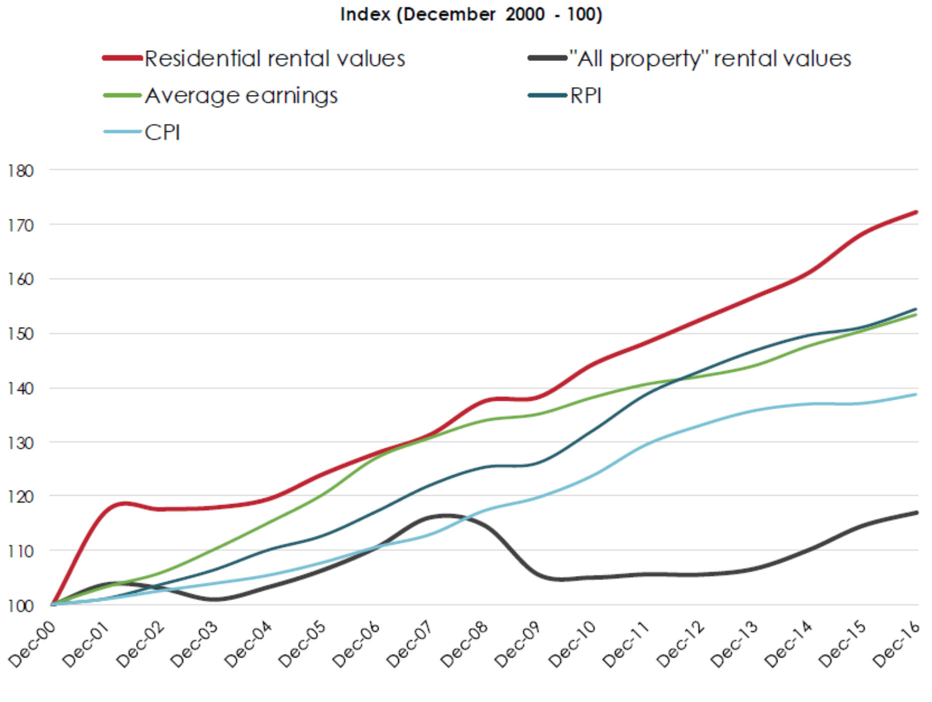
So, whilst we don't want to minimise potential risks ahead, it is worth remembering that this crisis - unlike the GFC - was not triggered by over-inflated house prices.

Assuming the predictions are correct that the virus will peak over the next few months, it seems likely that there will be a release of pent-up demand from buyers and sellers as more normal conditions return, much as we saw after December's General Election, which removed much of the political uncertainty that had overshadowed the market. That now seems a long time ago, as the 'Boris bounce' has been engulfed by the current uncertainties.

It is worthwhile remembering the strong long-term fundamentals of the UK Private Rented Sector. The UK desperately lacks good quality private rented homes, and the proportion of people renting privately has doubled from 10% to 20% over the past two decades. There is no reason to believe that these long-term trends will change. In case of a severe scenario where demand for housing drops, this would likely be offset by an increase in people looking to rent due to stretched affordability. But as mentioned, we are some way off such a scenario.

Finally, a quick look at the income side of the UK housing market. Given the shortage of homes, occupancy in the PRS sector, and indeed our portfolio, has been consistently high. A look at longer term residential rental values demonstrate their resilience throughout cycles – ultimately everyone needs somewhere to live.

UK residential rents, inflation and wages



Source: MSCI UK Property Index; ONS; Hearthstone, March 2018

Of course, we will monitor the situation closely over the coming weeks and update on our views accordingly.

Stuart Springham, Deputy Fund Manager
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