JULY 2020

MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the second 2020 edition of the Mortgage and Property Report. In this issue, we look at how the wider mortgage market has fared through the COVID-19 crisis. We examine how new lending has been impacted and what the recovery might look like, as well as what the changes in the industry, both temporary and permanent, mean for lenders and customers and the future of the sector.

Key Highlights

- The Covid-19 crisis temporarily shut down the house purchase market, and while demand bounced back quickly, the slow recovery in product availability in some segments means not all pent-up demand is being met
- The need to react to hurdles brought on by the lockdown led lenders to implement technological changes very quickly in an industry which has historically been slow to adapt to digital developments
- The crisis has caused fluctuations in demand for different types of properties, e.g. for holiday lets and student accommodation, as well property types and location, some of these changes are expected to be long-term as customers' lifestyles adapt to a new normal

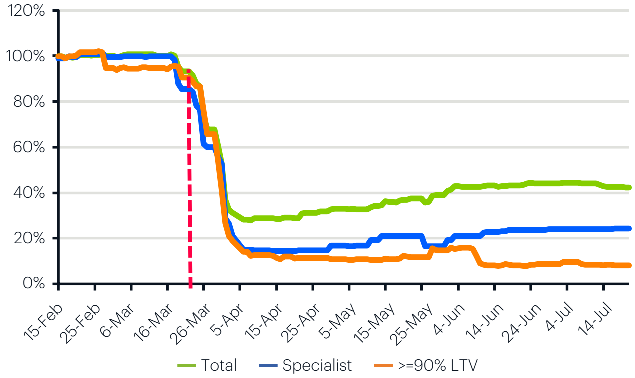
Introduction

Headlines around the mortgage market and the COVID-19 crisis over the last few months have focused predominantly on the large number of payment holidays and financial difficulties experienced by existing mortgage holders, but the crisis has had many other important effects. The most immediately felt impact was the significant hurdles it created for aspiring buyers – lenders abruptly reduced their product offering or ceased lending in entire segments of the market as they narrowed their risk appetites in the face of growing uncertainty. This combined with logistical issues such as the inability to view properties and carry out valuations meant home purchases had to be put on hold. Demand bounced back quickly when lockdown measures were eased, but there is a lingering misalignment of supply and demand in some segments of the market. Another more positive impact for customers was the adoption by many lenders of digital solutions to enable them to continue some lending (e.g. AVMs, digital document signing, and ID verification), and a greater move towards digital contact channels to ensure they could continue to interact with customers and brokers. This was long sought by the sector, and the crisis accelerated the adoption of many solutions for which there was previously demand, but which were slow to be implemented. The final impact is the possibility of a broader change in housing demand, both in terms of location and property type, driven by changes in travel and the wider population's working and living habits. It is still difficult to measure and too early to determine whether any changes will be long term. These changes could drive performance of some segments of securitised portfolios, especially with respect to repayment rates.

Product Availability

As the COVID-19 crisis hit the UK in mid-March and capital markets shut down, lenders quickly started to reduce their product offerings to reflect changing risk appetite in an uncertain time. Following the announcement of the lockdown on March 23rd, even the most optimistic ones had to pull many products, as the restriction on entering other people's properties made physical valuations, required by most lenders for at least some of their products, impossible. The total number of mortgage products available in the market dropped by more than 70% within 2 weeks, and closer to 80% and 90% for specialist products and high LTV lending respectively.

Fig 1: Availability of Mortgage Products
(100% = average of last 2 weeks of Feb)



The lifting of lockdown measures and the recovery of capital markets has given lenders renewed confidence, and the number of products is again rising, but the specialist segment has recovered more slowly. One reason for this is that specialist lenders focus on more multifaceted products, including customers with complex income and complex property types, which are more difficult to assess in uncertain economic times. Another reason is that they are generally significantly more dependent on capital markets than the high street, who use wholesale funding for diversification rather than as a main source of

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funding, and the fact that non-bank lenders had virtually no access to government support schemes, so were fully reliant on the return of functioning capital markets. As expected, the higher LTV segment has fared worse as the number of products has continued to shrink, with fewer products available in July than in April, when other segments were at their low. This is particularly troubling for First Time Buyers (FTBs) who typically have smaller deposits and far fewer options in this environment.

Fig 2: Number of New Loans for Home Owners

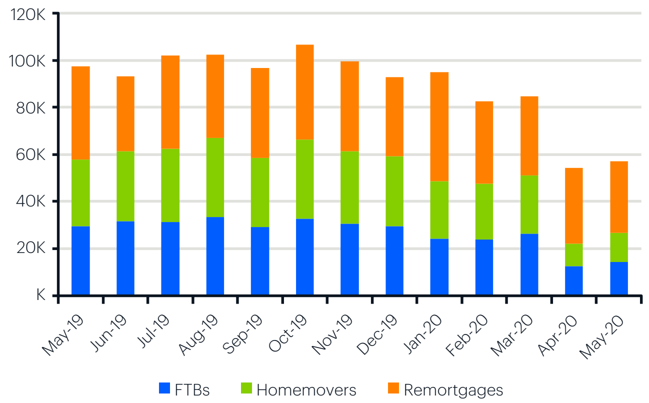
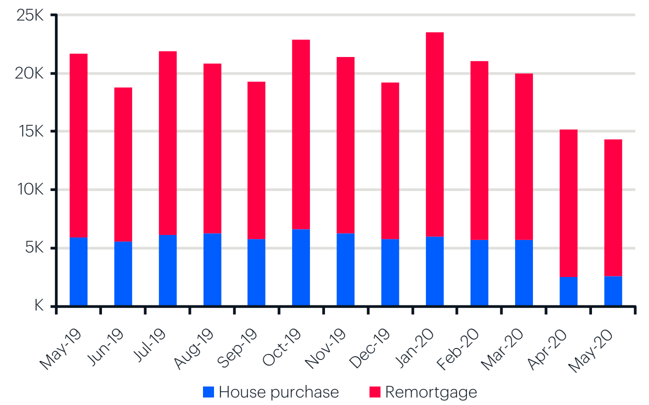


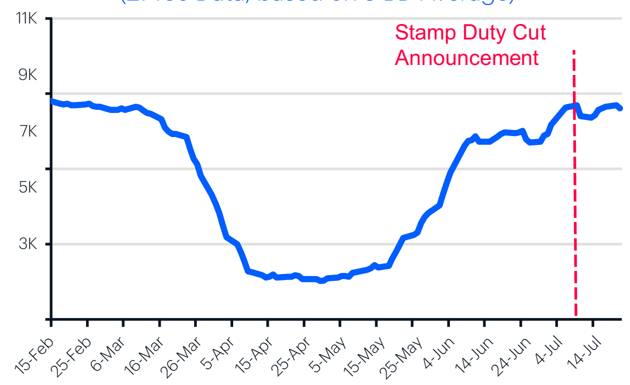
Fig 3: Number of New BTL Loans



The restrictions imposed by the lockdown led to a marked decrease in new loans for house purchase, with loans for home-movers down c. 56% and loans for FTBs down c. 52% in May 2020 vs. May 2019 (Fig 2). This led to the reversal of several long-term trends, including an inversion in the split between remortgages and purchase lending as restrictions on valuations meant refinancing of existing loans was the most straightforward business lenders could continue to lend on. This trend is not expected to last, but the impact on FTBs will likely remain until higher LTV lending becomes available again. The Help to Buy Scheme, a key initiative for FTBs, has also been hurt– the most recent government data only runs to March 2020, but total completions in Q1 2020 vs. Q1 2019 are down c. 8.5%, with the month of March down 17% year on year. There have been calls for the scheme, which is scheduled to end in its current form in March 2021 to be extended to cater for pent-up demand. The Buy-to-Let (BTL) segment was also impacted, although less significantly, with total BTL business down c. 34% year-on-year in May (Fig 3).

Encouragingly, since early June customer demand seems to have moved back to pre-Covid-19 crisis. 27Tec data shows that total illustrations are now back to the same level as in mid-February when the "Boris bounce" was in full swing, following a huge drop-off from early April to the end of May. A key driver was the announcement of the suspension of Stamp Duty on properties up to £500K, with 27Tec reporting the highest number of searches year-to-date in the following week. Nonetheless, a significant discrepancy in supply and demand for higher LTV product remains, meaning not all those hoping to buy will be able to. 27Tec reported that 16.4% of all searches in June were in the 90%+ LTV category, while only 2.5% of available products were in this range. This presents an opportunity for lenders willing to take on more risk, but means for the moment, customers in that segment remain underserved. Another segment which may experience difficulties is remortgages for customers who took advantage of a payment holiday (PH)– it is not yet clear how lenders will treat these, but some restrictions on mortgage availability for them are likely. There are also lingering operational challenges, as many lenders diverted resources from new lending to deal with PH requests and are just now starting to shift these back.

Fig 4: Illustrations for New Mortgages
(27Tec Data, based on 5 BD Average)



Adoption of Digital Technologies

On a more positive note, the restrictions on face to face interactions led to the adoption of some digital technologies which were long overdue in the industry. Most notable was the rapid acceptance of AVMs and desktop valuations by a number of lenders, including Kensington, who previously required physical valuations for most products. The technology is by no means new, but the absence of other options led to it finally being adopted on a large scale. While lenders will undoubtedly still prefer physical valuations for higher risk properties, it is expected that AVMs will become more common in the future. Hometrack, a leading valuation firm in the UK saw a 15% increase in the proportion of its business conducted by AVMs, and its desktop valuation tool for surveyors saw 500% growth. Lenders have reportedly also been more open to using technologies such as digital document signing and ID verification. Video calls, online chat, and emails communication also became the norm, replacing face to face meetings and traditional telephone calls. Of course, there is a question about whether these changes are here to stay, but in a sector where there has been demand for digital evolution for years, it is unlikely customers will be willing to move back to more traditional channels.

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Changes in Home Ownership Demand

The greater reliance on technology was not limited to the mortgage market - the lockdown has also significantly changed broader working habits for office-workers in the UK. Flexible working had been gaining pace for some time, but much like the adoption of new technology in the mortgage industry, it was previously a very gradual move, with many companies sceptical about having their workforce operating remotely full time. Necessity led this to change overnight, and both employers and employees are seeing some of the upsides of remote working, including costs savings on office space, and the end of long commutes. With many companies open to more regular home working, some customers are re-evaluating their living arrangement, with less emphasis on optimising commutes and more emphasis on space and location. This could lead to a more permanent shift in housing demand across the country.

On the BTL side, the rental market has been hit by a huge slowdown in short-term holiday lets, and the exodus of students, many of whom returned home in the absence of face to face classes. This has impacted London in an outsized way, with Rightmove reporting that rents in the city were down 2.8% in the last quarter, and supply has increased by 41% compared to the same time last year. These changes are expected to be less permanent, but will likely impact the market for some months yet. Nonetheless, optimism and the cut in the stamp duty on property prices up to £500K is expected to keep BTL investor interest up.

Conclusion

The impact of COVID-19 on the wider mortgage and housing market has clearly been significant. The pent up demand we've seen in recent weeks is promising, and we are optimistic that all the recent activity in capital markets will reassure lenders and investors, and allow for the re-introduction of some of the high-demand products offered by specialist lenders like Kensington which haven't been available since the beginning of the crisis. The technological advances we've seen in recent months are also a welcome development, and perhaps the silver lining of the crisis. How housing demand might shift in the coming months and years remains to be seen, but it is certainly an area to watch.

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