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Savills World Research
UK Residential
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THE IMPACT ON THE MAINSTREAM MARKET
Brexit Briefing

INITIAL REACTION
Caution is likely to affect sales in the housing market but low interest rates will underpin prices

SUMMARY

Market driven by short term sentiment and longer term economic fundamentals

■ **Buyer sentiment:** initially caution, particularly among discretionary buyers, is likely to curtail housing market activity as buyers' willingness to commit to a major purchase weakens. Over the medium term we expect to see sentiment improve but also fluctuate as negotiations to leave the EU proceed.

■ **Transactions:** buyer sentiment is likely to lead to lower sales volumes in the short term. The possibility of tighter lending could pull transactions numbers further down from recent UK highs of 1.3 million a year. However, at this stage, we do not expect sales volumes to decline to post credit crunch lows.

■ **Mortgage lending:** so far it has been business as usual. Should downside risks persist, there is a possibility that lenders tighten lending criteria. If stricter borrowing rules come into play, first-time buyers and second steppers will be the most affected.

■ **Low interest rates:** will underpin house prices with the prospect of a cut in base rates. This may present opportunities for those on low loan to value mortgages.

■ **House prices:** price growth is likely to slacken as a result of weaker demand in the short to medium term. Looking ahead the possibility of a slower economy could have an impact on price growth. We do not rule out the possibility of price falls in weaker markets.

■ **Low supply:** low levels of house building has resulted in a market that is fundamentally undersupplied. This has not changed.

Political, economic and financial uncertainty following the EU referendum will have an impact on house price growth and housing transactions with implications for existing and aspiring homeowners.

It will take time for the extent of those impacts to become clear. Much depends on how political and economic uncertainty affect sentiment, particularly in the short term. Further ahead, the economic impact on household finances will be critical. The prospects for earnings, inflation and effective costs of borrowing are key.

To add a further layer of complexity, the response of lenders and policy makers will influence the extent to which people are able to get on and trade up the housing ladder and consequently the underlying strength of demand. Measures to support lending or provide relief from stamp duty could, for example, mitigate market headwinds.

With so many unknowns, our view on the potential impact on the housing market will undoubtedly evolve. However, there are a number of factors that will shape the housing market going forward.

> "It will take time for the extent of these impacts to become clear"
>
> **Lucian Cook, Savills Research**

▼The economic impact on household finances will be critical

FIGURE 1

Political, economic and financial effects of Brexit on the housing market

	Political	Economic	Financial
Event	• Short-lived leadership uncertainty • Ongoing negotiations with Europe • Outside possibility of a General Election	• Prospect of inflation following fall in sterling • Slower economy affects wage growth and employment prospects	• Risk of tighter lending criteria • Possible rise in cost of higher LTV loans to new borrowers • Bank base rates lower for longer
Potential Impact	• Consumer, investor and homebuyer sentiment subdued HOW MUCH? HOW LONG?	• Squeeze on household finances constraining buyer demand • Rise in rental demand SCALE UNKNOWN. POSSIBLY MILD?	• Limit access to housing markets • First time buyers and second steppers most affected HOW SOON? TO WHAT EXTENT?
Possible Effect on Housing Market	Fall in transactions Greater impact on places where affordability most stretched Greater reliance on Government support	→	Prospect of slower price growth at a national level

Source: Savills Research

Short term sentiment

Sentiment will determine the impact of the Brexit vote in the short term.

In the run up to the vote there was little firm evidence that buyers had become more cautious in the mainstream market. Transaction levels were heavily distorted by the 1st April stamp duty changes, making it hard to identify trends. However, the RICS survey did record falls in new buyer inquiries in the months of March, April, and May in response to the risk of a Brexit vote.

We expect a further weakening in buyers' willingness to commit to a major capital purchase given the political uncertainty following the Brexit vote.

Buyers' reluctance to commit to a purchase may ease as the political picture becomes clearer but we expect sentiment to ebb and flow over the medium term, as negotiations to leave the EU proceed and the implications for different parts of the UK economy become clearer.

The short-term impact on sentiment is also likely to vary geographically and between different buyer groups, in part dependent on the level of opposition to or support for Brexit. That would potentially indicate more caution in the domestic markets of London and among first-time buyers and second steppers but less among mature homeowners.

While this short-term sentiment effect is likely to take longer to feed into the house price indices, we would expect the first indications of this impact to come from consumer confidence surveys and mortgage approvals.

Longer term economics

Ultimately housing affordability will determine the impact of the vote to leave the EU on house prices.

Income and inflation

There is likely to be some pressure on household finances from an anticipated spike in inflation triggered by a weak pound. Whereas the devaluation of sterling may stimulate overseas demand in the prime market, it is unlikely to have a significant impact on the mainstream market. Over the longer term, the prospect of reduced economic growth will constrain income growth, applying a squeeze on the domestic purse.

Both of these factors have the potential to act as a drag on house price growth and transactions, although in the absence of other drivers they are unlikely to cause significant price falls.

Mortgage availability

The housing market is likely to be more sensitive to the availability and cost of mortgage debt, which directly affects around two thirds of the current market.

The Bank of England has already taken steps to facilitate lending by easing capital requirements for banks, potentially freeing up £150 billion. We have yet to see how lenders respond.

Should mortgage providers adopt a more cautious approach, we could see a tightening of lending criteria in the form of loan to value and loan to income ratios. Such a move would primarily affect new borrowers and act as a restriction on transactions. Consequently, it would also act as a further drag on house prices. However, we would only expect lenders to respond in this manner as and when the Brexit vote feeds into the wider economy.

In the first quarter of 2016, low risk lending at loan to values of up to 75% accounted for just short of 70% of all mortgage lending, at levels within 12% of their Q3 07 peak. Lending at riskier higher loan to values remains far more constrained with very little (just 2.7%) at loan to values of over 90%.

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> **Lucian Cook, Savills Research**

▼ The market is likely to be more sensitive to the cost and availability of mortgage debt

We would expect lending in the 75% to 90% loan to value range (which is just under half its pre credit crunch levels) to come under the greatest pressure, impacting those in their early period of homeownership the most.

Should lenders rein in lending, we would also expect them to limit lending at higher loan to incomes, where affordability is more stretched. This is most prevalent in London and least common in the markets of the Midlands, the North, Wales and Scotland.

Importantly, the effect could be tempered by a continuation of Government support such as the mortgage guarantee scheme which is due to expire at the year end. It would also increase the relative importance of schemes such as Help to Buy to the house building industry.

Cost of mortgage debt

Much depends on what happens to the twin determinants of the mortgage interest rate – base rates and mortgage lenders margins.

The Bank base rate has now stood at an unprecedented low of 0.5% for over seven years. Its future depends on how the Bank views the relative requirements to control inflation on the one hand and encourage economic growth on the other. As things currently stand the consensus appears to be for further cuts this summer, though this may not be fully mirrored by a cut in mortgage rates.

There is a risk that the cost of mortgages may rise further down the line as banks seek to protect their margins. At the end of June the average quoted interest rate for a two-year fixed mortgage stood at 1.74% at a lender's margin of 1.24%. This figure has been largely unchanged over the last 12 months, having progressively fallen over the preceding five years.

Having levelled out before the referendum, there is a risk lenders margins will be put under some upward pressure in response to a more uncertain economy and housing market.

Overall that could put a squeeze on affordability at the point of purchase but not a rapid tightening across a wider cross section of mortgaged homeowners that leads to widespread repossessions. This limits any downward pressure on prices.

Conclusions

At this stage, it appears that the downside risks to the housing market are milder than the events that led to the 2008 financial crisis. However, political and economic uncertainty is likely to curtail housing market activity initially as discretionary buyers exercise caution.

The potential for lenders to tighten lending criteria presents a longer term risk to market activity, especially among first-time buyers and second steppers. This could mean that UK housing transactions, which reached a post credit crunch high of 1.3 million transactions over the past year, fall back. At this stage, we do not expect sales volumes to decline to post credit crunch lows.

Short-term weakening of sentiment is likely to slow annual rates of house price growth across the country. Thereafter, a squeeze on household finances and tightening of lending criteria look likely to act as a drag on house price growth. Regionally, we believe London is likely to see the biggest impact, given the extent to which affordability has become stretched in this market after a prolonged period of strong growth.

Though we cannot rule out price falls in some weaker markets or in the event of a more substantial economic shock, we believe prices will fundamentally be underpinned by a continued low interest rate environment and low supply.

MORE ON BREXIT: We will be publishing further reports on specific topics including prime, rental and development markets

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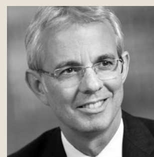

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