Resilient economy to be tested in latest crisis

Winter 2022

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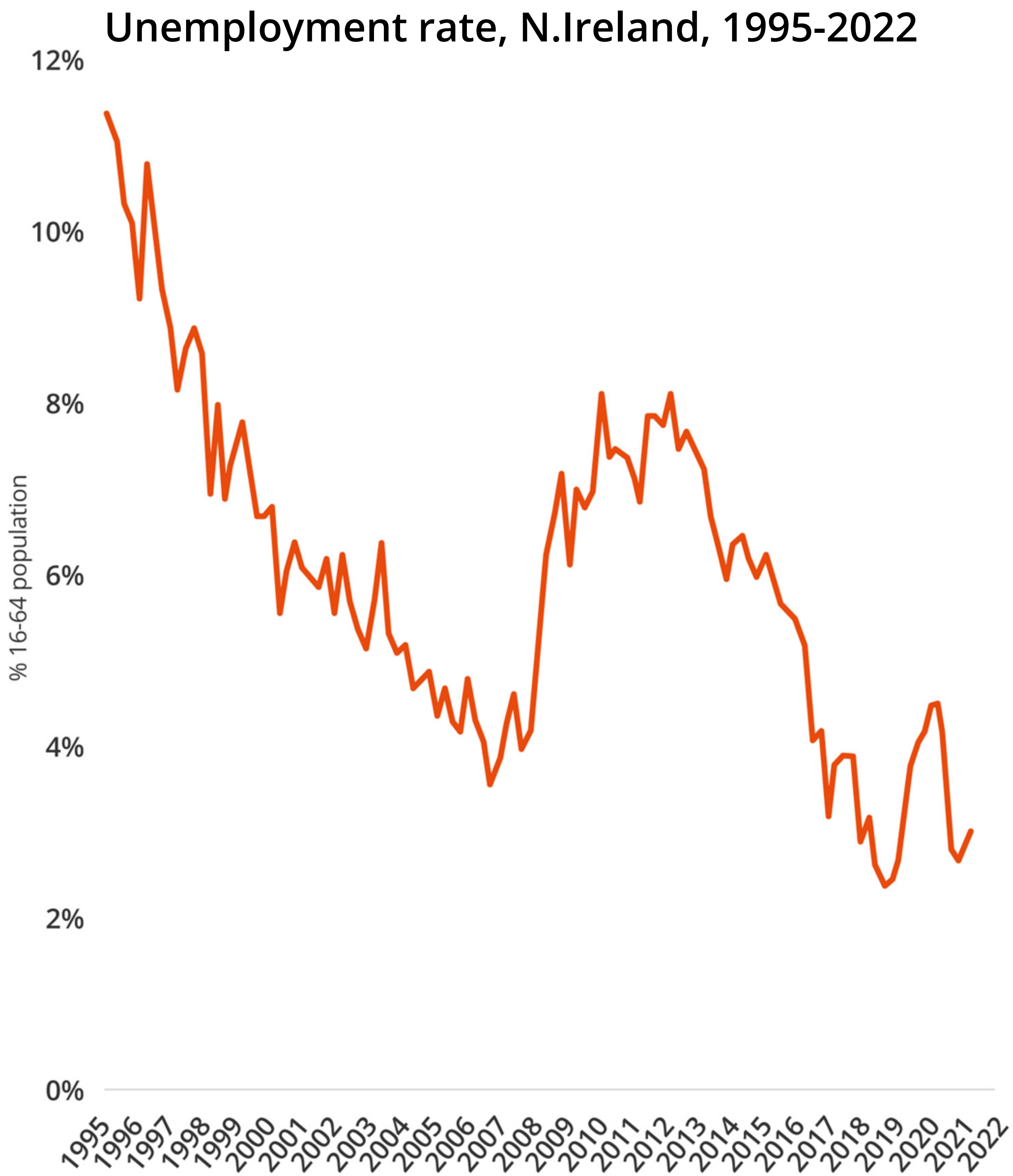
Agenda

1. Economic context
2. Monetary Policy & Housing Impact
3. Housing market- leading indicators
4. The outlook and closing thoughts

Economic Context

The labour market is still red hot



Source: NISRA, LFS, PropertyPal analysis

- **Unemployment is 3.0% and labour market outlook remains critical for future economic projections**
- Employees are up (but employment is down because self employment is down).
- Unemployment is low, but underemployment a feature as hours worked haven't recovered
- **Corporate 'hire freezes' means unemployment will rise** (replacement & expansionary demand) But 17k jobs advertised in N.Ireland in September 2022
- **Wages are up 5.7**% (but falling in real terms). This could prove inflationary in medium term and worries the BoE!
- **Economic inactivity up 30,000** (driven by increase in long term sick)
- High vacancies and **skills shortages** are commonly reported as significant challenges facing business which will keep some upward wage pressure across pockets of economy

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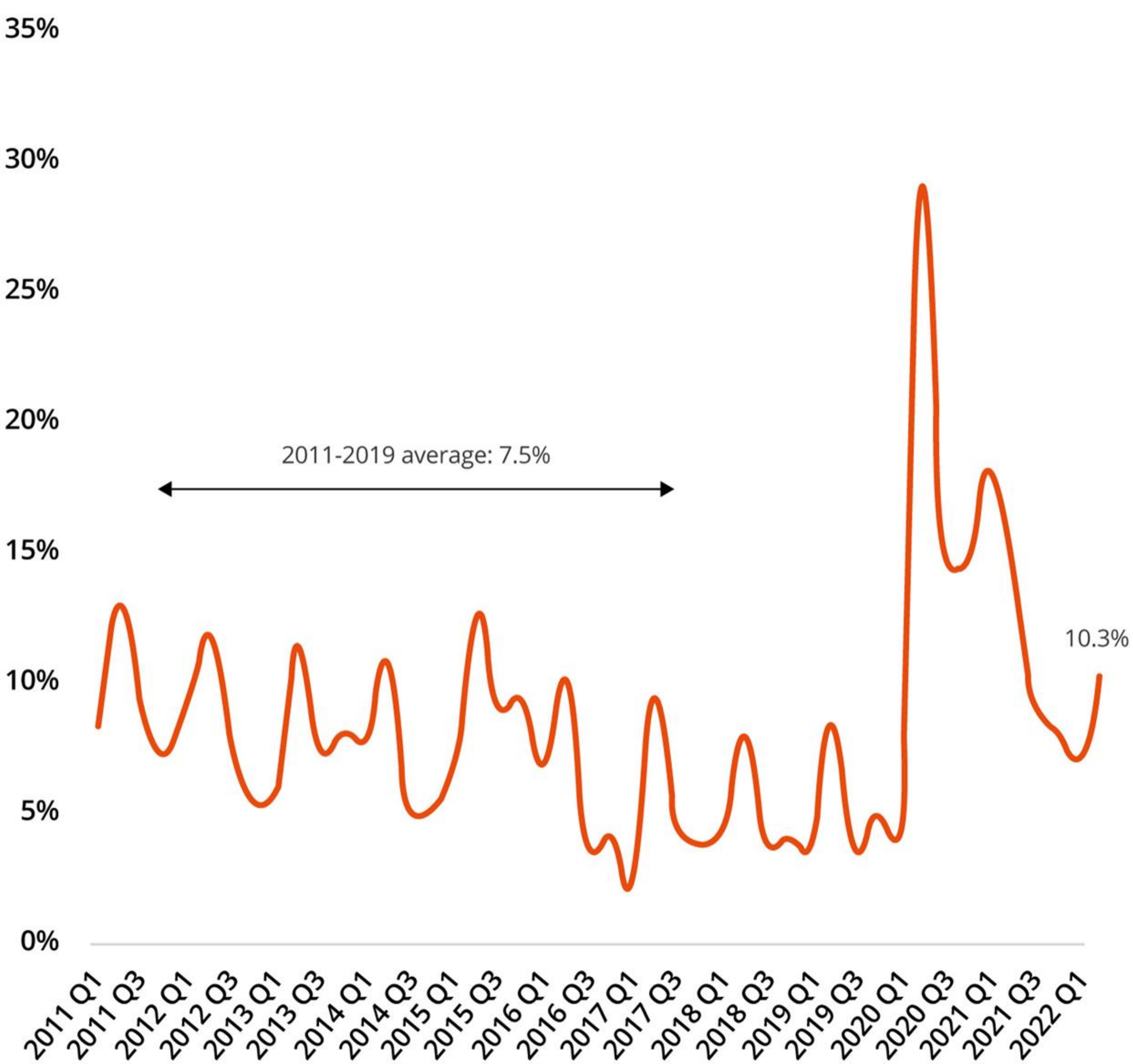
Personal savings balances surged - a big driver of housing activity

Savings ratio, UK, 2012-2022



- **Cash Mountains: £200 billion of additional savings during Covid-19 with the majority accrued by wealthier households.**
- **Mid-high-income households were 4x** more likely to have seen saving grow during the pandemic
- **Unsecured debt levels** were reduced since pandemic and are **4% lower than 2007/08** (as % income)
- **Mortgage debt is up since pandemic but a significant 19% lower** than 2007/08 (as % income)
- **Inequality has driven housing in last 2 years**, more money, better access to low-rate mortgages & tax holiday favouring expensive properties.
- **Saving balances running down current cost of living pressures (for some households!)**

Source: PropertyPal analysis; Bank of England

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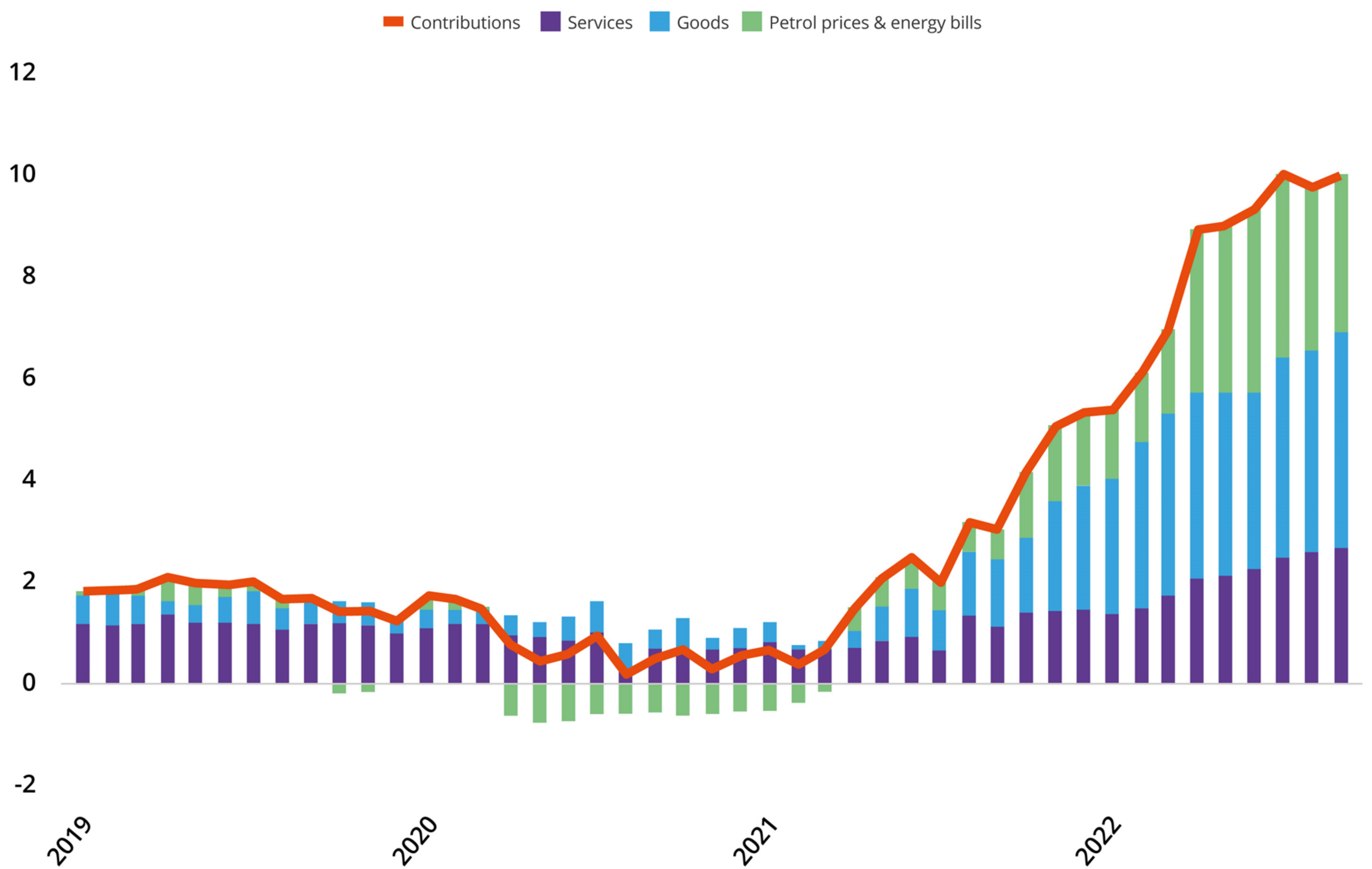
Inflation is a global phenomenon driven by supply side shocks

Annual inflation rate (% change) and the contribution of goods, services and energy prices



Source: Bank of England, Nov 22

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Trussonomics was spend spend spend…
& the rest is history

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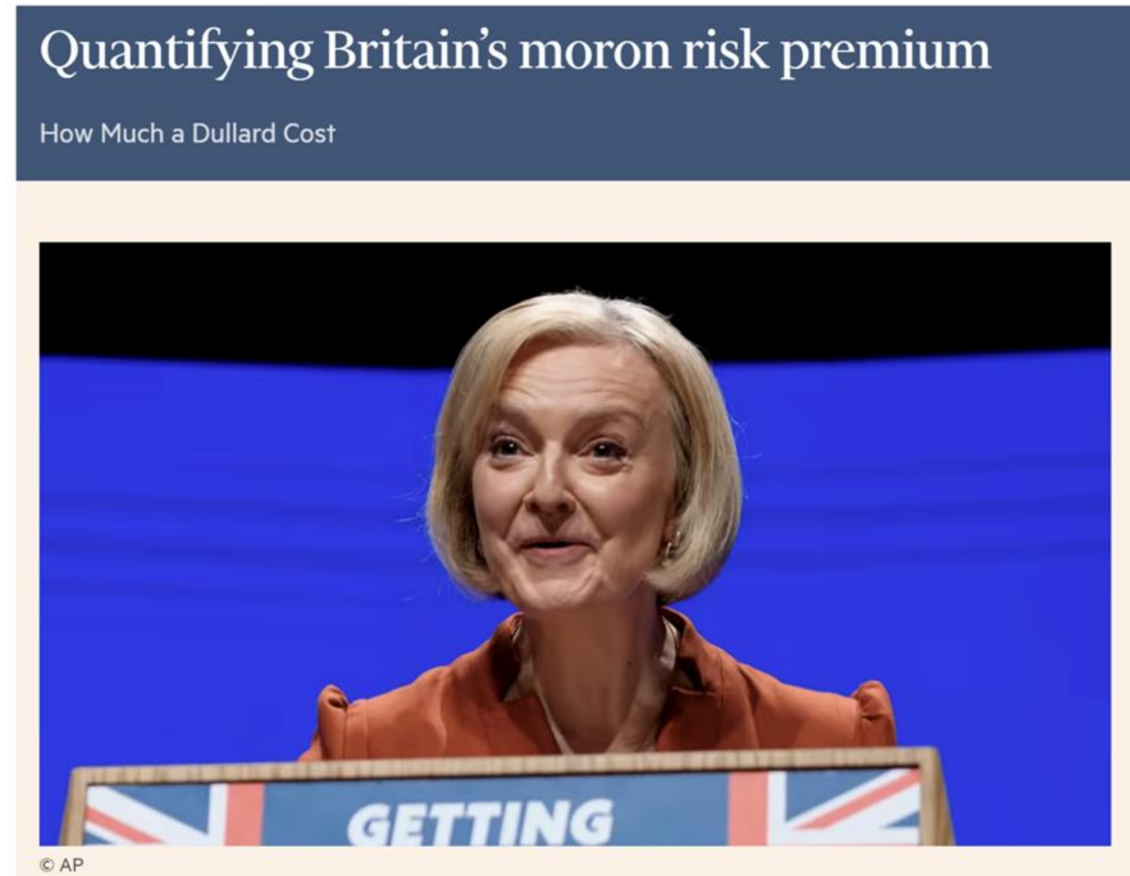


"The problem isn't that the UK budget was inflationary, its that it was moronic. And a small open economy that seems to be run by morons gets a wider risk premium on its assets - currency down, yields up"

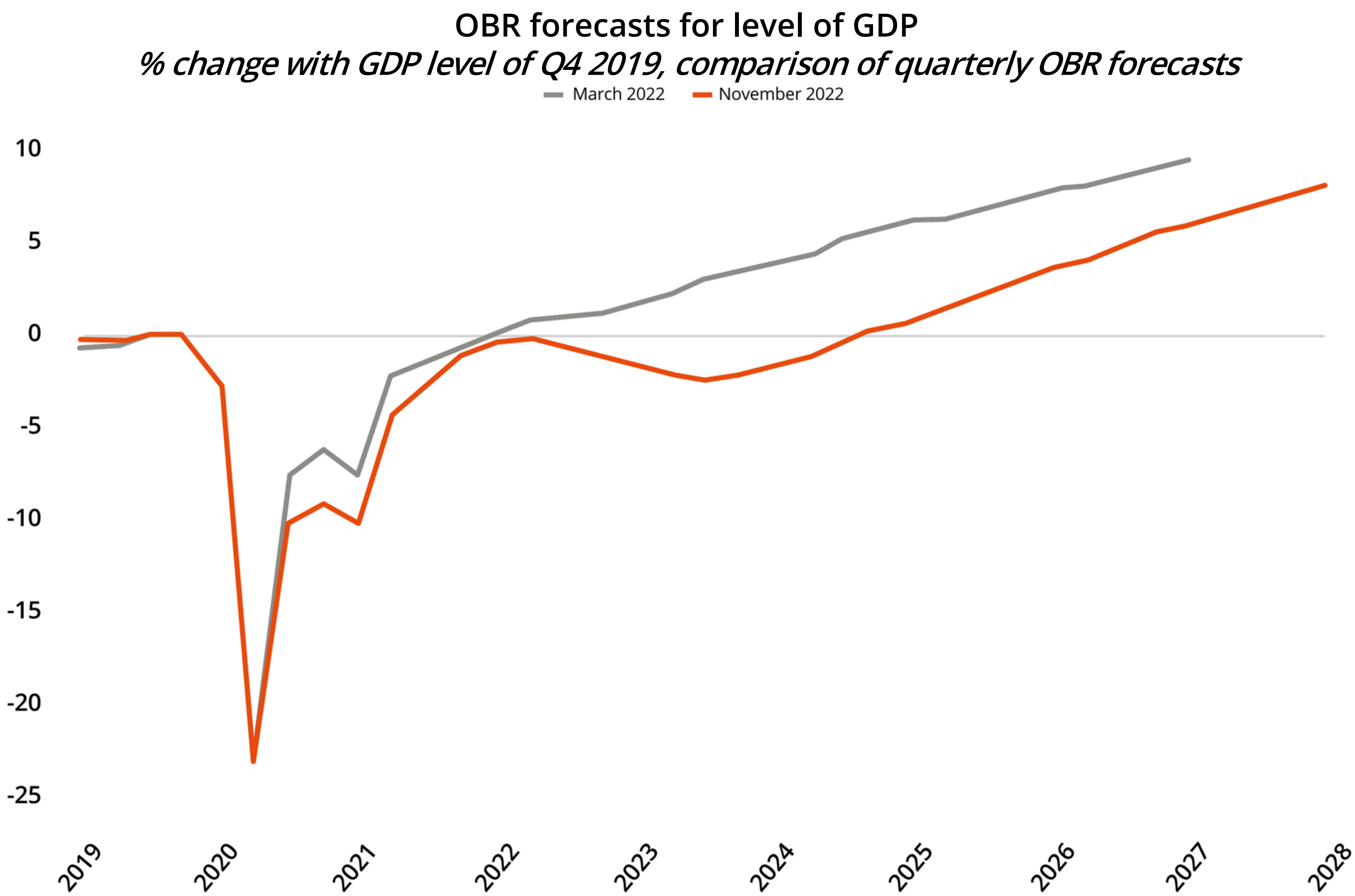
Sunakonomics is discipline / austerity 2.0

Budget 2022 summary:
Weak economic growth, high inflation, rising interest rates, spending reductions and tax increases

- A miserable economic outlook- recession lasting 12 months
- A hole in the public finances
- Austerity 2.0
- Stealthy taxes (freezing bands)
- Stability for markets.. (a very important signal)
- Benefits and pensions to rise by CPI (10.1%)
- Energy price cap increasing in April but targeted payments for vulnerable households

Source: FT

BoE expecting a sluggish and prolonged period of weaker activity, rather than a crash



Source: OBR, Nov 22

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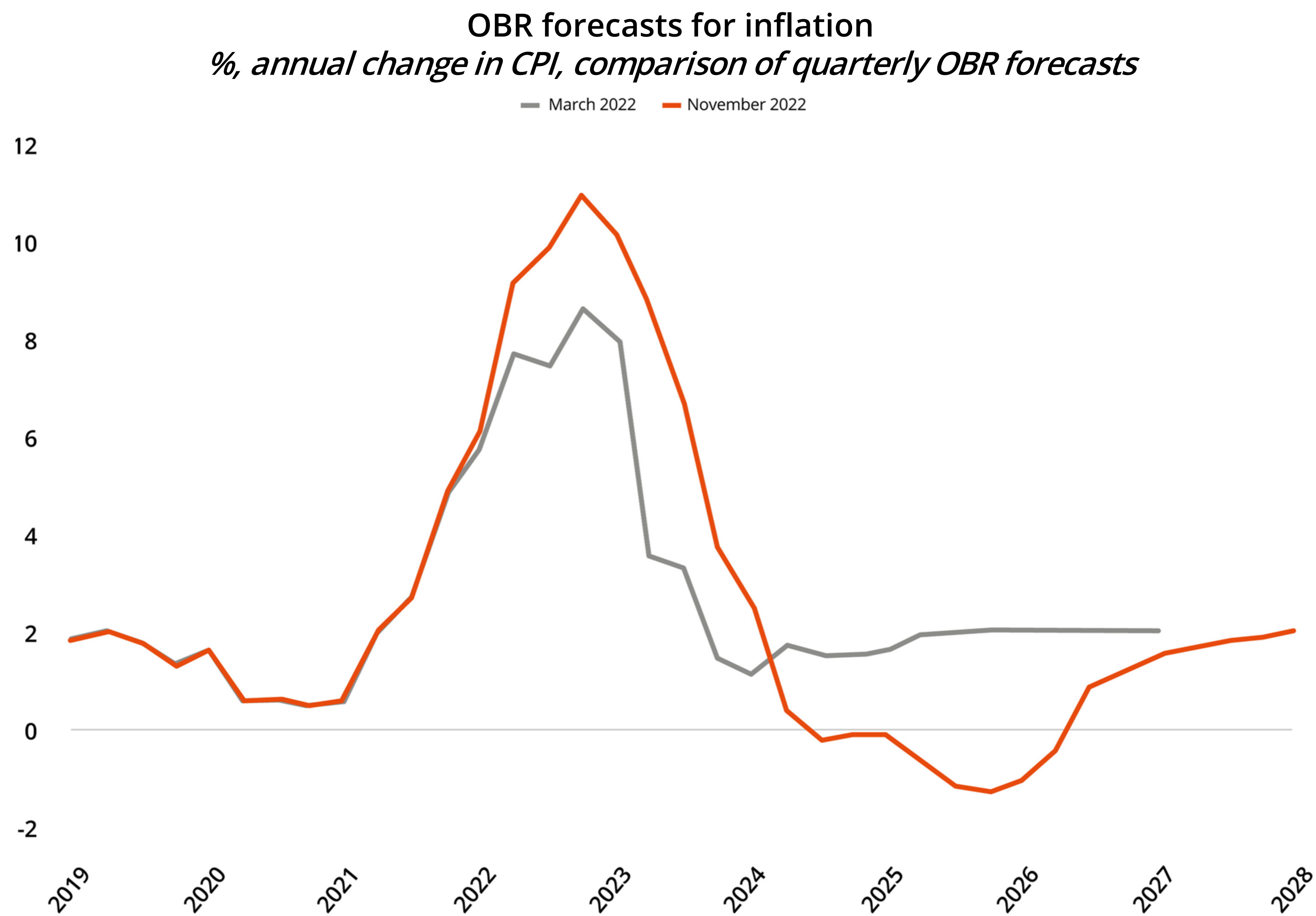
Forecast for inflation is encouraging.. but is deflation a risk going unnoticed?



Source: OBR, Nov 22

Rising rates and reduced gov spending as BoE announces recession will compound the challenge

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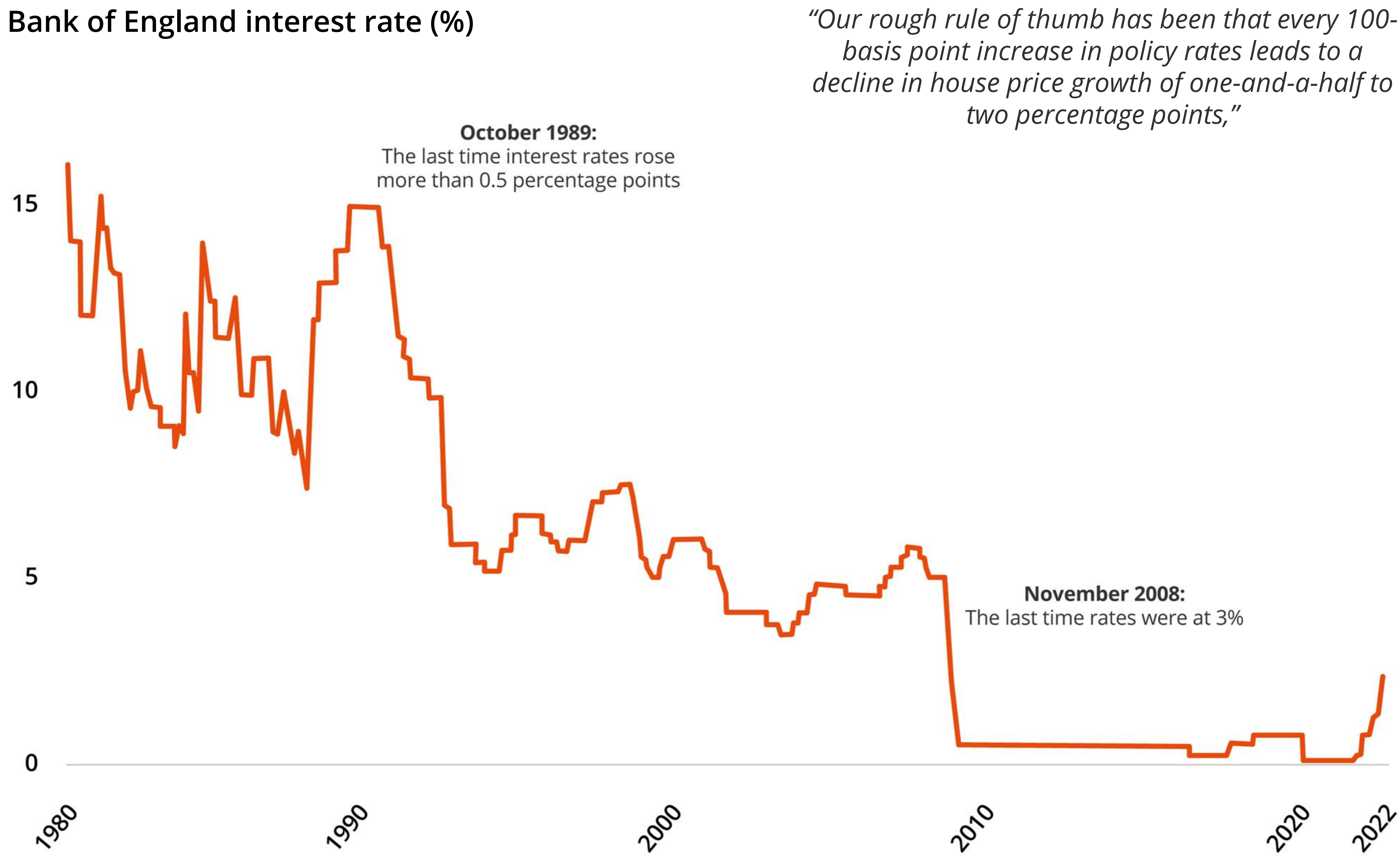
"Our rough rule of thumb has been that every 100-basis point increase in policy rates leads to a decline in house price growth of one-and-a-half to two percentage points,"



Source: Bank of England

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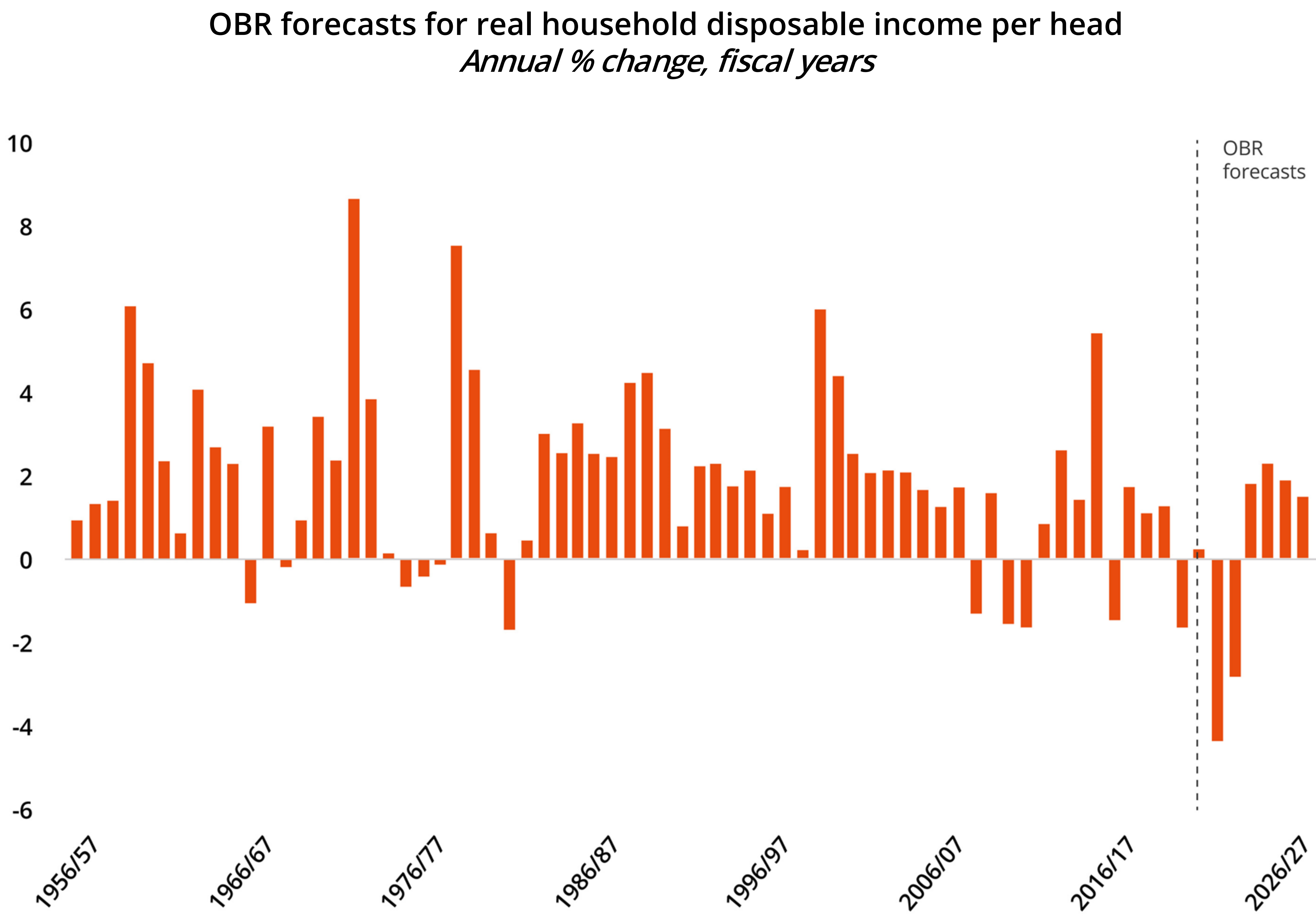
The brutal outlook for household finances (and consumer spending): *Household finances not back to pre covid levels until 2028*



Source: OBR, Nov 22

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Monetary Policy & Housing Impact

The whole housing system is still appreciating.. (in nominal terms) but for how long...

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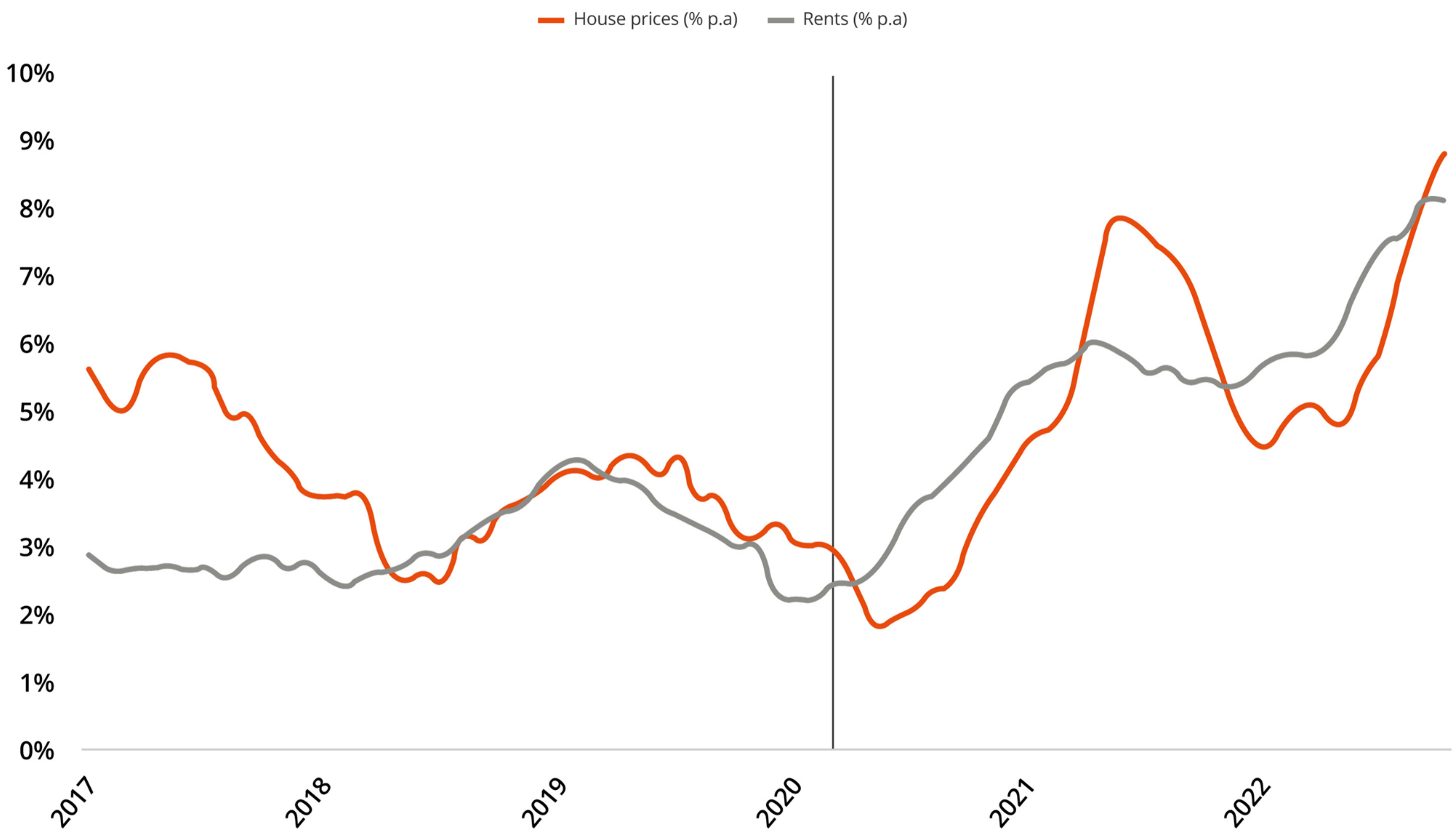
House prices vs Rents, % growth per annum, 2017-2022



Source: PropertyPal

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…given mortgage rates have doubled & affordability is squeezed

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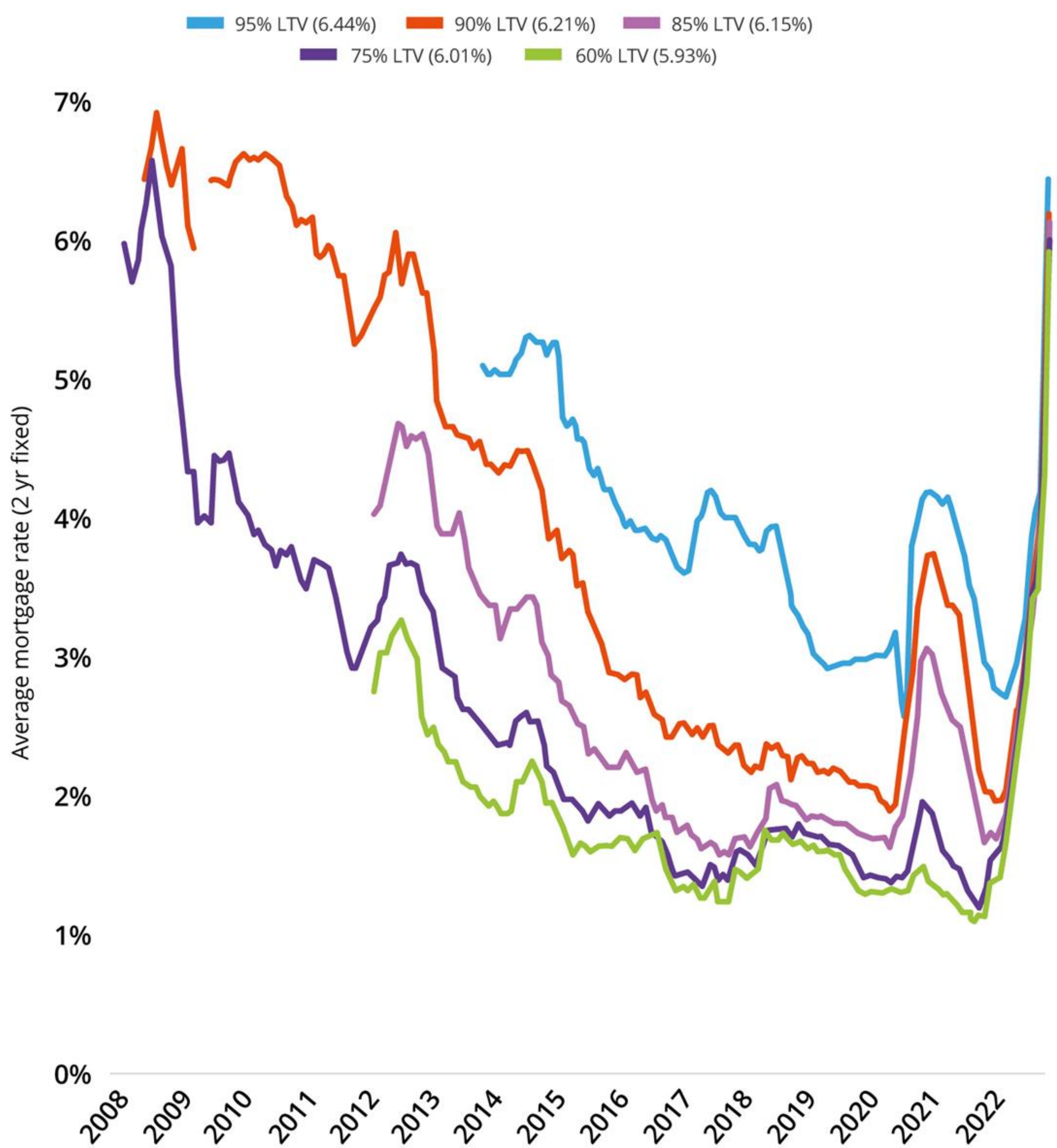
2 year fixed mortgage rates by LTV bracket, 2019-2022



- **Doubling of mortgage rates post 'Truss Mini Budget'** has hit housing demand via affordability- not a housing bubble- an interest rate led shock hitting economy and housing
- **Cost of living and affordability metrics** in lenders.
- **Surveying** industry valuing green premiums.
- Demand for **energy efficient homes**.
- **Start of 2022:**
  Avg Price: (£182k
  Mortgage of £155k (15% deposit),
  Mortgage rate of 1.75%
  Repayment: £637 per month
- **October 2022:**
- Avg Price: £197k
  Mortgage of £167k (15% deposit),
  Mortgage rate of 6.0%
  Repayment: £1002 per month
- **Net payment increase of c£350.** For equivalent mortgage rate of £637-the house would need to be valued at £117k!

Source: Bank of England, PropertyPal analysis. Latest data end of October 22

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A very important history lesson

New Mortgage activity

bills. And high interest rates will whack homeowners, the bedrock of the Conservative vote. An interest rate of just 3% today results in mortgages that absorb the same share of income as a rate of 14% did in 1980, after adjusting for the fact that mortgages are bigger and mortgage interest is no longer tax-deductible, calculates Neal Hudson of BuiltPlace, a housing website. Mr Kwarteng's desire to boost growth is laudable, but his plan is not going to work economically. It is likely to backfire politically, too. ■

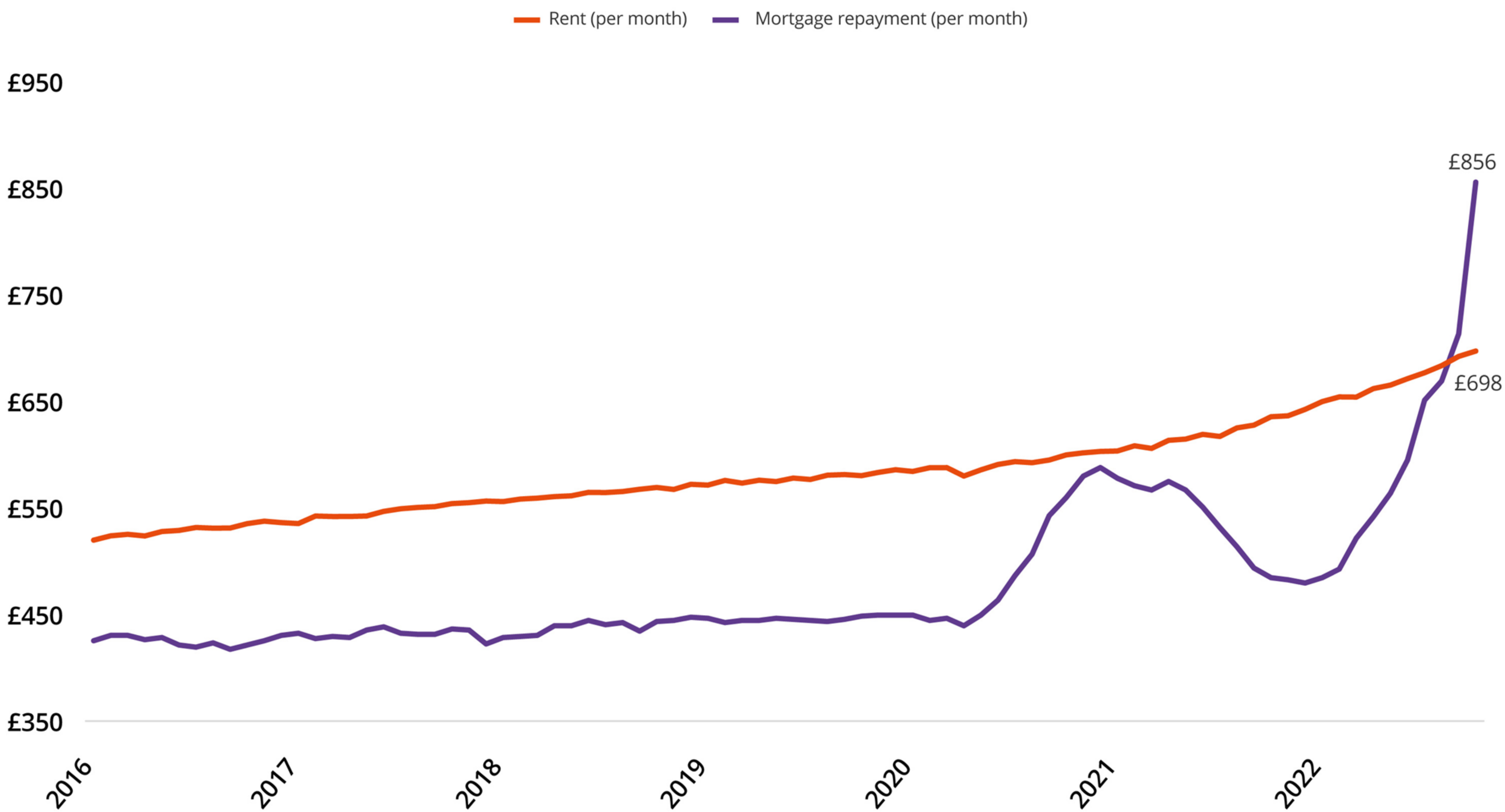
Source: The Economist

Total Mortgage stock/activity

- **Housing sector is less exposed to interest rate hikes** compared to previous periods. Smaller mortgage stock, more fixed rates.
- Approx 27% of households in NI own with a mortgage – down from 35% in 2009
- 90% of mortgages taken out over the past 5 years are fixed rate.
- This will instantly hit new demand (failing falling mortgage rates which is beginning to appear) **but the overall 'economic shock' will be less pronounced given mortgage stock and shielding time to remortgage**

Higher prices & higher mortgage rates = weaker affordability & lower housing demand = higher rental demand

Average monthly cost of First Time Buyer home to Rent vs Mortgage purchase



Source: PropertyPal.
Note: Mortgage repayment based on average 2 year fixed rate, 30 year term at 90% LTV. Both house price and rents based on weighted 2/3 bedroom property

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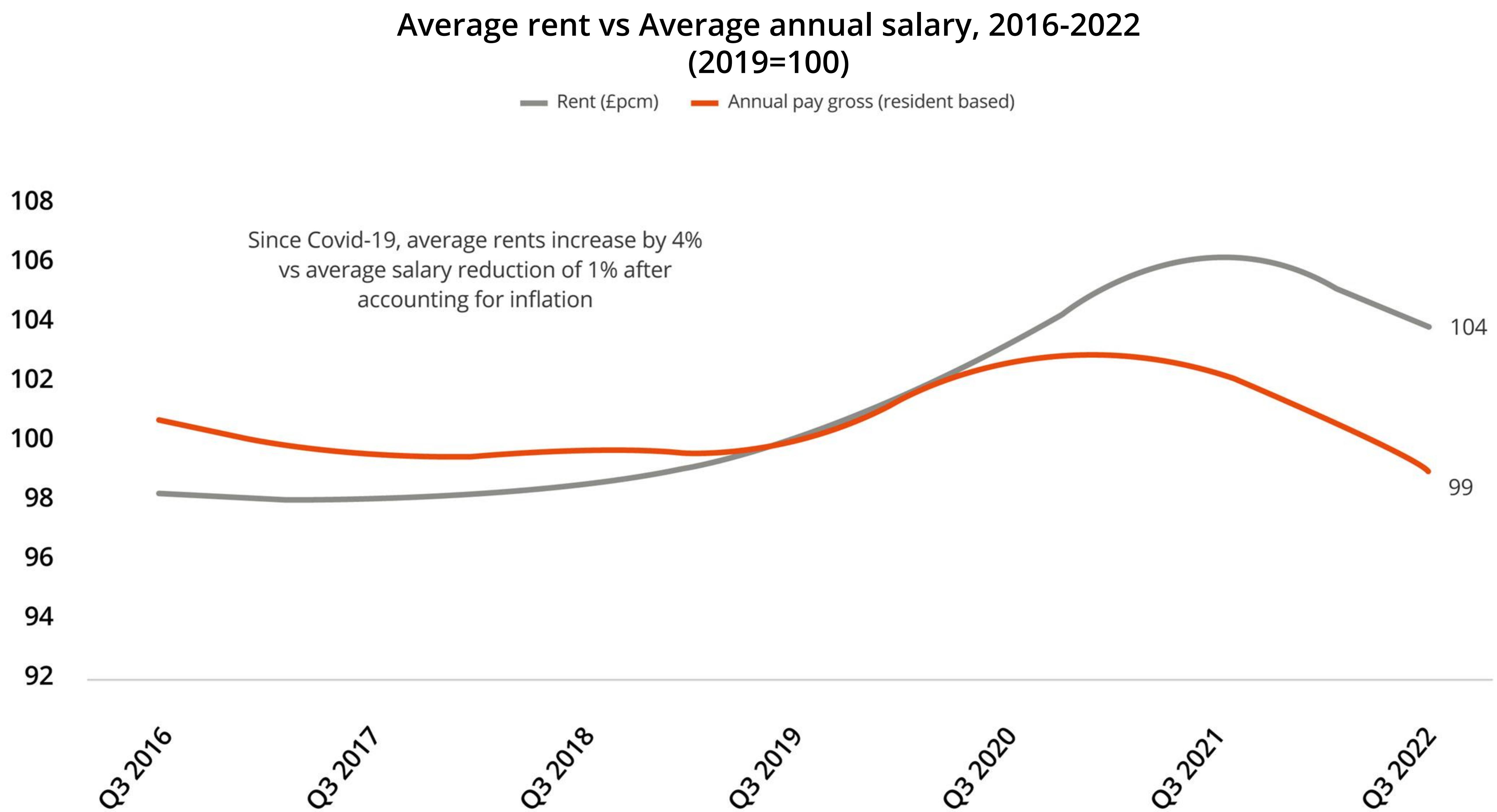
Post covid: Rising rents > income growth = lower discretionary income and household finances



Source: PropertyPal & ONS Annual Survey of Hours and Earnings
Note: Deflated using CPI in Q2 2022 prices

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Rent pressures concentrated in greater Belfast and ABC council

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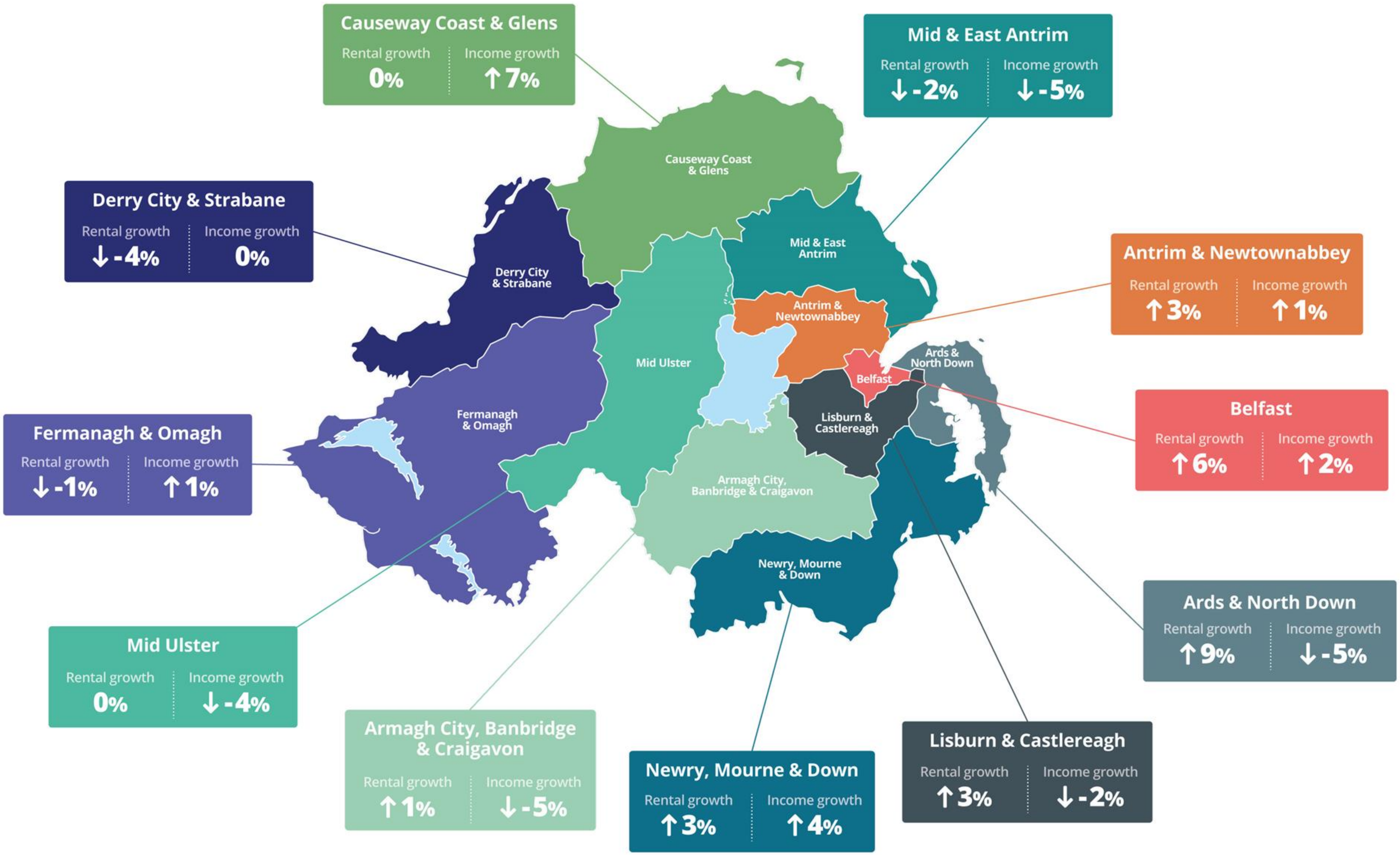
Profile of rental growth vs income growth (after inflation) since Covid-19



Source: PropertyPal, ONS. Inflation using CPI in Q3 2022 prices

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Race for space a factor in the rental market too

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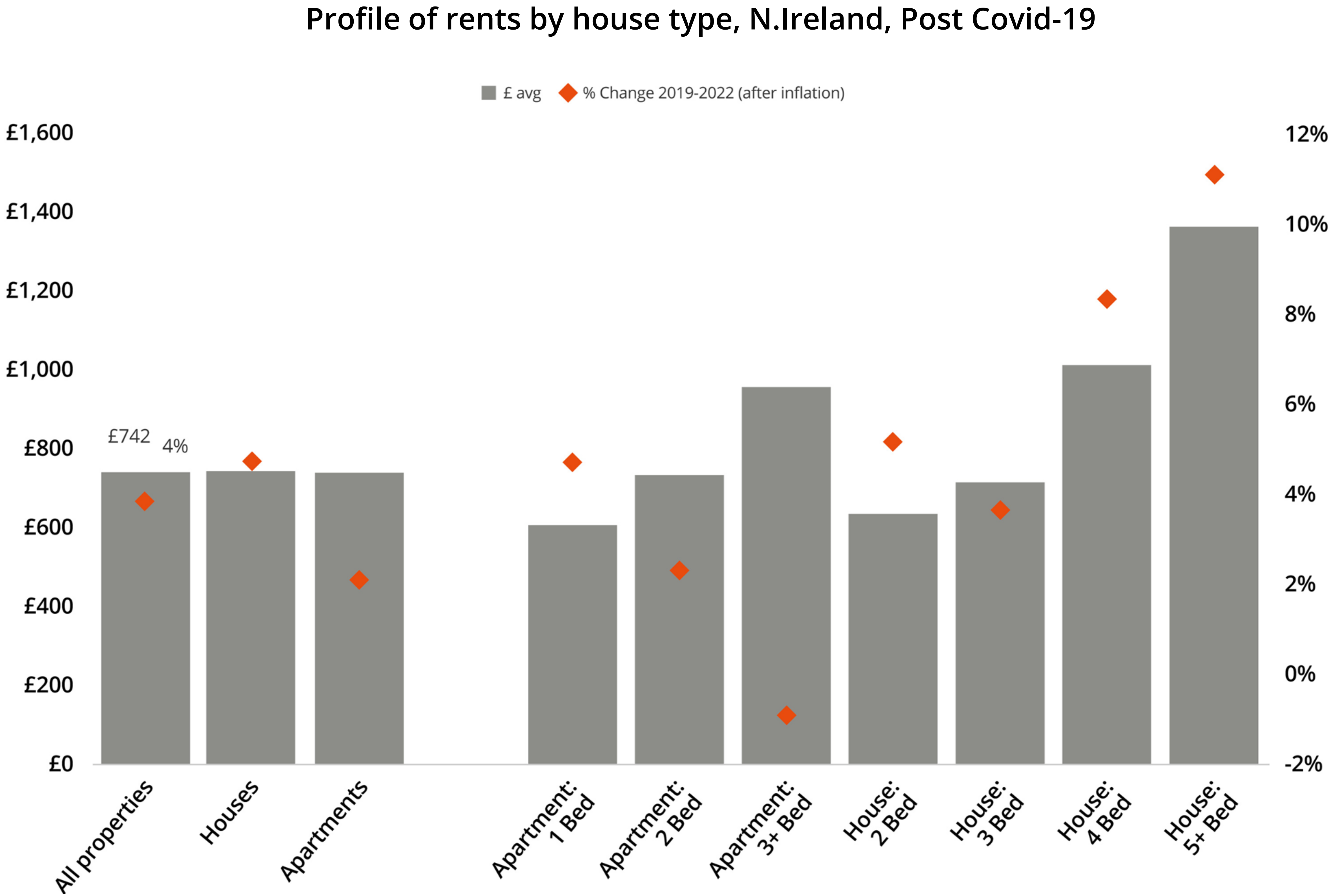

Source: PropertyPal, ONS. Inflation using CPI in Q3 2022 prices

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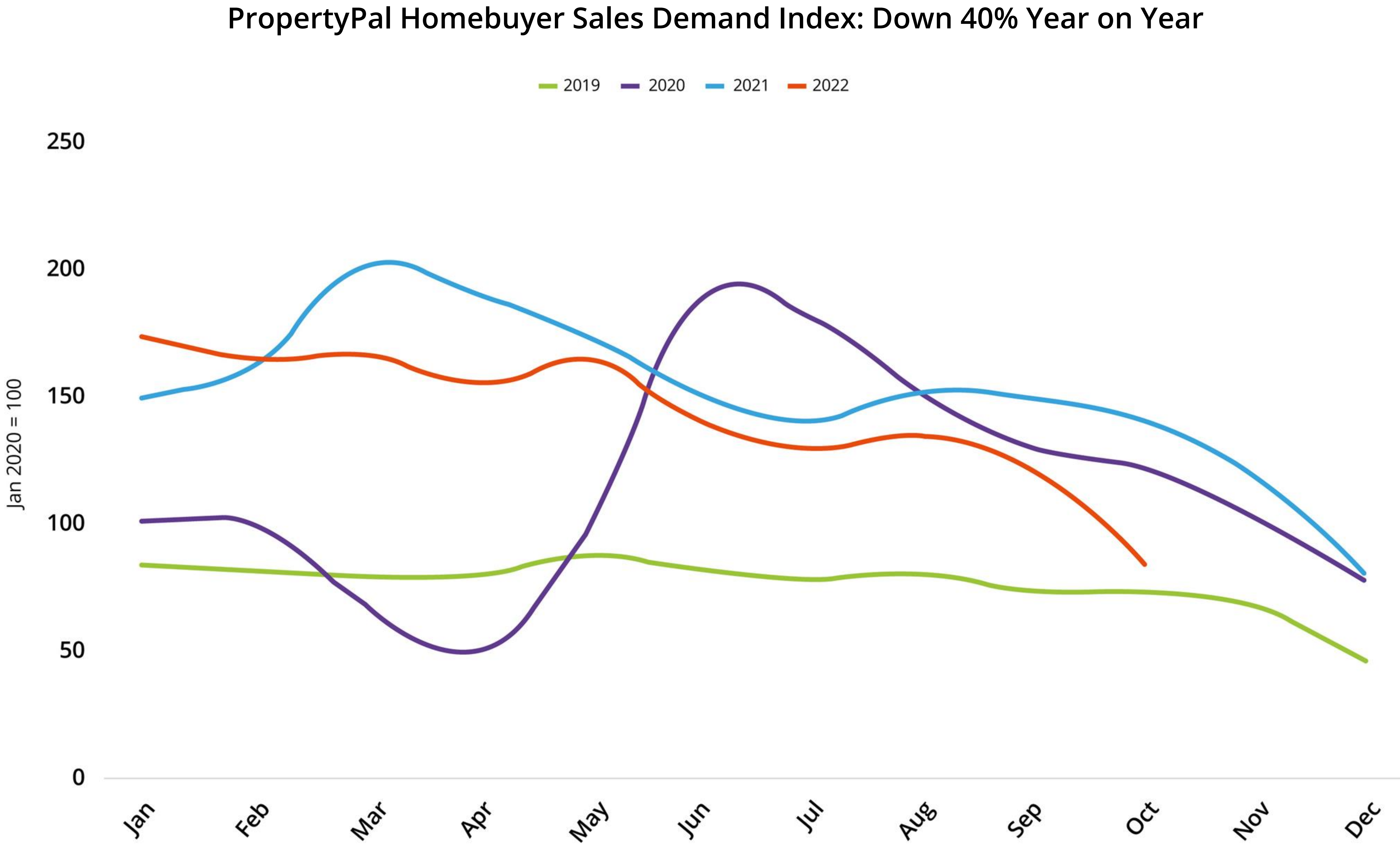
Housing market- leading indicators

In N.Ireland- Sales enquiries down 40% on 2021 levels, but up 16% on 2019



Source: PropertyPal

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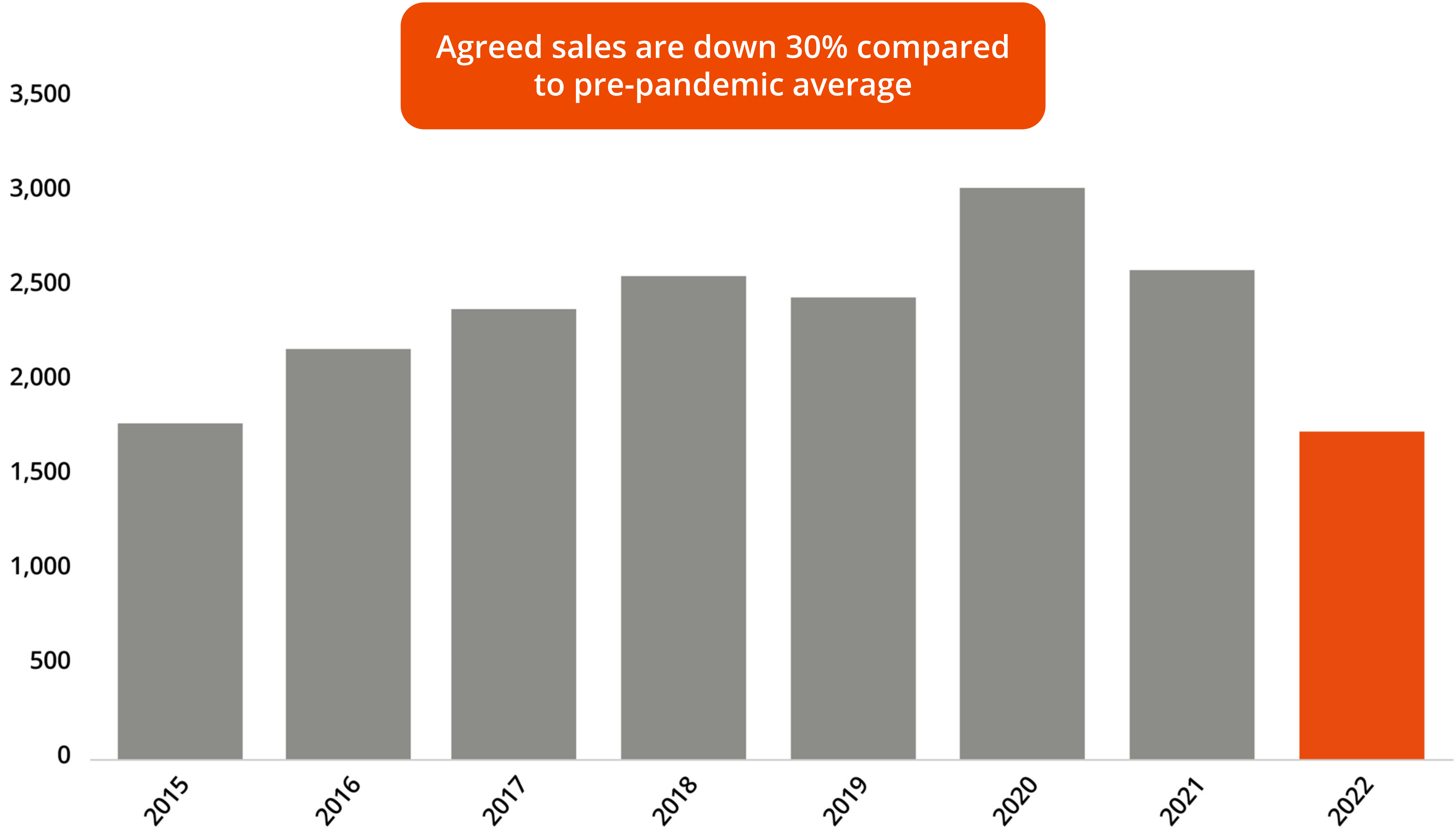
...but newly agreed sales are slowing suggesting price indices will reflect this in H1 2023

No. Of 'sale agreed' properties, October 2015-2022



Source: PropertyPal

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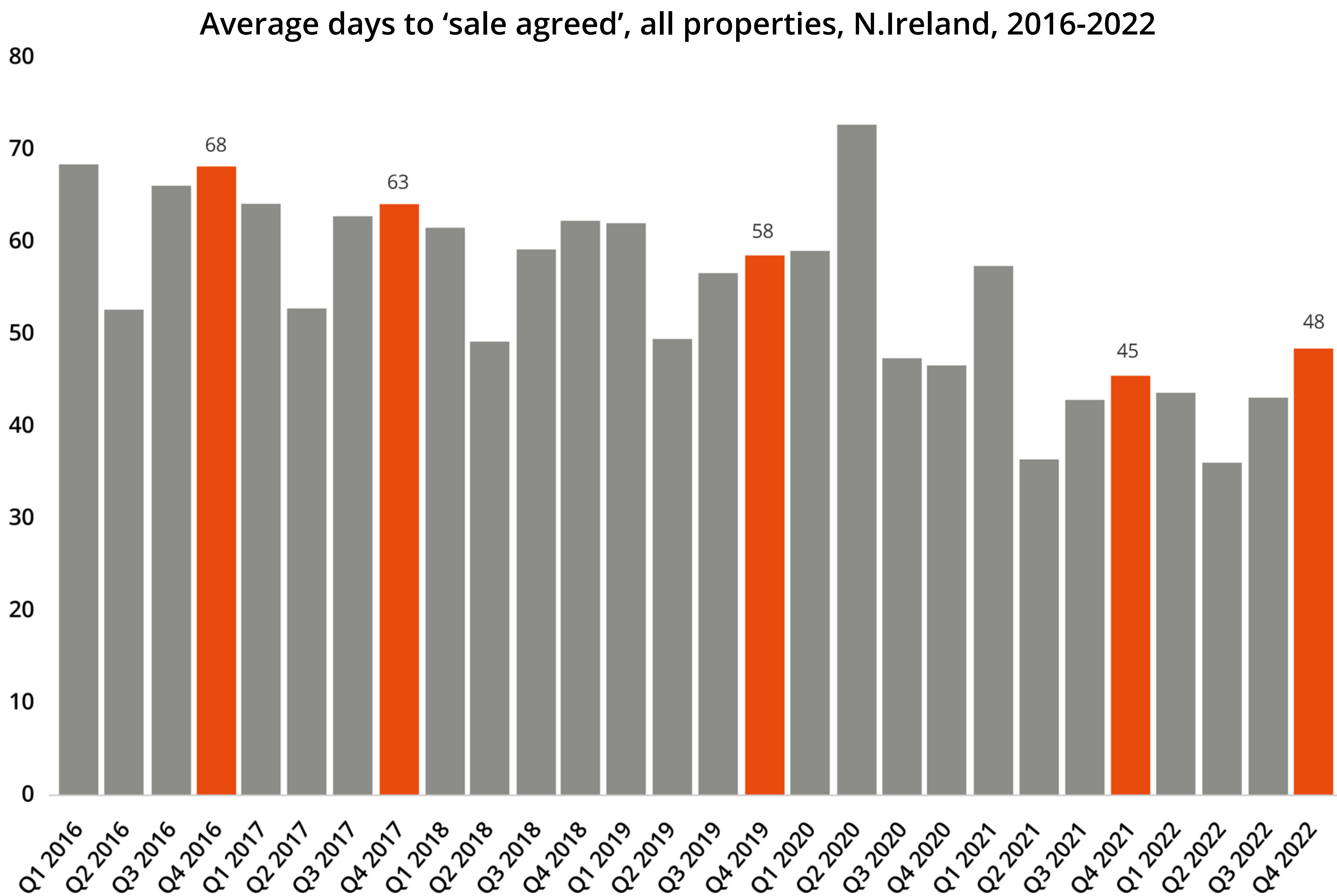
...& and properties are still transacting quicker than 'normal' suggesting underlying health



Source: PropertyPal

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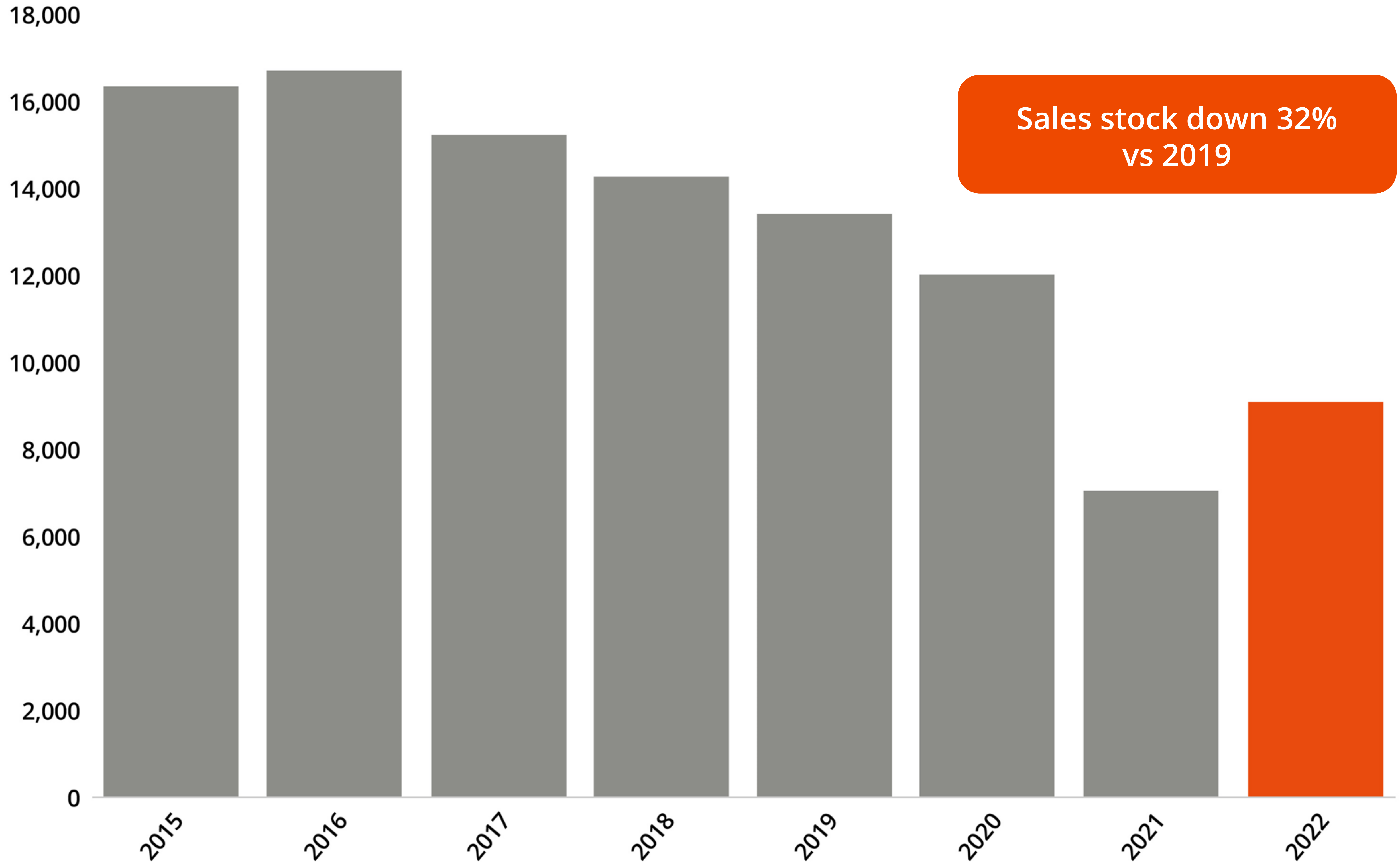
Low stock to remain a feature throughout 2023 (supporting prices somewhat)

Stock of properties listed for Sale the market, N.Ireland, October: 2015-2022



Source: PropertyPal

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Low stock to remain a feature throughout 2023 (supporting prices somewhat)

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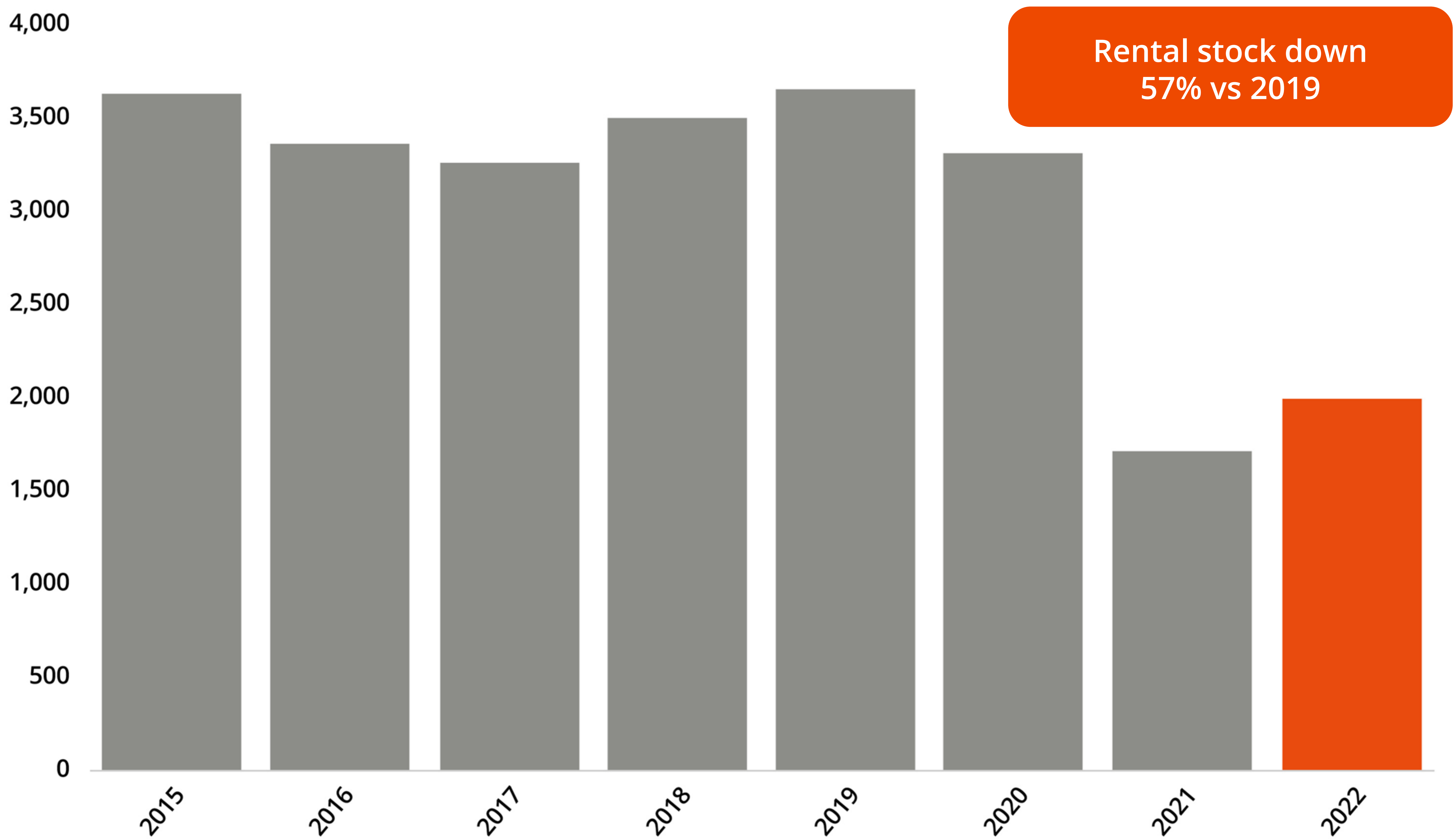
Stock of properties listed for Rent on the market, N.Ireland, October: 2015-2022



Source: PropertyPal

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Time to let agreed (on average) near record lows

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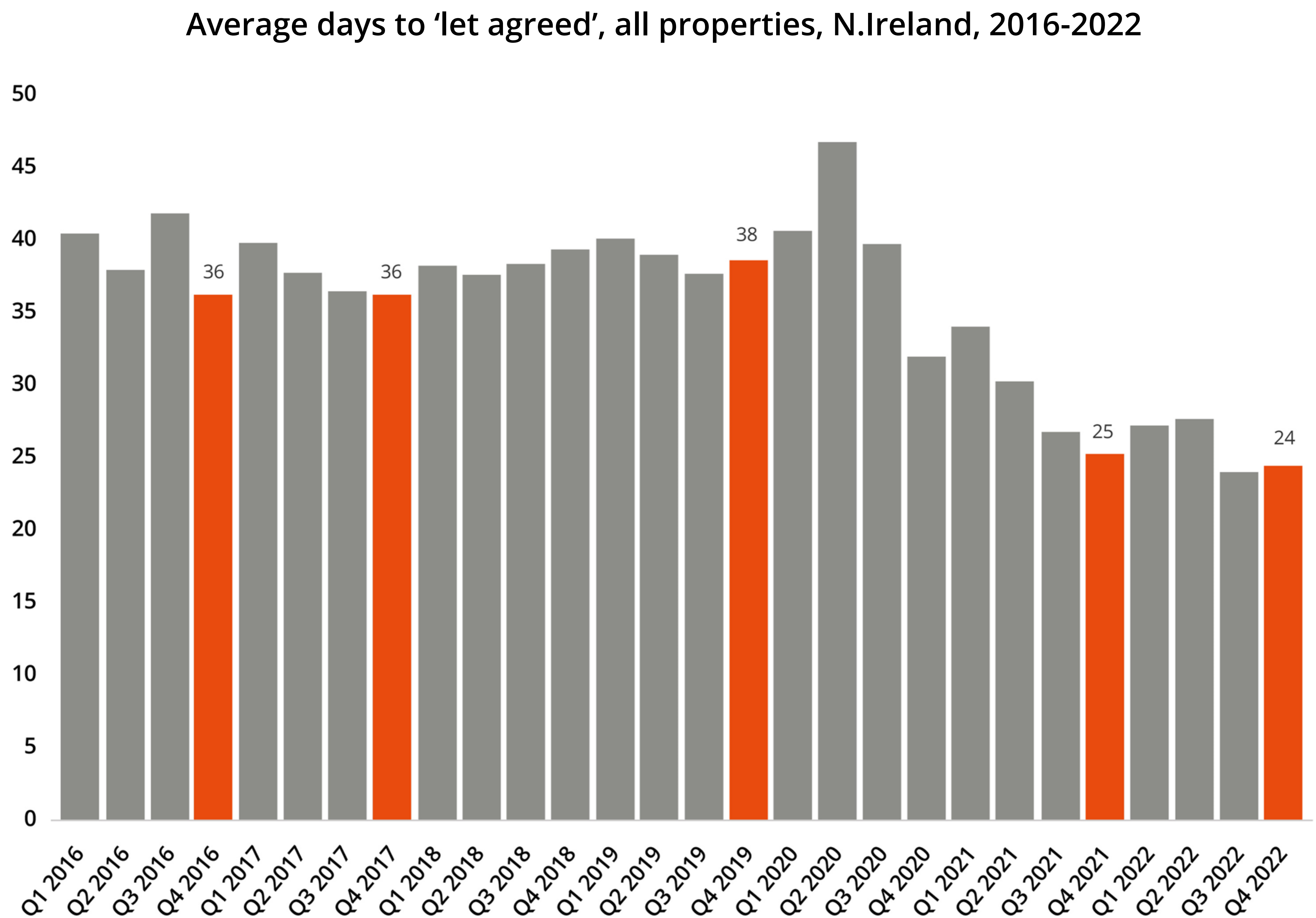

Source: PropertyPal

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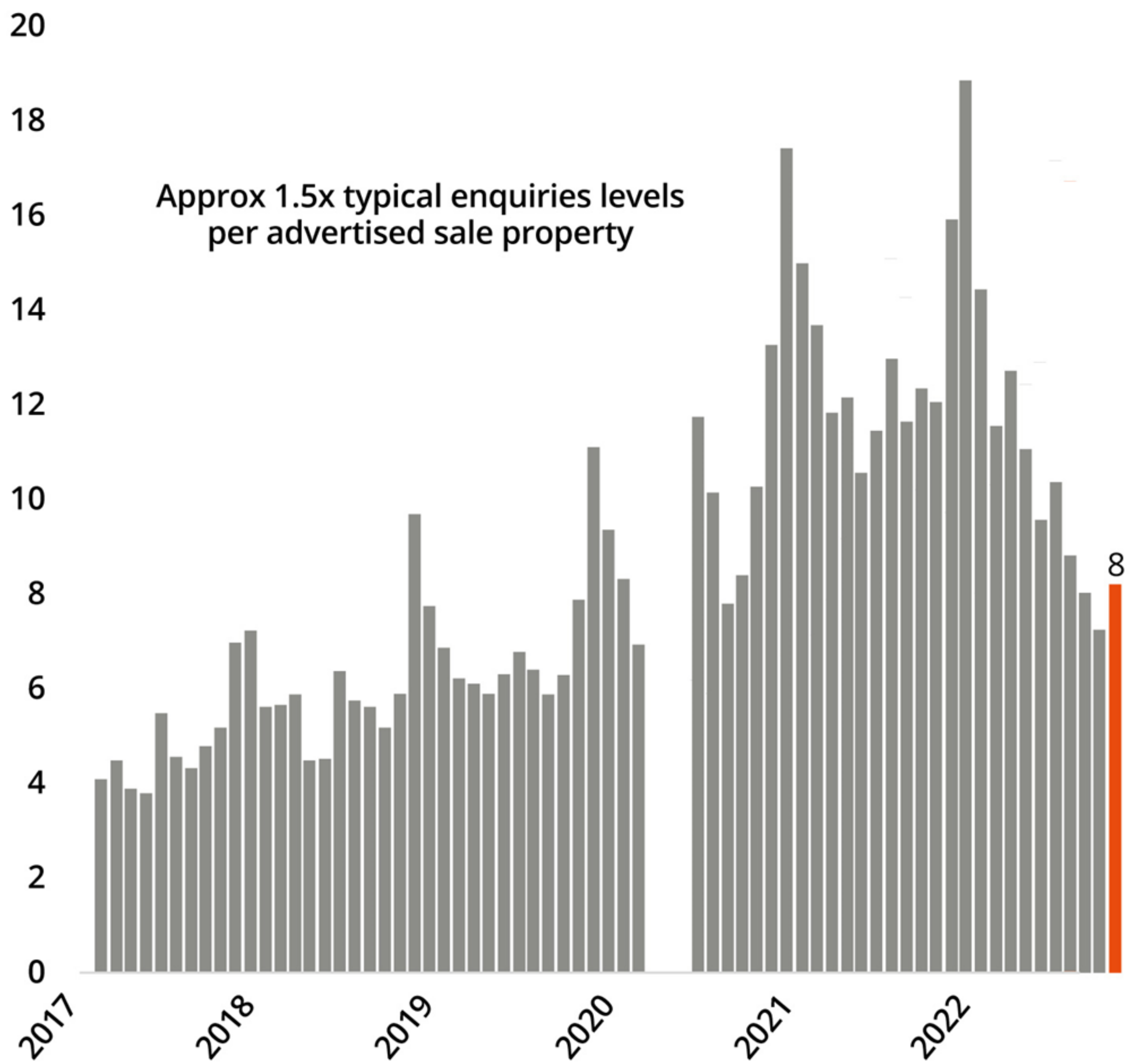
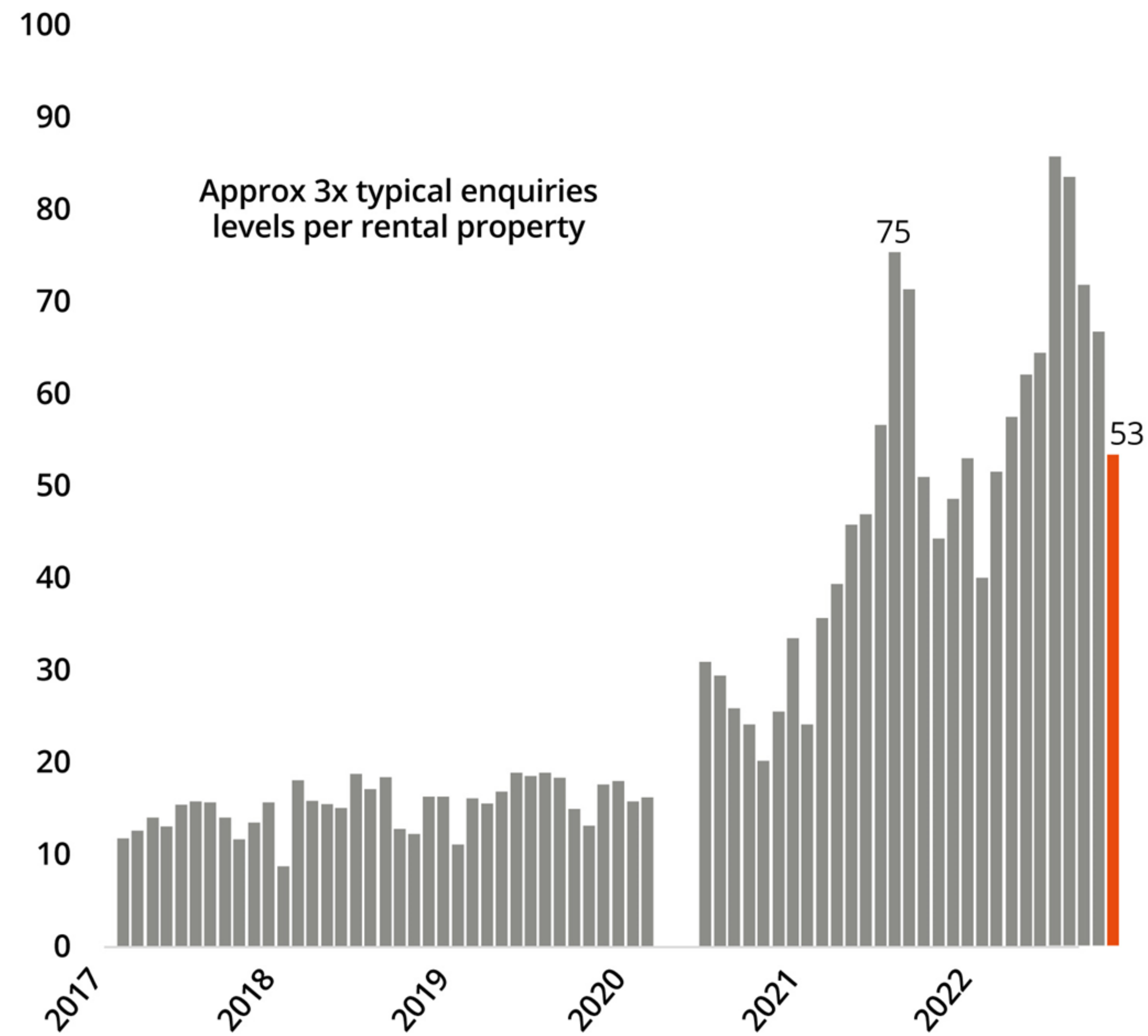
And once low stock factored in, demand still strong relative to pre-covid 19 levels

Enquiries; listings ratio, *(Sale properties only)* 2017-2022



Enquiries; listings ratio, *(Rental properties only)* 2017-2022



Source: PropertyPal

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The Outlook and Closing Thoughts

Northern Ireland: Property transactions; 20% reduction in transactions next year

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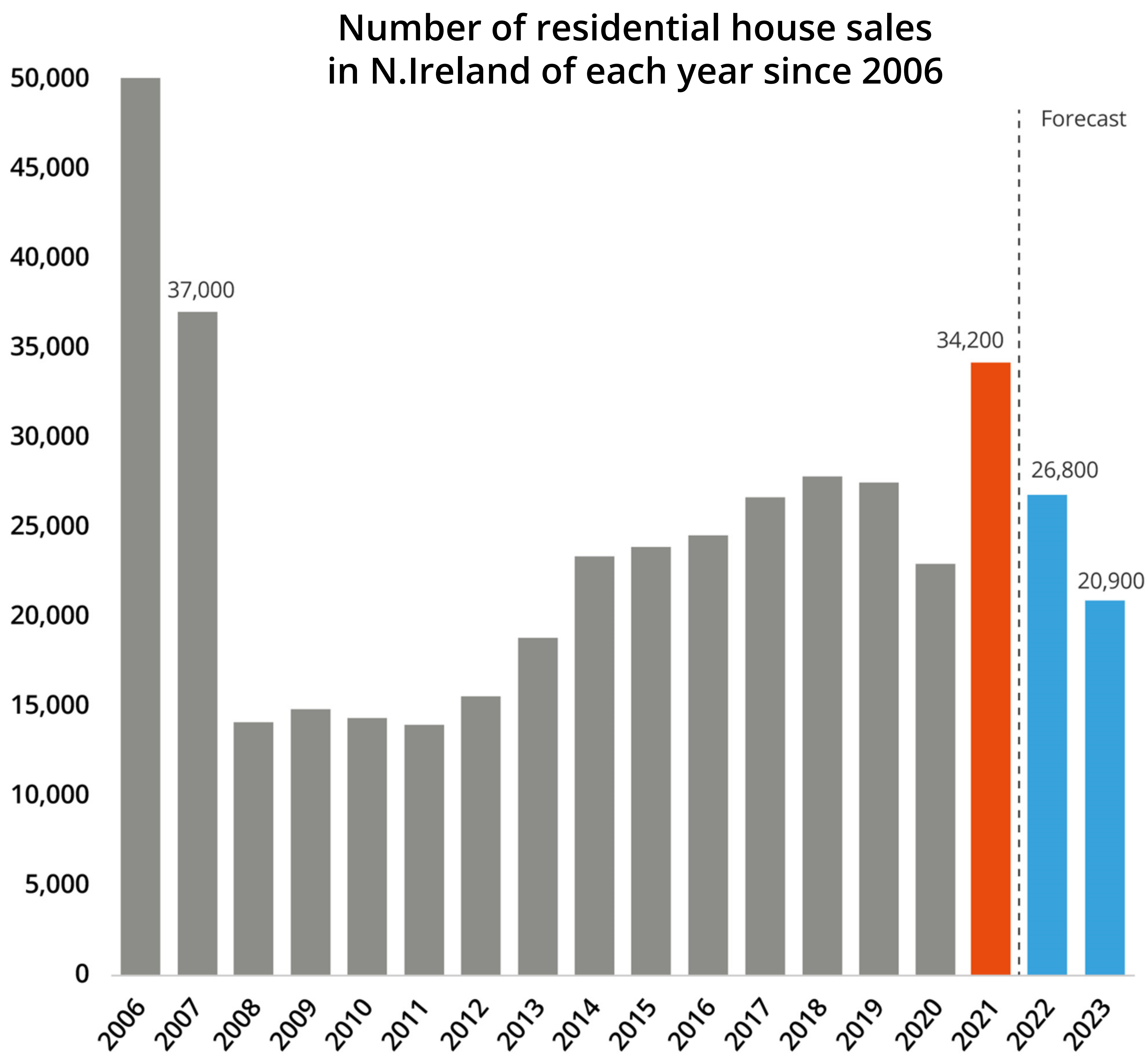

Source: PropertyPal; using HMRC residential transactions

- **Housing market activity forecast to cool over next 6 months as cost of living and rising interest rates dampen demand. Medium term is highly uncertain**
- **Different segment impacts; BTL greatest reduction followed by FTB. More modest impact for movers and cash purchases**
- Buyers' affordability has fallen considerably as mortgage rates sharply increased
- Price growth expected to moderate across 2023 with headwinds growing. Likelihood for stagnation vs. potential price falls
- With low stock supporting prices, the pending slowdown will be noticed **more in transaction activity.**
- Approx 21,000 sales forecast in 2023, down **20% on pre-covid levels.**

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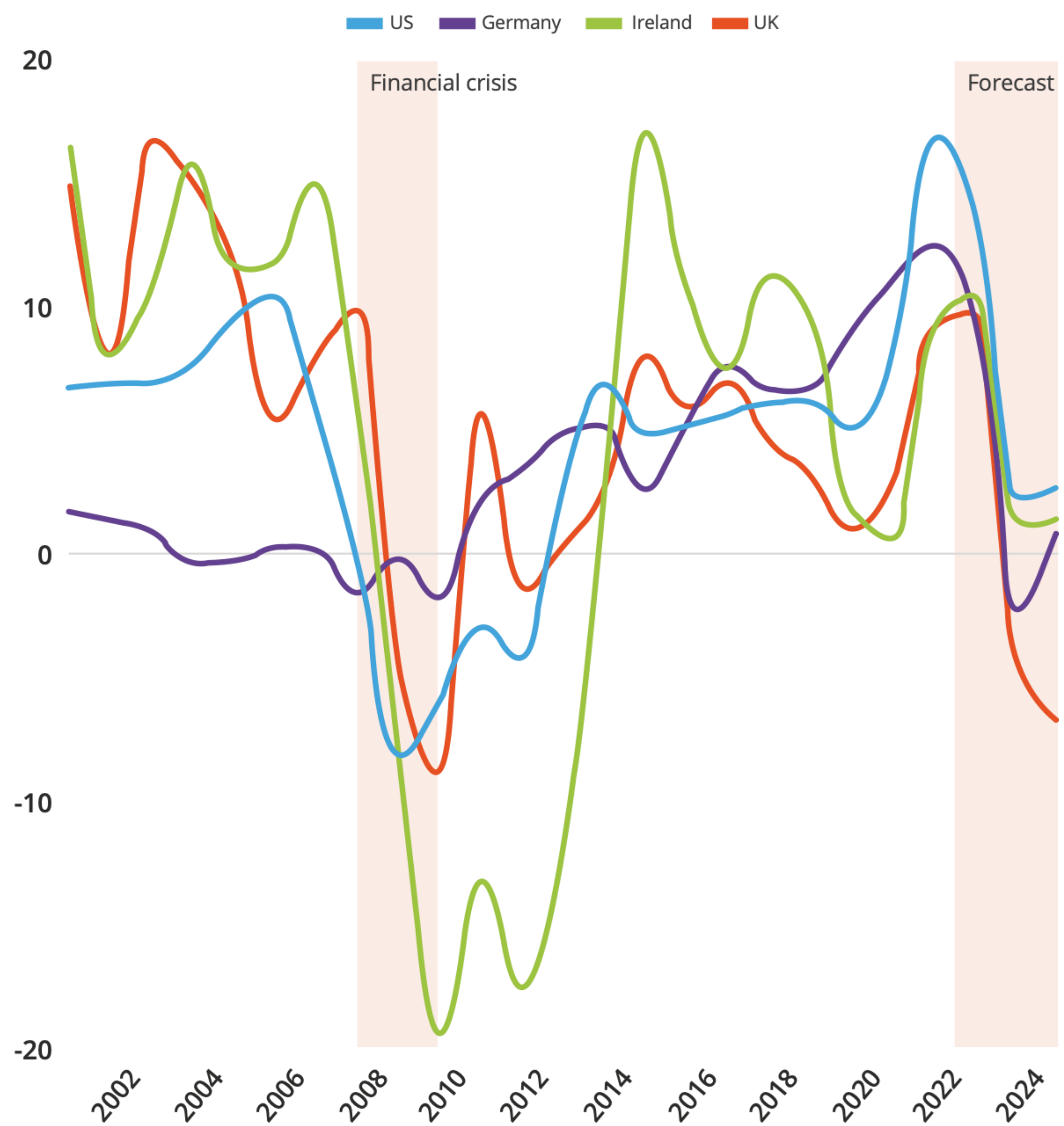
Tailwinds vs. Headwinds = too early to tell the impact but risks weigh on downside

Global house prices % growth, 2023



Source: OECD, FT

Market Headwinds

1. Pandemic and savings induced boom is over
2. Unaffordable mortgage payments
3. Prices rising faster than incomes
4. Cost of living crisis absorbs discretionary income
5. Tightening monetary policy
6. Contractionary fiscal policy

Market Tailwinds

1. Low mortgage debt relative to incomes vs. 2007
2. Tight supply
3. Labour market is strong
4. N.Ireland market is 'affordable' compared to other parts of UK

Market Outcome?

- Prices fall, transactions reduce
- Markets freeze at low transaction levels and price downturn is limited

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Rental market implications: Risks mounting, but stock shortages to keep rents high

Context: 2019 NIHE survey

- 29% of landlords are accidental in N.Ireland
- 52% of landlords have at least one mortgaged property
- 37% of landlords are dependent on rental income to cover mortgage repayments on their rental properties
- 19% of landlords said rising house prices would cause them to leave the sector (this is supported by PP dataset showing around 7% have since left since post-covid boom)
- 14% of landlords said rising mortgage rates would cause them to leave the sector

Future impacts (2023 >)

- Energy efficiency regulation and minimum standards (1/2 PRS properties at least).
- Rent controls- (CIH research to discuss)
- Already low stock levels- where does supply come from given economic backdrop?
- Vulnerable income profile, greater proportions dedicated to rental costs. Gov policy support (energy cap / welfare)
- Affordability already stretched: Of 130-135k renters, approx. 50k pay 25% of income on rent and 20k pay over 40% (Cache, 2021)
- 2023 to see rents continue to rise, albeit at slower rate given weaker economic climate and improving inflationary environment. Feasible to see rents still growing 4-5% + by end 2023

Thank you and good luck for 2023 and beyond

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