

Market Briefing

Scottish Housing Sales Market Review

Autumn / Winter 2020



Rebuilding a Market

Increasingly, we have become used to events being described as, 'once in a generation', or 'exceptional', or 'unprecedented'. This is often an exaggeration but not this time. The Covid-19 pandemic and subsequent lockdown has been unusual in the sense that it was a health intervention into the market rather than a behavioural market response. The lockdown restrictions effectively saw both the rental and sales market frozen over the usually active Spring market. After 3 months of isolation and introspection, both the sales and rental markets have seen sharp increases in activity as restrictions eased and the personal resolutions made during lockdown about lifestyle and aspirations were put into action. This has seen listings of new properties for sale in Edinburgh and Glasgow jump to levels well above last Summer/Autumn, and rental demand and activity is also strong.

Looking ahead, there can be no doubt that with uncertain economic and political conditions ahead, there will be more testing times in the market. However, as many households have come to realise during the lockdown, a home is now, more than ever, not just a place to lay your head. As society adjusts to a Post-Covid world (or perhaps Living-With-Covid world), the property sector is likely to feel many of these new realisations most acutely.



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Key Findings

- Average house prices have remained robust reporting positive year-on-year growth +1.6% across Scotland in the first three quarters of the year.
- Housing sales remain -35% down cumulatively in the first three quarters of 2020 compared to 2019.
- LBTT returns are -34% down in January to September 2020 compared to the same period in 2019, which, combined with the LBTT holiday, will see Scottish Government revenues well down on forecasts.
- Mortgage product choice has retreated significantly, with higher rates especially at higher LTV. This is impacting on activity and First Time Buyer access to affordable products.
- Rettie & Co. forecast average house price growth of 11% by 2024 with transactions recovering to 2019 levels by 2023.

Introduction

Rettie & Co. was founded in 1993 in the wake of the recession of the early 1990s. A founding principle of the company was the provision of exceptional client care and advice at a time of economic challenge. Over the past 17 years, we have guided our clients through unprecedented market growth, but also unprecedented change, be it the Global Financial Crisis, referendums on Scottish Independence and EU membership, and now a global pandemic.

While the Government restrictions curtailed the ability of most households to physically move, this has not meant that the lockdown has been a quiet period for our teams. The same ethos that the company was founded on has meant that we have continued to be proactive for our clients during these extraordinary times to ensure they have the best market information and guidance to mitigate potential risks, but also to place our clients in the best position to maximise the opportunities in the market as we see changing patterns of work and living.

In the sales market, we have witnessed a clear shift in demand, with households taking the time during lockdown to reconsider living arrangements and aspirations. While it is hard to quantify at this early stage of the post-lockdown market, the demand for larger homes and outside space has been clear, as has been the demand for rural locations, where lifestyle is now a priority and being enabled by remote working.

During lockdown, there has also been an upturn in demand for prime and prestige properties, especially in Edinburgh. From multi-million pound family homes in The Grange to the launch of the super prime New Eidyn development at Edinburgh St James, the buying power that has entered the Scottish

market post-lockdown (from both domestic and international buyers) has been clear to witness.

An area of the market that has seen the most immediate disruption has been the rental sector. With a collapse in the short-term rental sector and concerns over the potential for extended voids in the private rental sector as a result of Covid-19, managing our clients' investments has meant that, even though the market has been effectively closed to moves, the rental team has been busier than ever. During this time, the still nascent Build to Rent sector in Scotland has illustrated the value of professional management and a focus on customer care. This has seen client satisfaction, rent collection and occupancy rates remain high on all the developments we manage.

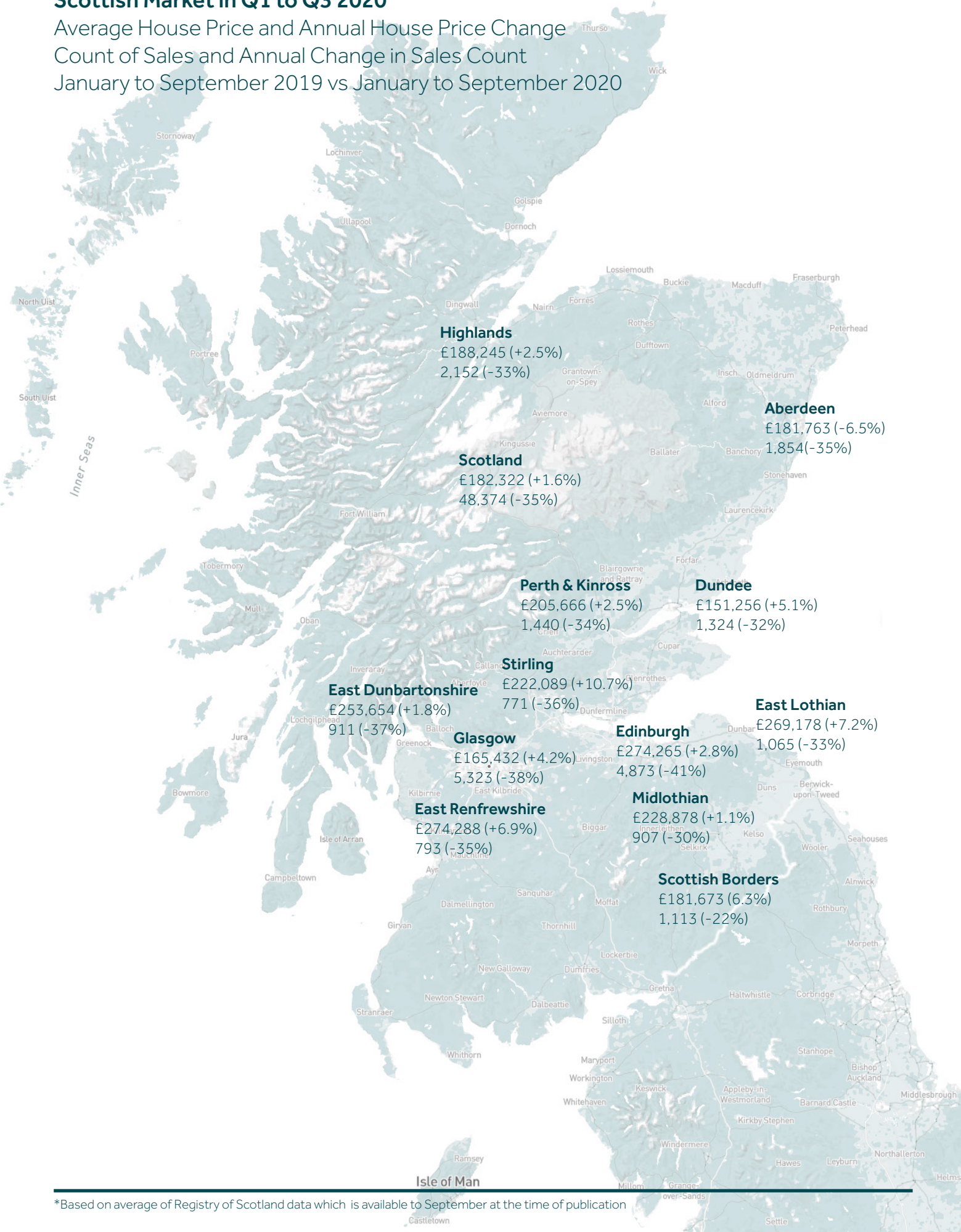
As we emerge into a changed world and changed market, we will continue to follow our founding principles to ensure that in these times of uncertainty and likely economic challenges ahead, our clients, customers and tenants are best placed to achieve their ambitions and aspirations.



Simon Rettie
Managing Director

Scottish Market in Q1 to Q3 2020

Average House Price and Annual House Price Change
 Count of Sales and Annual Change in Sales Count
 January to September 2019 vs January to September 2020



*Based on average of Registry of Scotland data which is available to September at the time of publication

The Covid Effect

An Unprecedented Event

The Covid-19 pandemic and subsequent lockdown has created a market intervention unlike any experienced before, with transactions being constrained by state intervention on health grounds rather than economic conditions driving consumer choices, as was the case during the Global Financial Crisis (GFC). While we are still navigating the pandemic and its potential economic and social consequences, so far, the Scottish property market has experienced a markedly different pattern of activity compared to previous market downturns.

The first thing to note has been the sharp fall and then recovery in activity. Over the course of 2018 and 2019, the Scottish market had seen a plateauing of transaction growth after a period of strong growth and this trend had continued into the start of 2020. With the effective closure of the market under the lockdown restrictions, transactions almost ceased completely, with just over 100 registered sales in April across Scotland when there would typically be over 8,000. This fall was more precipitous than during the GFC but the recovery was almost immediate after lockdown lifted at the end of June. New properties coming to the market surged in the wake of lockdown, with the pent-up activity from the Spring market displaced into the Summer months. Property listings in the weeks after lockdown in Edinburgh and Glasgow surged 50% to 100% higher than the same time in 2019. This supply meant that by September registered sales activity was at parity with September 2019, although the cumulative number of registered sales to Q3 remained -35% down. However, due to the lag between sales being agreed and registered, the true level of the market recovery will likely not be seen until the full year figures for 2020 are published.

One similarity between current market conditions and previous downturns has been the robustness of house prices. Much like during the GFC, house prices in the wake of the lockdown have not experienced significant downward movement and have even seen growth in some localised markets. Pent-up demand, combined with people reconsidering their life aspirations has supported sales values.

Looking ahead, there remains much uncertainty as the furlough scheme comes to an end and Brexit moves back into the headlines. This said, the pandemic has made many households reconsider the importance of a home as more than just a dormitory and this is underpinning demand and movement in the market, as well as shaping the character and location of property being sought.

Fig.1 Average house price growth has remained positive in the post-lockdown market
Average House Prices 2010-Q3 2020

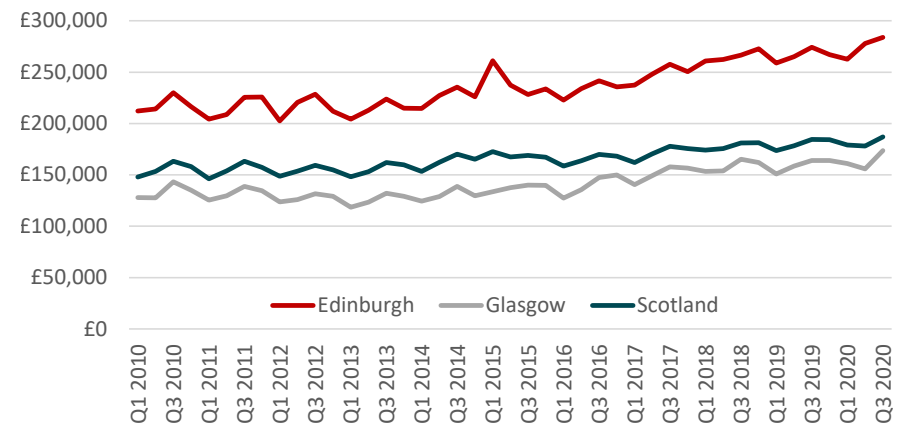


Fig.2 Cumulative transactions in Scotland are down -35% year-on-year
Count of Transactions in Scotland by Month and Year

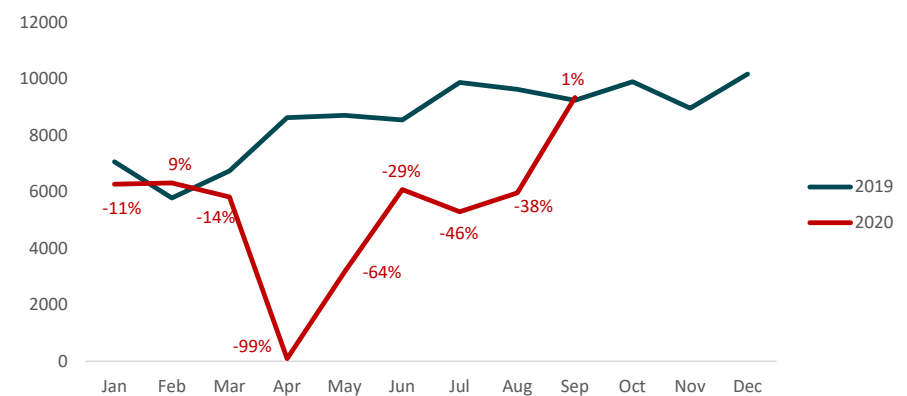
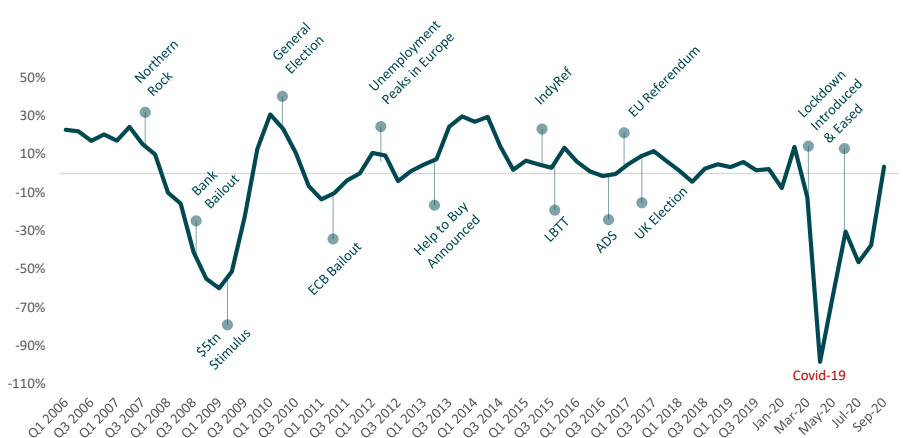


Fig.3 Sales activity recovered strongly in September
Year on Year % Change in Total Value of Property Sold in Scotland



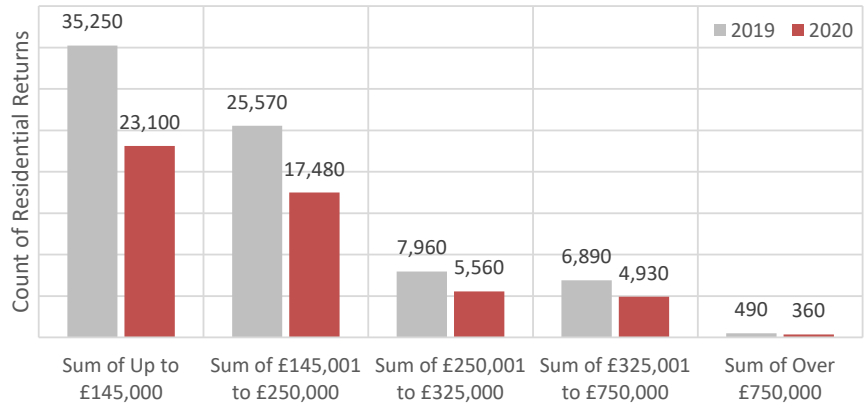
LBTT Revenue

Fig.4 LBTT returns in 2020 remain down on 2019

Count of Residential LBTT Returns by Price Bracket to September by Year

The constraints placed on residential transactions has had a significant impact on Residential LBTT returns and this will impact Government revenue for 2020. From the temporary closure of the application record on the 25th March through to the Government lifting restrictions on house moves on the 29th June, LBTT returns were down -60% on 2019 levels.

Since the market has reopened, there has been a significant increase in activity with revenue in September this year exceeding the same period in 2019. Despite this increase, the total value of revenue received over the calendar year to September remains -34% down on 2019 levels.



Source: Revenue Scotland

Fig.5 LBTT returns dropped to their lowest levels since the introduction of the tax but have rebounded in September

Residential LBTT Returns by Week

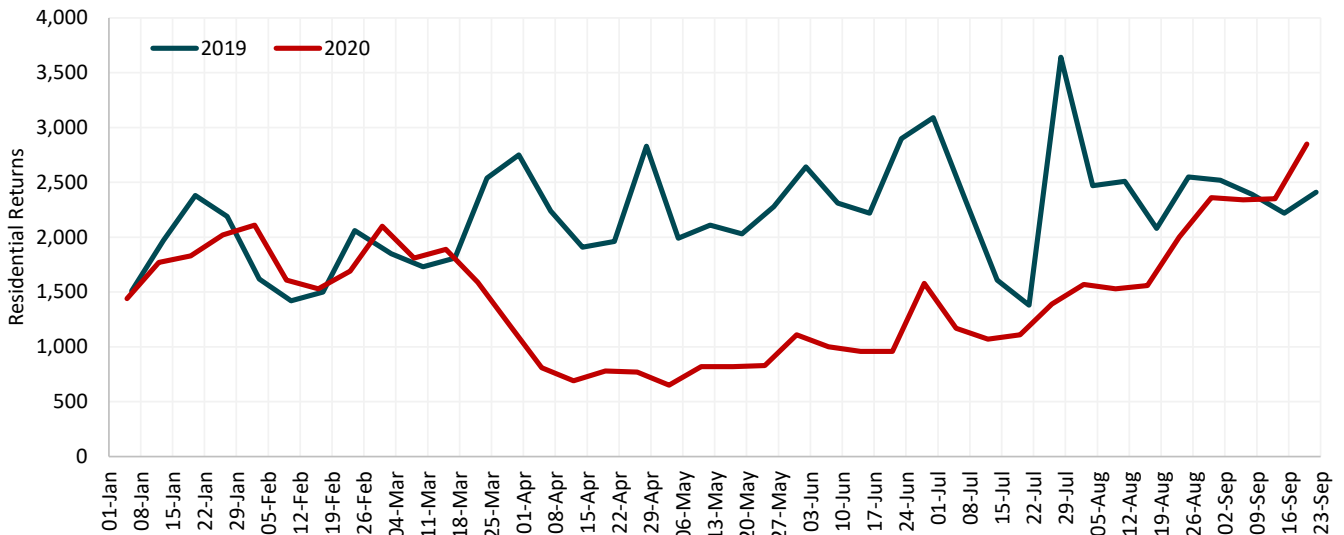
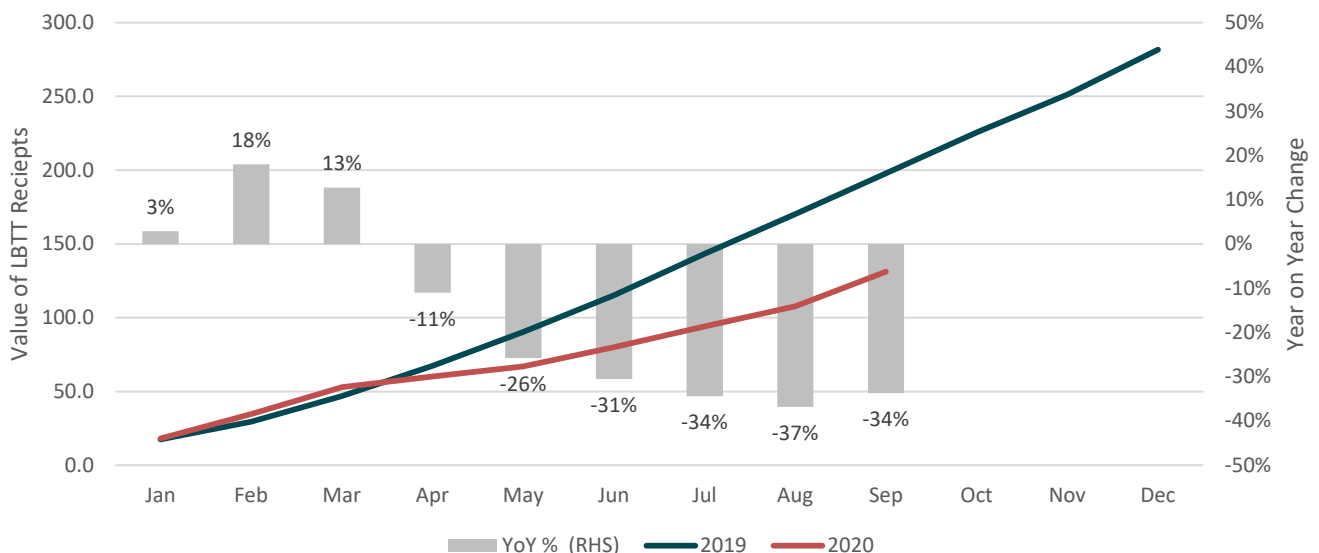


Fig.6 LBTT Residential Revenue for the calendar year to September is down -34% compared to 2019

Cumulative Value of Residential LBTT Revenue by Month and Year



Lending Landscape

While house prices and demand have remained strong in the post-lockdown market, a major challenge facing buyers, especially First Time Buyers (FTB), has been access to lending. With lenders looking to minimise risk exposure, the availability of high loan to value (LTV) loans in the marketplace noticeably diminished during the pandemic. At the same time, mortgage rates, especially for higher 85% plus LTV loans, have jumped significantly. This decrease in availability and increase in cost of mortgages placed an increased deposit burden on buyers looking to secure competitive lending rates as well

as impacting on affordability. The higher cost of servicing these loans may also disincentivise the move from rental sector into home ownership.

The FTB market is an important 'canary in the coal mine' of the wider housing market as it is often reflective of affordability and confidence in a market, as well as being important in enabling upward movement on the housing ladder.

Figures from the Bank of Scotland¹ suggests that, in the first half of 2020, the number of FTBs entering the

market has dropped by over one-third. Figures from this report suggest that the average deposit for an FTB in Scotland is now over £31,000. In the capital, this figure is nearly £50,000, or around 24% of the property's value.

However, as recent figures from the Bank of England show in Fig. 8, there has been a sharp bounce back in lending post lockdown. The number of mortgage approvals in September 2020 hit their highest levels since 2007. These figure point towards a rebound in activity in the mortgage market.

Fig.8 In September 2020 mortgage approvals hit their highest level since 2007

UK Mortgage Approvals for House Purchase and Remortgaging 2006 to 2020

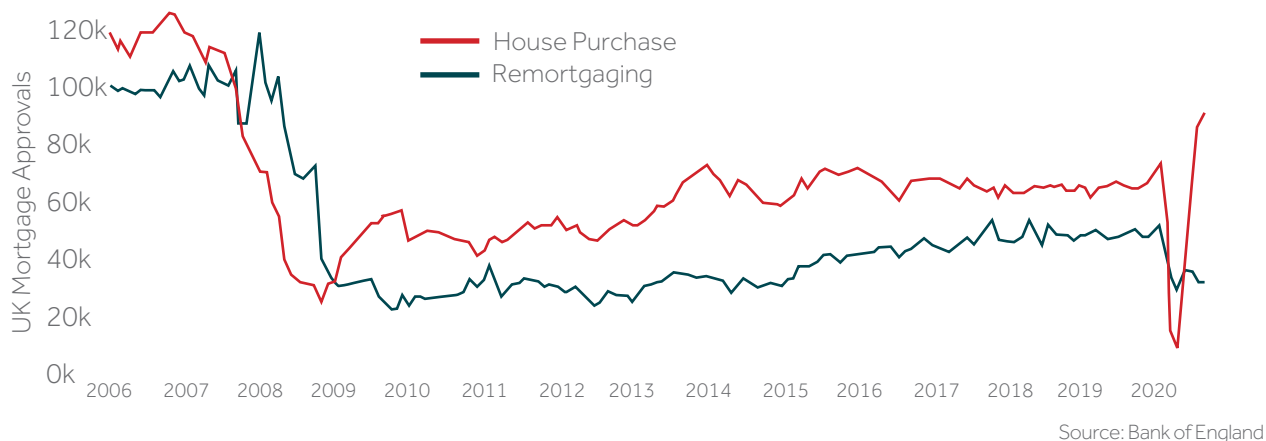


Fig.7 Mortgage rates have increased in rates especially at higher LTVs

2 Year Fixed Rate Mortgage Rates by Loan to Value Ratio to Jan 1995 to Oct 2020



¹<https://www.lloydsbankinggroup.com/Media/Press-Releases/2020-press-releases/bank-of-scotland/number-of-first-time-buyers-in-scotland-at-seven-year-low/>

Forecasts

We have revised our forecasts since the lockdown phase, but not by much. We were correct in anticipating that there would not be the house price crash that some commentators were suggesting. Instead, house prices have risen this year to date, despite the collapse in the economy, as the surge in demand post-lockdown has met a surge in supply of properties coming onto the market. As the market moved into Autumn, this demand appears to have been largely satiated in most locations and the market in some areas is now looking at over supply.

This will likely push back prices into next year, when coupled with stronger economic headwinds as a result of the ending of generous government support packages, will likely dampen sentiment further. However, the correction in house prices will probably be limited, as they were in 2008/09, unless there is a flood of distressed sales. With very low interest rates and the banks not as over-stretched as they were in the previous recession, we are not anticipating a high level of distressed sales, unless, for example, there is a marked and sustained increase in unemployment or a collapse in lending.

Over the next 5 years, we expect house prices to rise by around 11%, i.e. at a similar growth rate as over the previous 5 years, which is subdued by historical standards.

The main hit is likely to be in transactions. These are already -35% down this year to date. We would anticipate that they will be c.-27% down by the end of the year, with recovery unlikely next year based on current economic forecasts. Again, based on a gradual economic recovery from 2022, we would expect transactions levels to be back to 2019 trading levels by 2023, more pessimistic than our previous forecasts. This is broadly aligned with current Bank of England general economic forecasts.

A more optimistic forecast would see better recovery at the end of this year but it is difficult to foresee transactions being less than -25% down in 2020 overall. Our more optimistic forecast has transactions holding steady in 2021 before growing back sharply in 2022 and above 2019 trading levels before the end of that year.

A more pessimistic forecast would be that transactions will remain -35% down over the final few months of 2020 and decline further (-15%) in 2021 as recession bites. This would see the type of loss in activity last experienced in 2007-08. Recovery from 2022 is more limited. Any individual year since the 2008/09 recession has never been more than 16% growth year-on-year and averaged just over 4% per annum over 2010-19. This forecast would also be reflective of the previous stagnant pattern, with the housing market not back to 2019 levels even by 2024.

Fig.10 Prices are forecast to rise by 11% over the next 5 years

Rettie & Co. Scottish House Price Forecast

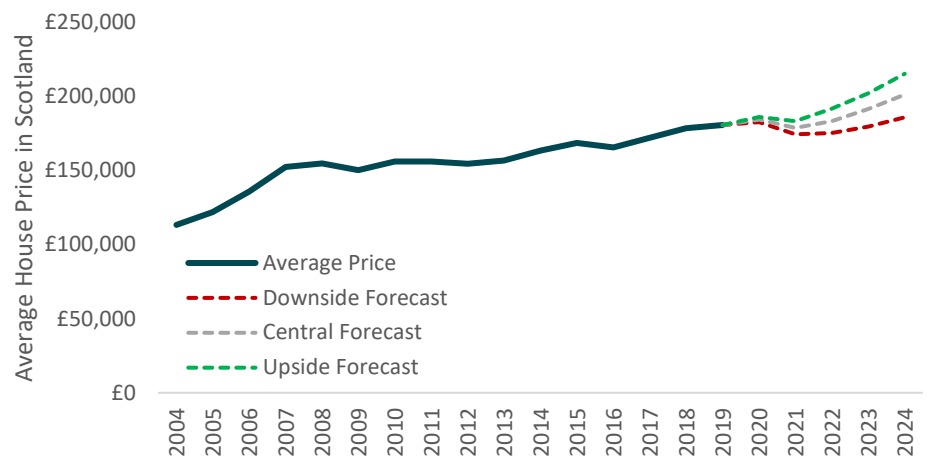
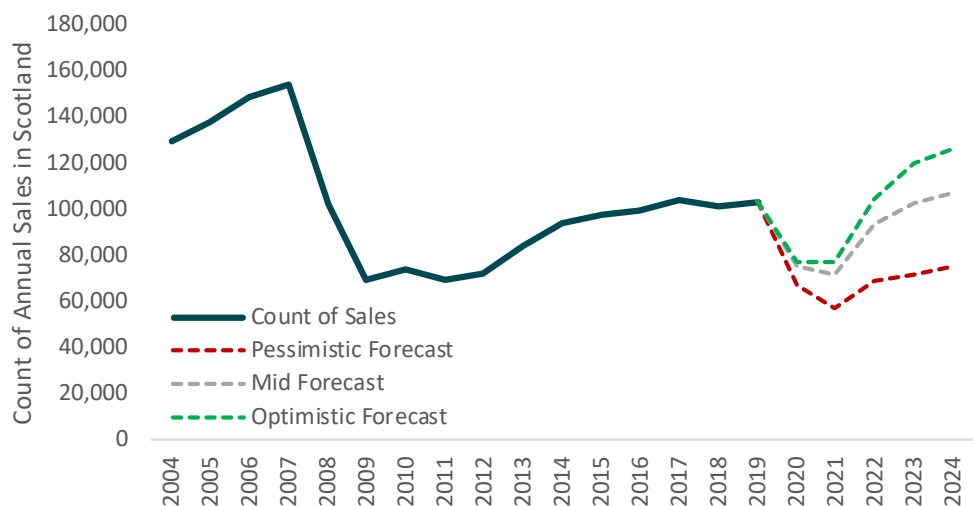


Fig.11 Transactions are forecast to remain subdued over the next few years

Rettie & Co. Scottish House Transaction Forecast



“Over the next 5 years, we expect house prices to rise by around 11%, i.e. at a similar growth rate as over the previous 5 years, which is subdued by historical standards.”



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Our Consultancy & Research team is the largest in the Scottish Private Sector and provides a broad range of services to both private and public sector clients. Covering all parts of the Scottish residential market, the team provides clients with in-depth, reliable and up-to-date information that enables evidence-based decision making.

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Our Structured Finance team provides innovative funding solutions for both private and public sector developments. We are expert in all project stages including: initial financial modelling; JV/contract structuring; sourcing and securing short- or long-term funding; legal negotiations; public sector procurement; and asset management and rental.

New Homes



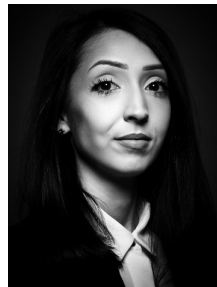
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Our New Homes Sales and Marketing Team are market leaders, responsible for selling approximately £96m of new build property over the last 12 months. The team are currently sole agent on 21 developments, totalling 644 properties, providing exceptional levels of service across Scotland in all aspects of sales and marketing, from campaign set-ups through to property handovers.

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Our Land & Development team advises on land and property development projects, on residential investments and Build to Rent. We cover residential, non-residential and mixed-use development sites and advise on every stage of the project cycle, from early appraisals and funding through to site disposals.