MAY 2020

MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the third edition of Kensington's Special COVID-19 Update Series. In this newsletter, we look at how the coronavirus crisis has impacted different segments of the UK workforce. We examine trends we see across Kensington's recent originations, focusing on various aspects of customers' employment as a driver. We also look at how the government's job retention scheme is helping different groups of employees, and how these different segments of the workforce might recover from the current crisis.

Key Highlights

- Individual segments of the workforce have been impacted differently, with older and more experienced employees more sheltered than younger customers and the self-employed
- Industry is by far the largest driver of how customers are faring in the current crisis, and the key reason the self-employed have been harder hit is that they are significantly likelier to be employed in impacted sectors
- The government's job retention scheme has proven very popular, with almost 1 million firms applying to it as of mid-May, but the time to implement it means its effect has not yet been fully felt
- The far-reaching but uneven impact of the crisis means different groups of customers will be able to escape their current hardship via different solutions and at different speeds

Introduction

Initially hailed by some as a "great equaliser," the continuously unfolding COVID-19 crisis has proven in many ways that it is anything but that. Frontline workers have been disproportionally hit from a health perspective, but the devastating financial impact it has brought is also being felt unevenly. In our last edition, we examined how characteristics such as loan size and historical performance impacted the likelihood of a customer to require a mortgage payment holiday (MPH). In this edition, we focus on employment and industry as drivers, and for this look at Kensington's own recent originations and the trends we are seeing in our book. We also examine how the government schemes, announced very early in the crisis, have been implemented and worked thus far to support the UK's workforce, and what this means for employees in different industries.

Portfolio Trends – Employment and Industry

In order to determine how customers' employment type and the industry they work in impacts how they are faring in the current crisis, we look at Kensington's own originations between the beginning of 2019 and the end of February 2020. We limit the date range so as to use only data that is up-to-date, as details on customers' income and employment are not typically updated after origination. We also limit the analysis to owner-occupied (OO) loans, as buy-to-let (BTL) customers' ability to keep up payments on their loans is generally driven by their tenant's financial situation, rather than their own. This leaves us with a sample of just over 6,000 loans.

The first thing that stands out (as seen in figure 1) is a notable difference in requests for payment holidays amongst the self-employed (c. 46%) vs. the employed (c. 26%) - this is largely driven by the sector the customer works in, as we will detail later. Interestingly, for the employed, income does not appear to be a huge driver. For

Fig 1: Percent of Customers with a MPH by Employment Type (by count)

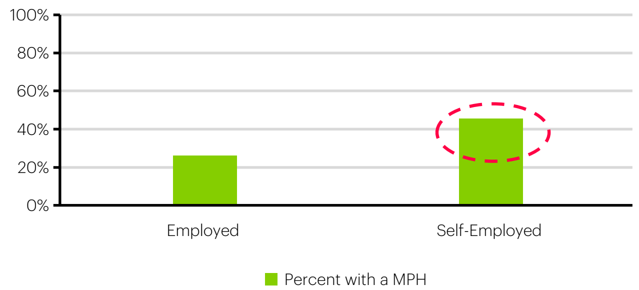
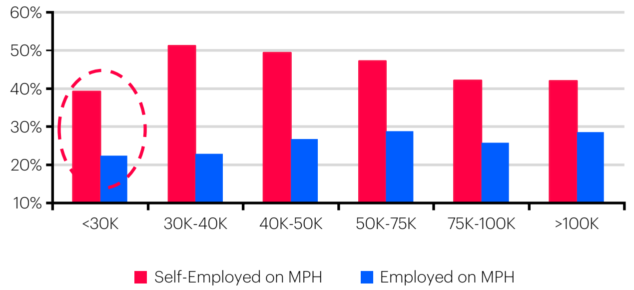


Fig 2:Payment Holidays and Income (by count)



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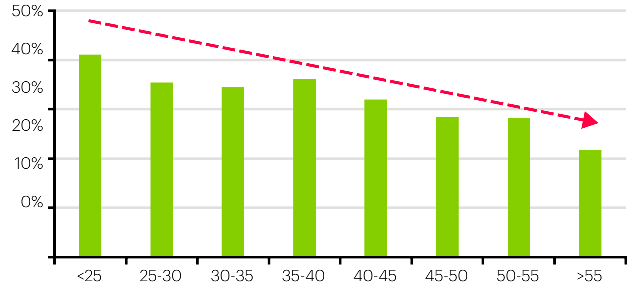
both the employed and self-employed, the customer groups with the lowest MPH take-up rates were those in the lowest income bracket of less than £30K. Take-up rates for the self-employed peaked in the £30K-£50K brackets, which account for c. a third of all self-employed customers in the portfolio, and then decreased gradually as income increases. For the employed the peak use is actually amongst the higher earners, over £50K, which account for c. half of all employed customers in the portfolio.

Fig 3: Percent of Borrowers in each Age Group who are on a Payment Holiday (by count)



The next pattern that stands out was a significant difference based on the age of the customer (figure 3). The youngest customers had the highest take up rates, at over 40%, which gradually decreases, down to less than 30% for those over 45 years old, and less than 25% for those over 55 years old. This is not surprising, as most older borrowers will be more established in their careers, have higher savings to fall back on, and generally will have smaller loans and monthly instalments, as they have more equity in their properties. They are also likely to have more established and secure jobs.

This leads to the final, and most significant trend we've observed, which is that industry is by far the most important factor in determining the likelihood of customers needing a payment holiday. Sectors which have been completely shut down by the current lockdown rules are the hardest hit. The "Health and Beauty" industry, which includes roles such as hairdressers, fitness instructors, and salon owners saw the biggest take up of payment holidays, at 65%. While these account for a very small portion of our book, the scale is nonetheless notable. "Holiday and Leisure" was the second worst hit, followed by all property-related roles. These industries are ones in which working remotely is generally not possible, and it is difficult for them to re-invent themselves to offer alternative goods or services while the strictest restrictions remain in place. Unsurprisingly, "Restaurants and Catering", which was heavily impacted still fared slightly better, as some have pivoted from their normal offering to alternatives such as a take-away or online cooking tutorials, allowing them to keep some of their normal workforce employed. The public sector has been the least impacted of all sectors followed by the "Food Retail and Production" sector, which has been vital in this time of crisis, and if anything, the latter has in many cases experienced significant uptick in sales as more and more people are consuming most of their meals at home.

The role of industry also explains why we see such discrepancies between take-up rates for the employed and self-employed. The latter are significantly more likely to work in exactly those roles which have been hardest hit, such as salon owners, tour operators, and construction-related roles. Conversely, they have a very low presence in lesser impacted roles such as those in the public sector, education and office workers. We expect the industry our customers are employed in to continue to determine how they will be able to emerge out of the current situation, with those businesses allowed to re-open first and fully the most likely to bounce back. Others, such as travel and leisure, are expected to face longer term downturns, as a new "normal" takes hold and common practices like business travel remain largely non-existent for the foreseeable future.

Fig 4: Payment Holidays by Industry (by count)

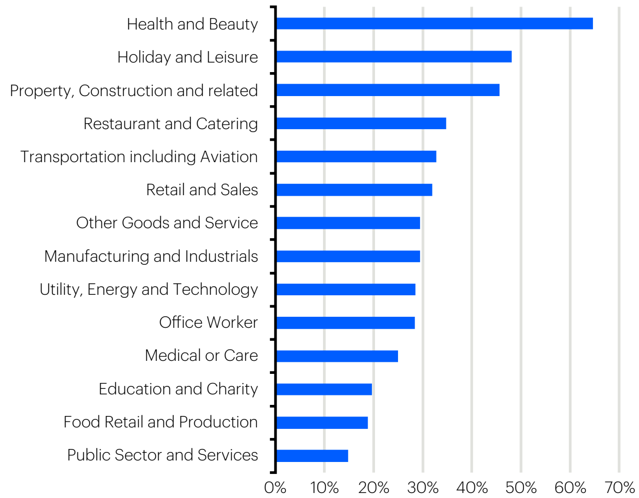
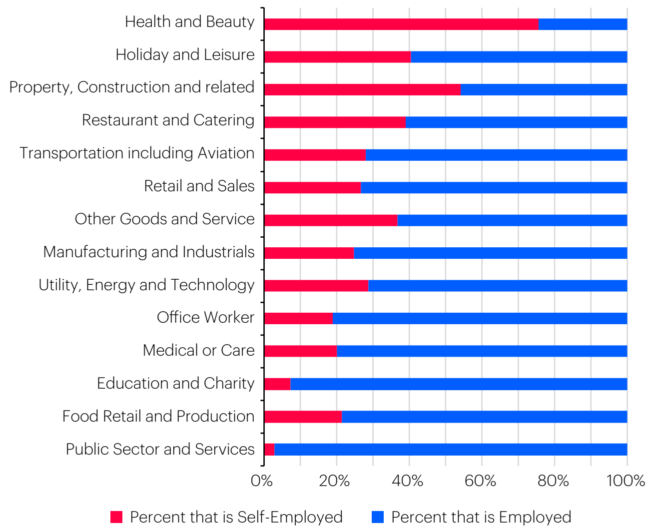


Fig 5: Percent of Customers in each Sector by Employment Type (by count)



The Furlough Scheme – Has it helped?

The outsized impact the COVID-19 crisis and ensuing lockdown is having on some industries was clear early on, and when mass redundancies began to be announced in mid-March, the government quickly responded with the Coronavirus Job Retention Scheme (CJRS). The scheme provides much needed relief for many employees of businesses which have closed completely or are operating at much more restricted levels by encouraging employers to furlough them rather than make them redundant, by covering up to 80% (up to £2.5K gross salary per month) of furloughed employees' normal wages.

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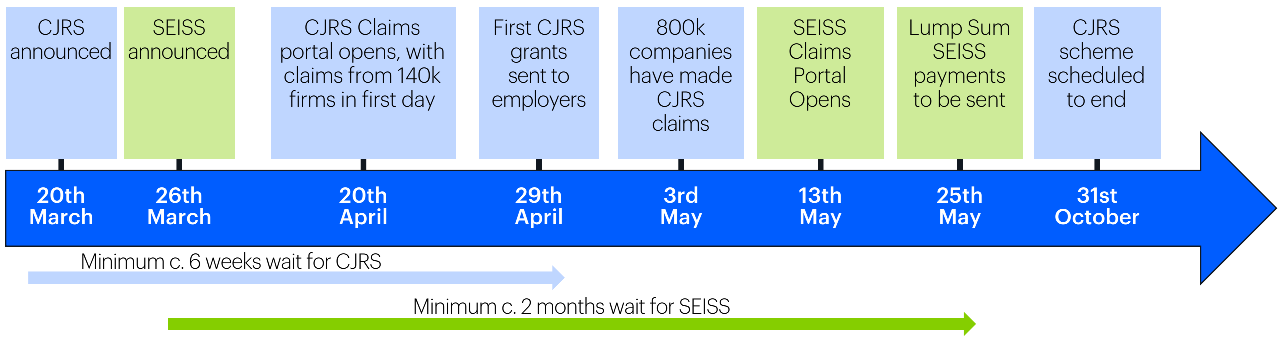
Fig 6: Timeline of Key Coronavirus Job Retention Scheme Events



However, the relief was not immediate, and for many customers certainly not fast enough to support them in maintaining mortgage payments. As seen in Figure 6, it took a month for the CJRS scheme, which has just been extended by 4 months to run until the end of October, to accept employer claims, and a further 6 days for payments of approved claims to be made to employers, who would then typically pay these amounts to their employees via regular payroll. While getting such a large scheme up and running so quickly is an impressive feat, the reality is that for employees, waiting 5-8 weeks (depending on payroll cut-off dates) for cash can feel like a very long time, and mean there are many normal financial obligations which they will not be able to meet.

For the Self-employed, the wait is even longer. The Self-Employed Income Support Scheme (SEISS), which was designed to offer similar support to the self-employed was announced days after CJRS. The government only started contacting customers who may be eligible for the scheme on May 4th, but the claims portal won't be open for a further 9 days, and the actual payments won't reach customers until May 25th, more than 2 full months after the beginning of the lockdown. However, at that time, eligible customers will receive a taxable grant worth 80% of their average trading profits up to a maximum of £7.5K (equivalent to three months' profits), which is paid in a single instalment, meaning these customers will have waited longer, but will receive a significant sum in one go, possibly enabling them to get back on track quickly.

In spite of its delays, the CJRS is proving very popular. As of May 12th, almost 1 million companies have made claims covering 7.5 million employees (c.25% of the overall employed UK workforce). The average claim per employee has been for £1.3K, well below the maximum £2.5K, which suggests it will benefit many lower income customers. At current levels, the scheme costs over £10 billion a month, and this is expected to continue increasing. This popularity worries some, who are concerned about the burden the scale of these payments will put on UK taxpayers. Nonetheless, rumours that the scheme would be downscaled or end have proven unfounded with the recently announced extension to the end of October. However, even with the extension, there are concerns that certain industries will likely have to make some portion of their furloughed employees redundant once it does end, e.g. the airline and travel industry, as they do not expect to quickly recover to their pre-crisis business levels. This will create a separate and longer term problem for those employed in these sectors, which will be more difficult to solve quickly.

Wider Industry Data

The ONS has started reporting how different industries have been impacted by the crisis, based on a fortnightly survey which captures turnover, workforce, trade, and business resilience. The latest data, published on May 7th and in reference to the two weeks leading up to April 19th, has found that almost a quarter of businesses across the UK had fully closed or paused trading. Of those that did continue to trade, 58% reported decreased turnover, and of these, c. one fifth of the pre-crisis workforce was furloughed. The size of the business did not appear to have a significant impact – businesses with 250 employees or more were as likely as smaller businesses to temporarily cease trading, and regional differences were also not note-worthy, although there was a slight uptick in businesses closing in Northern Ireland vs. the rest of the UK.

Figure 7: ONS Survey: Percent of Workforce on Furlough By Industry (as of 19th April)

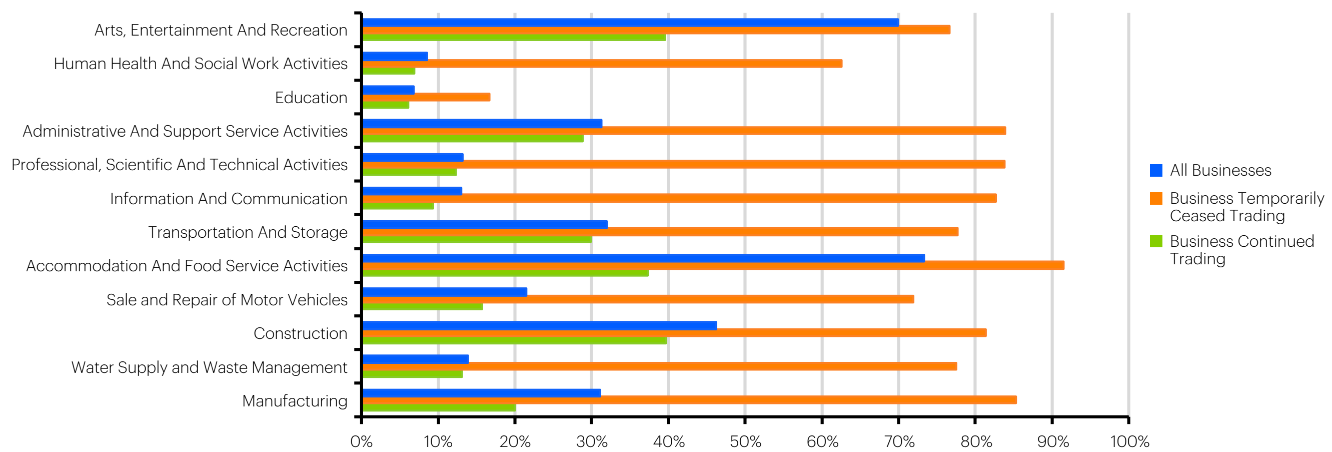


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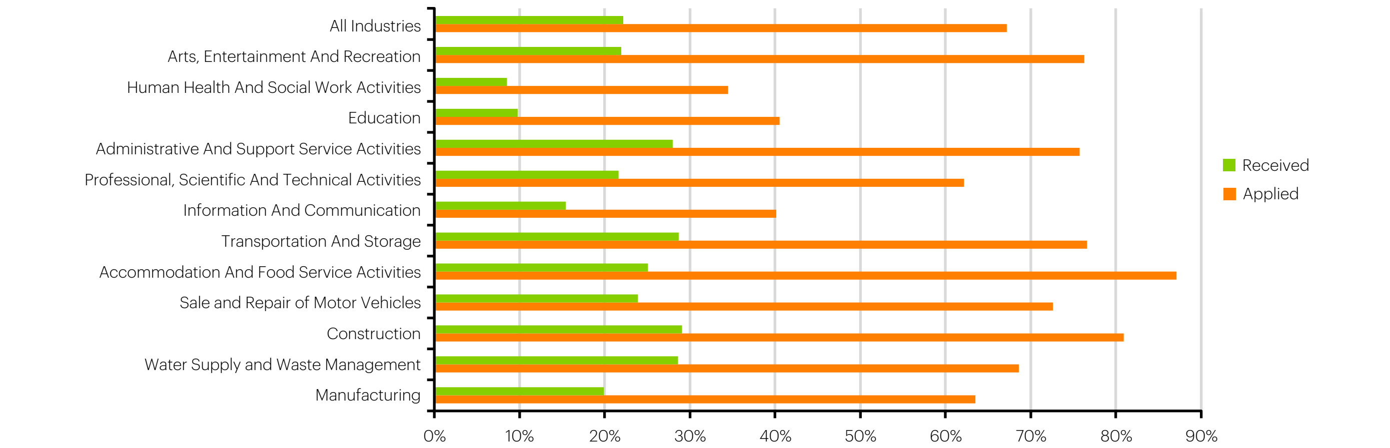
Figure 8: ONS Survey: Percent of Businesses in each Sector Using the CJRS (as of 3rd May)



As in our own findings, there were significant variances across industries. The survey found that the 2 sectors that reported the largest percentages of businesses temporarily closing or pausing trading were the "Arts, Entertainment and Recreation" sector and the "Accommodation and Food Services" sector, reporting 80% and 81% closures respectively. In line with this, it also found that the highest proportion of workforce being furloughed was recorded in the same 2 sectors (figure 7). Amongst businesses that ceased trading, furlough rates were almost all above 70%, with the exception of the "Education" and "Human Health and Social Work" sectors. Even businesses that continued to trade had very high proportions of furloughed workforces in some industries, including once again the "Arts, Entertainment and Recreation" and "Accommodation and Food Services", but also "Construction", suggesting even some industries that continued to operate are doing so at much more restricted levels.

The survey also found that the government's CJRS was very popular, with a huge proportion of all businesses reporting that they had applied for the initiative. For this section, the ONS allowed answers to be collected up to May 3rd (as the application window only opened on April 20th, with the first payments not made until the end of the month) – this revealed that of those that had applied, the vast majority had yet to receive the grants (figure 8). It will be interesting (and telling) how these numbers evolve in the ONS' next release of this data on May 21st.

Conclusion

There is no doubt that different buckets of customers will emerge from the current out-of-work segment of the workforce with very different longer term financial outlooks, and that these will require support customised to their situation. The scale of the government's various support schemes mean many impacted businesses and customers are being helped. The huge number of payment holiday requests both Kensington and the wider industry have seen have no doubt been exacerbated by the unavoidable delays in customers receiving the cash support they have been waiting for. We are optimistic that as more customers receive these payments and others can return to work, some will be able to quickly get back on track. This should particularly be the case for the self-employed who are eligible for the lump sum grants due to be paid on May 25th. Nonetheless, for many, transitioning out of payment holidays will take some time - mortgage lenders cannot use a one size fits all approach. Some customers will inevitably fall into longer term financial hardship, but solutions are being developed to minimise this. Portfolios with a greater bias towards the most impacted industries will fare worse, and will need more complex solutions which will take time to implement and create greater operational challenges for lenders and servicers alike. As this information is generally not disclosed (or updated through the years) many investors in mortgage-backed securitisations may ask for more transparency with these data points in the future.

Sources

1. https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessimpactofcovid19surveybics/current