JUNE 2020

MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the fourth edition of Kensington's Special COVID-19 Update Series. In this newsletter, we examine the impact of the easing of the lockdown and the return of large groups of people to work on the mortgage market. We look at how this, as well as the government's ongoing intervention, are affecting trends for existing mortgage payment holidays and take up rates for new ones. Finally, we look at how the wider economy is bouncing back as the economy re-opens.

Key Highlights

- Government schemes to support workers are now fully operational - cash is reaching claimants, and applications for new claims have slowed down considerably, despite both major schemes being extended
- Payment Holidays have been extended for a further 3 months, but the evidence suggests that requests peaked very early in the crisis and are continuing to trend downward considerably, with some customers taking them as a precaution rather than out of need
- The economy is continuing to re-open and more and more employees are being moved off furlough and back to the workplace

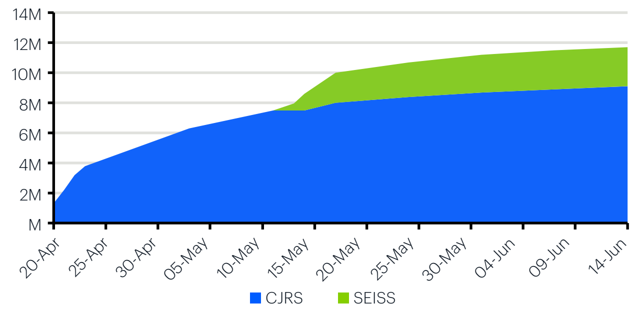
Introduction

Whilst the onset of the lockdown and the ensuing economic crisis were sudden, the easing of both has been a lot more gradual. Nonetheless, with the re-opening of schools and outdoor markets on the first of June, followed by the phased re-opening of shops mid-month and hospitality services expected to follow in early July, we are starting to see a slow but clear return to normality. More and more employees are returning to work, and cash from government schemes, including the first lump sum payment to the impacted self-employed on May 25th, is now reaching the workforce. This means that many mortgage customers who required payment holidays because they faced short-term cash flow problems brought on by their abrupt stop in employment are now moving back to a position where they can make their monthly payments. With the government's recent announcements of extensions to both the Coronavirus Job Retention Scheme (CJRS) and the Self-Employed Income Support Scheme (SEISS), customers and lenders can rest assured that there won't be a cliff edge over the summer. Additionally, despite the recent announcement that mortgage payment holidays (MPHs) would be extended by a further 3 months, we have seen a clear drop in new requests from customers. This means that mortgage lenders are now able to shift their focus from managing new requests to working with customers to get them back on track, a sign that the worst of the crisis may well be behind us.

Government Schemes

Both major schemes to support COVID-19-impacted workers are fully operational and payments have been received by workers. When the CJRS opened in late April, claims came flowing in, with over half a million employers applying for support for almost 4 million employees worth £4.5bn within the first 3 days. While claims continue to be made, the number of new ones is slowing considerably – the total stood at 1.1m employers making claims for 9.1m jobs as of June 14th. The SEISS has seen a similar pattern of

Figure 1: Number of Jobs Supported by Government Schemes



take up rates, with 2 million applications in the first 4 days, which has so far only increased by a further 600K over the ensuing 4 weeks.

The cost of these programmes to the government is both enormous and unprecedented. Combined, the value of the claims made to date is over £28bn, with CJRS accounting for £20.8bn and SEISS £7.6bn (as of June 14th). Because of this, some significant changes have been announced, particularly for CJRS. For one, even though it has been extended to the end of October, the scheme will close to new entrants from 30 June. After this, employers will only be able to furlough employees that they have furloughed for a full 3 week period prior to 30 June, meaning that the final date by which an employer can furlough an employee for the first time will be 10 June.

Other key changes are intended to encourage a return to work even if it is gradual. This includes giving workers and employers more flexibility by allowing them to work part time and be furloughed part time (rather than not be allowed to work at all as with the initial scheme). To lessen the financial burden on the government, from

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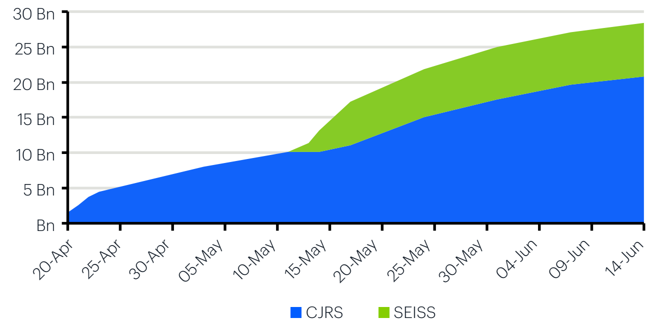
Figure 2: Value of Claims Made via the Schemes



August 1st the CJRS grant will no longer cover the cost of employers' National Insurance or pension contributions (with employers expected to cover the costs) and while employees will continue to receive at least 80% of their salary (up to £2.5K), employers will start covering some of that burden (10% from September, and 20% from October).

SEISS was also extended at the end of May, with a second lump sum payment being made available to those eligible, this time capped at £6.75K (vs. £7.5K for the first grant). Anyone who has not yet applied can still apply for the first grant up to July 13th. Unlike CJRS, when the scheme re-opens in August, anyone eligible will be able to apply for the second grant, even if they did not claim for the first one. This means we could still see a rise in take up rates for some time, both for the first and second phases of the scheme. While this puts a further burden on the government, this additional flexibility is positive for self-employed mortgage customers, and lenders like Kensington who cater to them.

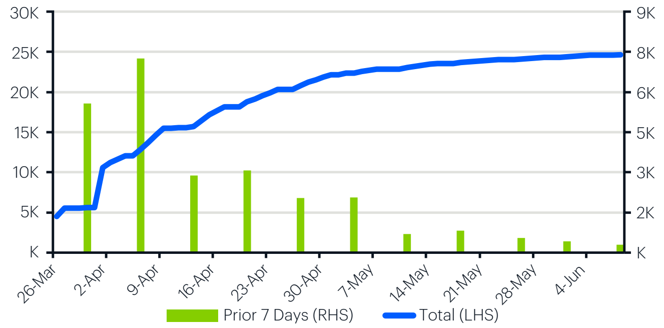
Payment Holiday Take Up Rates and Extension

Similar to the extensions to income support schemes, in late May the FCA announced a proposal to extend payment holidays for mortgage customers beyond the original 3 months, which was confirmed on June 2nd. The extension allows customers who have not yet applied for a MPH to do so until October 31st, and also asks lenders to continue to support customers who are already on one, including offering the option of a further 3 months full or part payment holiday.

While the extension means that customers currently on a MPH may stay on one longer than initially anticipated, take up rates for new MPHs have slowed down considerably. As seen in Figure 3, requests for new payment holidays really peaked in the first 2 weeks after they were announced, and have since decreased significantly. The extension is expected to lead to some increase in take up rates, but we have yet to see evidence of this, and the curve is clearly flattening.

When we look at Kensington's full serviced book, which comprises of c. 110K loans, c. 20% were on a payment holiday as of the end of April. Through the month of May, an additional 2% of the customers in that book by count went on a MPH, although this was offset somewhat by a small number of MPH customers who redeemed their loan, as well as a small number of customers whose MPHs came to a close and did not ask for an extension, or asked to be taken off their MPH prior to the scheduled end.

Fig 3: Kensington Serviced Assets - Payment Holiday Requests Through Time



Most customers in the UK who took a payment holiday were granted one for an initial period of 3 months, regardless of their wider circumstances. In a survey of over 18,000 people who went through their mortgage payment holiday tool[1], Koodoo, a digital platform which works with lenders and aggregators, found that factors such as the lender, the loan balance, the loan term, or the repayment type did not play a significant role in the initial length of the payment holiday. Three months seems to have been the default that the vast majority of lenders gave to customers, with only slight variations, e.g. customers with very small outstanding balances or short remaining loan terms (<£50K or <5 years) were somewhat more likely to be on a shorter break, likely because they requested this. Interestingly, a notable portion of all customers took the MPH as a precaution rather than out of necessity (figure 4). There were some variances in this by employment type, with those customers who are self-employed or part-time employed more likely to take the payment break due to lost or reduced income, vs. 29% of full time employees who reported taking it as a precaution. Similarly, customers with larger loans and longer remaining terms seem to have been more likely to use the break as a precautionary measure. This is reassuring as it suggests that when those payment holidays end, if the customers feel confident of their future earnings,an extension is less likely to be requested. In any case, we are unlikely to see a material reduction in payment holidays until the initial 3 month period customers were widely granted is over.

Figure 4: Customer Reason for Taking Payment Holidays by Employment Type (Koodoo Research)

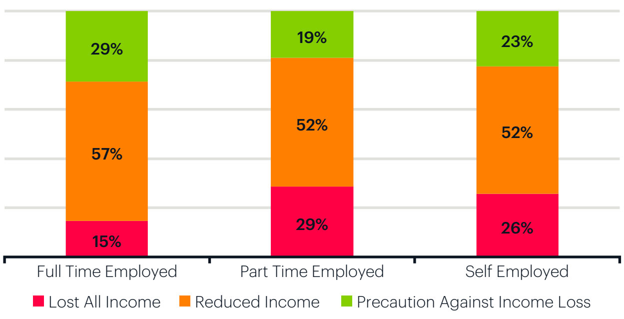


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Figure 5: Time Horizon for Businesses who have Paused Tradings to Start Trading Again (as of May 17th)

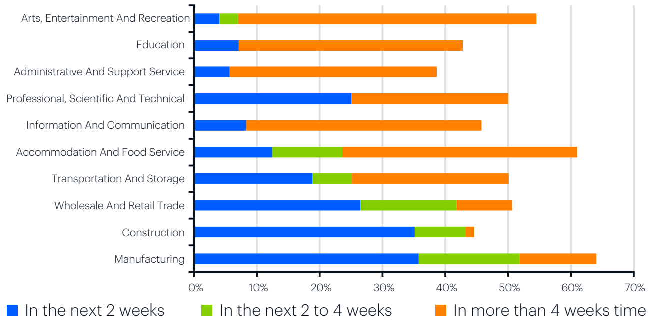


Figure 6: Percent of Workforce of Businesses that have Paused Trading Expected to Return to Normal Work place in Next Two Weeks (as of May 17th)

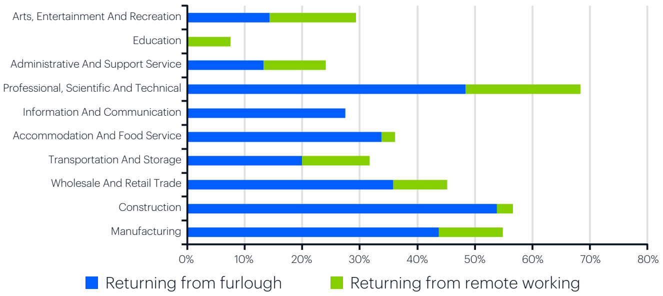
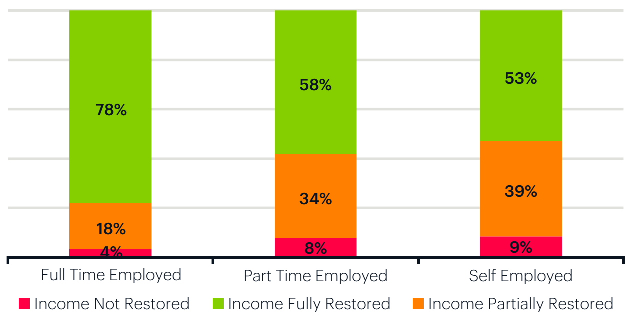


Figure 7: Future Income Outlook by Employment Type (Koodoo Research)



Wider Economic Outlook

According to the latest ONS data[2], as lockdown measures continue to be eased, more and more businesses are reporting re-openings and the increased return of their workforce, or are expecting it in the coming weeks. Of all businesses that paused trading, 25% reported they expect to restart trading within the next four weeks, 30% intend to restart trading in more than four weeks, and 45% were not sure (all as of May 17th). The Manufacturing and Construction sectors (which together account for over 1.5 million furloughed employees) reported the most imminent intentions to restart trading, followed by the Professional (c. 500K furloughed employees) and Retail (c. 1.6 million furloughed employees) sectors. A high proportion of the Accommodation and Food sector (c.1.4 million furloughed employees), which was one of the worst hit, is also expecting to return to work, albeit somewhat later.

Encouragingly, those same sectors are expecting a high proportion of their workforce to return from furlough, which will simultaneously alleviate the burden on the government, help re-start the economy, and mean their employees can hope to regain their pre-crisis income. Koodoo's survey found that 78% of full time employees expect their income to be fully restored, 18% expect it to be partially restored, and only 4% expect it not to be restored. Unfortunately these numbers are less optimistic for the self employed and part time employed, where only 53% and 58% respectively expect a full recovery. It will be key to monitor these differences and ensure those harder hit customers receive the support they need.

Conclusion

As a first for some time, the news seems to be broadly positive. The government is meeting the tests it set out for itself to control the virus. The economy is restarting, people are going back to work, and cash to bridge this difficult period is reaching those who need it. Payment Holiday rates are broadly steady, and measures are in place to help those who need them. That being said, a huge challenge lies ahead for lenders and customers to overcome the hardships the COVID-19 crisis has caused and return to their normal financial position. Kensington has started an extensive programme to manage its loans with payment holidays and ensure that customers are being offered the most suitable approach to return to paying as soon as is appropriate to minimise the long term cost of these payment breaks on them.

References

1. https://mortgageholiday.co.uk/
2. https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessimpactofcovid19surveybics

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