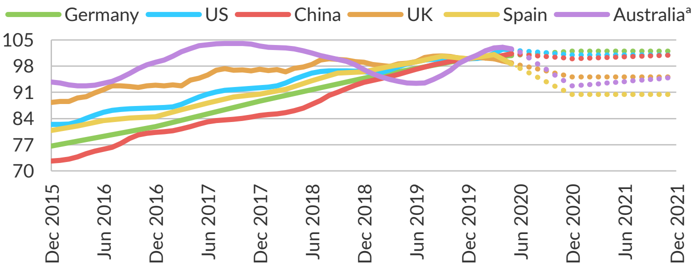
The Next Phase: Coronavirus Derails Home Price Growth

Nominal Homes Price Indices and Midpoints of Forecasts
(Indexed to 100 as of end-2019)



[a] Eight state capitals
Source: Fitch Ratings, S&P/Case-Shiller, CoreLogic, HM Land Registry, BulwienGesa AG, INE Spain, National Bureau of Statistics China, Haver Analytics

Fitch Ratings expects nominal home prices to fall in the UK, Spain and Australia in the rest of 2020 due to the impact of the coronavirus pandemic. Under Fitch's forecast, Spain suffers the most significant fall in house prices, decreasing by 8%-12% for full-year 2020. Australia will suffer a decline of 5%-10%, whereas the UK will experience a decline of 3%-7%.

In the US, a weaker 2H20 will counteract growth in 1H20, resulting in mainly flat prices for the full year. Prices should also remain broadly flat in Germany for the rest of 2020. China, which we already expected to have flat home price growth this year, will experience the smallest relative impact from the pandemic, with flat to slightly negative home price growth in 2H20 and largely stable prices over 2020-2021.

We have revised downwards our full-year forecasts for 2020 for all these countries (except for China) since we published the Global Housing and Mortgage Outlook - 2020 in December 2019, but the size of the revisions varies significantly.

All price changes are likely to be based on fewer sales for the remainder of the year despite lockdowns mostly easing. We expect sales volumes to recover from 2021, when we broadly forecast prices to stabilise, although Australia could have a slightly larger home price rebound. However, there are substantial downside risks, chiefly from the economic impact of renewed lockdowns.

We expect home price growth in most countries globally to be adversely affected by the global pandemic. We have highlighted these six countries due to their important or growing residential mortgage-backed securities (RMBS) or covered bond markets, and their differing levels of containment of the pandemic.

Country-Specific Factors Key to the Pandemic's Impact on Home Prices

All markets have suffered from contracting economies and deteriorating labour-market conditions due to the pandemic and our home price forecasts incorporate the relative size and duration of these impacts.

We also consider the degree to which the impact on home prices will be mitigated or magnified by country-specific factors. These include policy responses, supply constraints, changes in demand drivers such as immigration, the timing of potential foreclosures and contrasting home price trends entering the pandemic.

Related Research

The Next Phase: Coronavirus Accelerates Changes to the Structured Finance Landscape (July 2020)

U.S. RMBS Sustainable Home Price Report (Second-Quarter 2020) (June 2020)

Coronavirus Grinds U.S. RMBS Non-QM Originations to a Virtual Halt (June 2020)

The Next Phase: Change Accelerated (Coronavirus Pandemic Brings Forward Important Shifts for Credit) (June 2020)

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Spain and Australia to Experience Largest Price Falls

The economic cost of long domestic lockdowns drives the projected drops in Spain and the UK. The hit to Spain's tourism sector, which represents 13.5% of employment (versus an average of 6.9% for OECD countries), affects Spain's macroeconomic fundamentals and home prices.

Extremely low immigration and fewer foreign students this year will reduce Australian home prices, which were only recently recovering from a downturn.

The UK's lockdown lasted longer than initially expected, and high frequency indicators suggest that the immediate post-lockdown recovery is lagging that seen in some Eurozone countries. The UK home price and macroeconomic forecasts in this report assume the avoidance of a cliff-edge Brexit, which could significantly drag on the post-crisis recovery in GDP that we expect in 2021, despite previous no-deal preparations mitigating the risk of extreme trade disruption. Demand for housing would decrease from late-2020 as the risks become more apparent, and we would expect the price fall in 2020 to be closer to the lower end of our baseline forecast range. Price stabilisation would be much less likely in 2021.

We expect US home prices to end 2020 largely flat versus 2019. The robust YTD home price growth (of 2.5% through April) will be counterbalanced in 2H20 by price declines in markets hit hard by lockdowns and job losses. However, limited new supply in the low- to mid-price tiers in recent years and low mortgage rates are likely to attract previously side-lined buyers, which we expect will prevent large price falls. Markets that reopened too quickly face more downside risk from the re-imposition of restrictions and resultantly weaker labour markets.

Our forecast for largely flat prices in Germany for the remainder of 2020 is driven by the economic benefit of the country's relatively quick emergence from lockdown and mortgage rates remaining very low. In addition, supply that was already tight before the pandemic should limit the price impact of slowing demand.

We expect the pandemic to have the smallest impact on home prices in China, where the government was already moving to dampen the accelerated growth from previous years. Pent-up demand, a quick reopening after lockdown, lower mortgage rates and the easing of regulatory restrictions will support largely stable home prices for the rest of 2020 and 2021.

Home Price Forecasts

			Updated forecasts (Jul 2020)		Prior forecasts (Dec 2019)	
(%)	2019	2020 (year to)	2020F	2021F	2020F	2021F
US	3.7	2.5 (April)	0 to 2	-2 to 2	3	3
China[a]	3.8	1.3 (May)	-2 to 2	0 to 2	0	0
UK	1.0	-0.1 (1Q)	-7 to -3	-2 to 2	1	2
Germany	5.5	2 (May)	0 to 4	-2 to 2	5	4
Spain	3.6	1.1 (1Q)	-12 to -8	-2 to 2	5	5
Australia[b]	3.0	1.7 (June)	-10 to -5	0 to 5	5	5

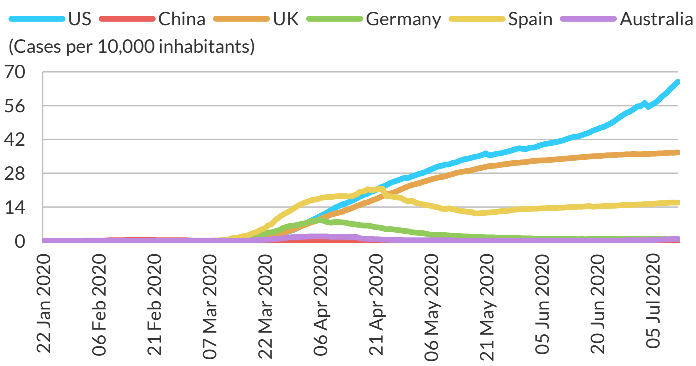
[a] The 2020 YTD and updated forecast ranges are for China as a whole. The Dec 2019 forecasts are for Tier 1 Cities (Beijing, Shanghai, Guangzhou and Shenzhen).
[b] The figures for Australia reflect the eight state capitals.
Source: Fitch Ratings, S&P/Case-Shiller, CoreLogic, HM Land Registry, BulwienGesa AG, Instituto Nacional de Estadistica (INE) Spain, National Bureau of Statistics China, Haver Analytics

Handling of Pandemic Feeds into Macroeconomic Forecasts

The intensity and duration of lockdowns, the relative exposure to heavily affected industries (including tourism) and the scale of policy responses play an important role in the projected depth of economic downturns and the pace of their recovery. Of the countries in this report, Germany, Australia and China have had the most success containing the pandemic. Infections continue to increase in the UK, while the pace of this increase is accelerating in the US.

However, all six countries are facing or have recently faced local coronavirus outbreaks, for which specific restrictions were put in place. The US stands out with new daily coronavirus cases (based on a seven-day average) rising in 46 states, as per NPR's calculation on 13 July 2020 based on Johns Hopkins University data. Australia has re-imposed a strict lockdown in the Melbourne metropolitan area for six weeks.

Active COVID-19 Cases



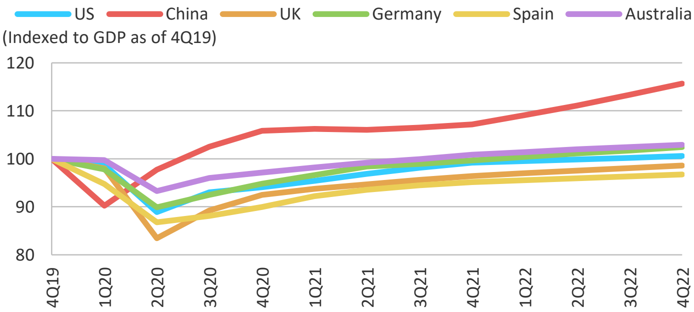
Source: Fitch Ratings, Johns Hopkins University

The substantial drops in real GDP in 2Q20 (and 1Q20 for China), followed by a slow recovery (see *Global Economic Outlook: June 2020 - Coronavirus Disruption Easing*), are major drivers of our revised property forecasts. Our unemployment forecasts, which consider government support for businesses and workers, also contribute to our home price expectations. Spain and the US face the largest forecasted growth in annual average unemployment, to 18%-19% in Spain in 2020 and 2021 (from 14% in 2019) and, in the US, to 9% in 2020 and 8% in 2021 (from 4% in 2019).

Our home price forecasts are based on our baseline scenario (see *Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases – Update*), which assumes a slow macroeconomic recovery from 3Q20 (2Q20 for China).

Our downside scenario (see *Downside Risks Dominate* below) includes a more severe and prolonged period of stress with a recovery to pre-crisis GDP delayed until around the middle of this decade. The likelihood that our downside scenario transpires varies with the risk that a re-emergence of coronavirus cases causes the re-imposition of widespread, more economically disruptive lockdowns. This will in turn depend on how well the initial pandemic outbreak was handled, and the timing and speed of the easing of initial lockdowns.

Real GDP Baseline Forecasts



Source: Fitch Ratings

Government and Central Bank Pandemic Responses Limiting Home Price Drops

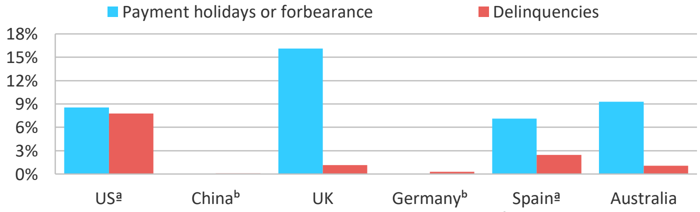
Policy measures related to fiscal support and quantitative easing (see *Coronavirus Macro Policy Responses Unprecedented*) have fed into our macroeconomic and home price forecasts. The US has taken the largest cumulative policy rate cut of the six countries, at 150bps, compared to the UK's 65bps, Australia's 50bps and China's 30bps, and unchanged but very low rates in the eurozone. The rate cuts have led to record-low mortgage rates in both the US and Australia.

The first direct support for property markets has begun. The UK has announced a higher stamp-duty threshold on home purchases until end-March 2021, which we think may provide some modest support for transaction volumes and prices. The Australian government has launched a homebuilder scheme for 2020 which offers grants of AUD25,000 to eligible owner-occupiers to build a new home or substantially renovate an existing one.

We do not expect a substantial increase in forced sellers in 2020. Mortgage borrowers can make use of government support through furlough schemes, government or lender-led payment holidays, forbearance measures and limits on foreclosures (see *Structured Finance's Forbearance Challenges Go Beyond Liquidity*). Those most affected by the economic crisis, namely individuals working under temporary contracts or within the retail and leisure services sectors, are also less likely to be mortgage borrowers.

Payment Holidays in Residental Mortgage-Backed Securities

(Fitch-rated unless specified, as of May 2020)



[a] US data includes all US loans. The Spain payment holiday total is from the 4.3% government-led payment holidays for mortgage loans plus 2.8% lender-led payment holidays for all credit (mortgage and consumer).
[b] We estimate forbearance of less than 1% in these markets.
Source: Fitch Ratings, investor reports, MBAA, BlackKnight, Bank of Spain

Several of the borrower support measures are in place until at least September 2020, which should help borrowers to bridge the gap until economies start to strengthen. In the UK, both payment holidays and the furlough scheme will be in place through October. Government and lender-led support in Spain can last up to 12 months. In Australia, the regulator has announced that the temporary capital treatment for bank loans with repayment deferrals can be extended to the earlier of 1Q21 or ten months from the start of the deferral, which will support lenders that extend payment deferrals on a case-by-case basis after the current expiration date in September.

Chinese individuals have not benefitted from direct payments from the government due to the pandemic and the use of payment holidays has been limited. However, we expect forced sellers to be rare in light of low arrears and defaults. Some local governments eased purchase restrictions to spur demand, driving an increase in property prices in 1H20.

Restricted Lending for High-Risk Mortgages in Several Markets

We expect the supply of mortgage lending, which is supported by lower interest rates or quantitative easing and strong liquidity positions for banks, to remain sufficient for borrowers with strong credit quality seeking standard mortgages in these countries. However, credit availability is becoming more limited for weaker borrowers and non-standard products in most of the countries.

Some US lenders have tightened qualification standards by raising the minimum credit score for borrowers, lowering loan-to-value (LTV) ratios and requiring borrowers to have more liquid reserves. Furthermore, the surge in unemployment and underemployment has directly affected self-employed borrowers and non-qualified mortgage (non-QM) production. Most originators with high concentrations of non-QM production have responded by freezing originations and furloughing staff as they wait for further stabilisation in labour markets (see *Coronavirus Grinds U.S. RMBS Non-QM Originations to a Virtual Halt*).

Credit is becoming more limited for high LTV and high loan-to-income borrowers in the UK, property investors in Australia, and self-employed and temporary workers in Spain (who have largely been excluded from the Spanish mortgage market since the last crisis). We expect some lenders in Germany to limit higher-risk lending that is not standard in the market.

Lenders in Australia have confirmed that they have started checking if the borrower has received government support payments, requesting employer confirmation that the borrower is working the same hours as before the pandemic or to see their most recent salary payment, and reducing the maximum LTV ratios for high-density apartments in central business districts. These properties face the most downward price pressure from the pandemic.

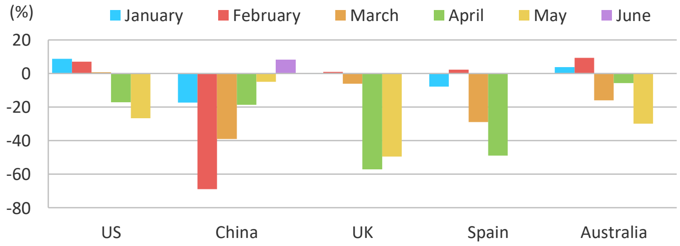
In China, the opposite trend is occurring, with some city authorities loosening local lending practices in response to softer demand. Regulators had implemented much stricter controls over housing purchases and mortgage lending to curb speculation since 2017. Loosening at city level is mainly through lower down-payment requirements for investment properties but still within nationwide regulatory limits, i.e. 20% for first-time buyers (FTB) and 30% for second-home purchasers.

Low Demand and Supply in 2020

The easing of lockdowns in recent weeks is a positive development for home prices with home viewings now possible again in most markets. Data for May has shown a boost in sales from an April trough in the UK, but it has yet to be known if these are new sales or completions of pre-pandemic sales.

Changes in Property Transfers, Transactions and Sales

(Changes in 2020 compared to the same month in 2019)



Source: Fitch Ratings, National Bureau of Statistics China, HM Revenue & Customs, Instituto Nacional de Estadistica, National Association of Realtors, Housing Industry

We expect potential buyers to reduce their offer prices as long as significant uncertainty about the pandemic's progression remains. However, the lack of forced sellers means that many potential sellers will withdraw from sales instead of accepting significantly lower offers.

Pent-up demand in some parts of the US and Germany is supporting home prices. Construction of new properties will have also slowed due to the pandemic. Purchase restrictions in higher-tier cities in China have led to pent-up demand in a country where property continues to be the preferred form of wealth investment.

Various other factors will determine demand levels for the remainder of this year. Many potential FTB may find themselves further away from home ownership if they became furloughed or unemployed, although those with stable jobs will likely have increased their deposits because of their limited spending.

Australia faces the challenge of almost no immigration expected for the rest of the year. High immigration has been a large driver of its home price growth in the past decade. Sydney and Melbourne will also lack the large numbers of foreign students they usually receive each year, while Spain faces a drop in demand from foreign buyers.

Large cities such as Sydney, Melbourne and London as well as coastal areas in Spain previously attracted many domestic and international property investors, some of whom were focused on short-term lets. The drop in tourism has pushed these properties to the long-term letting market where possible. This has increased vacancies and put pressure on yields, and we expect demand for these properties to decrease.

Pandemic Likely to Shift Buyer Preferences

We explore the potential short- and long-term effects of the coronavirus pandemic on structured finance assets in *The Next Phase: Coronavirus Accelerates Changes to the Structured Finance Landscape*. We expect that some of the factors highlighted in the "How Will We Live?" section of that report could start to affect home price growth as soon as this or next year.

For example, potential home buyers are likely to react to the crisis in different ways. Many buyers will hold back from purchases in light of the economic uncertainty while others will quickly respond to the lockdown experience, greater remote-working opportunities and low mortgage rates by relocating to (or purchasing second homes in) suburban and rural areas where there are larger homes with dedicated work spaces and gardens. However, city centres may continue to attract younger inhabitants and be popular with those who cannot work remotely.

Some investors are likely to continue to be interested in property investments as interest rates stay low for longer but they will look to determine which areas will stay or become safe havens.

Economic Growth and Foreclosures Projected to Return in 2021

We forecast home prices to largely stabilise in the UK and Spain with a higher possibility of muted growth in Australia in 2021 after the sharp falls projected for 2020. However, even price growth at the top of our forecast ranges would keep prices below pre-pandemic levels. In the US, China and Germany, any growth will also be muted, and there is potential for prices to fall slightly in both the US and Germany. Our forecasts take into account the fact that government support schemes for workers are likely to be withdrawn as economic growth recovers to some degree, while foreclosures and forced sales are likely to resume after the end of current forbearance periods.

In the US, we expect to see some increase in the number of distressed property sales in 2021 after current government protection and lender support subsides. The forced sales will be concentrated in areas with high unemployment or high rental vacancy rates. However, servicers are well-positioned (and required) to pursue loss-mitigation strategies for those borrowers who need payment assistance due to reduced income, which should temper rates of defaults and foreclosures.

We anticipate the resumption of foreclosure activity in the UK because the current moratorium on repossession activity expires at end-October 2020. In the first instance, the borrowers that face foreclosure will be those who were already in late-stage arrears before the pandemic. For loans that entered arrears or default during lockdown or enter afterwards, lenders will first explore restructuring options. We expect foreclosures to peak in 2021 or potentially as late as 2022, because of the implementation time for the lenders' various forbearance processes.

We expect a moderate increase in foreclosures in Germany in 2021, as a weaker labour market and stagnating or decreasing incomes reduces some borrowers' ability to pay. However, the support scheme for employees subject to reduced working time (Kurzarbeit) is generally available without limitation, and discussions have begun on extending firms' recent easier access to the scheme beyond end-2020. German payment holidays ended at end-June.

In Spain, we will most likely not see foreclosures until 2022. This is because lender-led payment holiday schemes can last up to 12 months and because the period from the first missed payment to the beginning of foreclosure proceedings is at least 12 months.

In Australia, we expect increased foreclosure activity in 2021 due to higher unemployment, even though banks will be able to offer payment deferrals on a case-by-case basis up to and including March 2021, and government stimulus packages may be extended past their scheduled expiry dates in some limited capacity.

Payment deferrals have been very limited in China, so we do not expect a jump in foreclosures in 2021. The central government has maintained its resolve not to stimulate the economy with real estate development. As such, we expect any price increases in 2021 to be modest despite our forecast of a relatively strong economic recovery.

Downside Risks Dominate

Uncertainty around both macroeconomic and home price forecasts has increased since December 2019. Downside risks dominate, especially around the possibility of extended or additional waves of infection and whether government and lender support schemes will continue to support borrowers until economic recoveries are underway.

Under our downside scenario, which is not our expected case, we would expect to further reduce our home price forecasts by about 5pp in 2020 and 2021 from the baseline forecast ranges in this report.

Upside risks are less common but could arise if the rebounds in economic growth are stronger or faster than we expect. New (or additional, in the case of the UK and Australia) stimulus to the property market would provide further support for home price growth.

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