Resilience in the housing system

Market institutions from the global financial crisis to COVID-19

Final report

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UK COLLABORATIVE CENTRE FOR HOUSING EVIDENCE

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Contents

Executive summary 4

1. Introduction 10

2. The Mortgage Industry 16

3. The housebuilding industry 28

Conclusion 42

UK COLLABORATIVE CENTRE FOR HOUSING EVIDENCE

Executive summary

Introduction

This report provides evidence from a project that seeks to examine the evolution of the housing system between the Global Financial Crisis (GFC) and the COVID-19 pandemic, and the response of two key housing market institutions – mortgage lenders and the housebuilding industry - to the pandemic. It covers the period up to March 2022.

Background

The Global Financial Crisis (GFC) was a huge external shock to the UK economy with particularly strong impacts on the housing system. It led to large-scale government intervention to prevent bank failures, and large rise in government debt.

Subsequently, the mortgage industry was subjected to new micro- and macro-prudential regulations. Although there was no parallel effort to reform the housebuilding industry, it has benefited from the Help to Buy shared equity schemes operated in England, Wales and Scotland. The long decade between the GFC and the pandemic experienced slow economic and earnings growth, accompanied by historically low interest rates and few inflationary pressures.

The advent of the COVID-19 pandemic in the early months of 2020 presented another shock to the world economy. Whereas the economy shrank by two per cent in the autumn of 2008, one-fifth of it disappeared almost overnight in 2020, although the subsequent sharp recovery halved the size of the contraction. The fiscal stimulus in 2020 was even greater than after 2008 – some 20 per cent of GDP was borrowed in 2020 alone.

Government introduced a range of measures to protect incomes and support the economy, notably the "furlough" scheme and the £20 a week enhancement of Universal Credit and Working Tax Credits. The Bank of England reduced base rates to 0.1 per cent and undertook a quantitative easing programme amounting to £450 billion.

To assist mortgage borrowers and to protect the housing market, the Financial Conduct Authority issued guidance suggesting that lenders should exercise forbearance regarding mortgage arrears, and allow borrowers to defer payments (popularly - if misleadingly - known as a "mortgage holiday").

Stamp duty holidays were also introduced, the design and duration of which varied between jurisdictions. A Term Funding Scheme was introduced to allow banks and building societies to access funds for four years at close to base rates.

Resilience

The project examined the mortgage and housebuilding industries by employing the concept of "resilience."

In academic literature (see literature review for this project by Earley, 2021), resilience was interpreted by engineers as being part of an "equilibrium model" whereby the subject is able to return to a static norm having experienced external stress. The concept has been developed in social science, where it has been interpreted in a broader way, often rejecting the idea of equilibrium because systems are always evolving. It is therefore more about adaptive capacity within the context of change and uncertainty in internal and external environments.

Resilience that is based on returning to a static equilibrium has been characterised as being "conservative" and that which is based on adaptation can be "radical."

Methods

The research was conducted in three stages:

- A literature review informed the methods, and in particular the concept of resilience.
- Two rounds of semi-structured interviews with key informants and senior providers in the mortgage and housebuilding industries in August/ September 2020, and January/ February 2022.
- Interviews were recorded, transcribed and analysed manually.

Findings from first stage interviews

The findings of the first stage interviews were reported in our interim report (Stephens, et al, 2021), but a summary of the conclusions is reproduced here for convenience:

- Both mortgage and housebuilding industries had adopted business strategies that depended on an inflationary housing market. Neither sector exhibited resilience, and both have depended on forms of state support to survive.
- Both industries have adopted more risk averse business models since the GFC. In different ways, both derisking strategies have, in the absence of a greater housing market correction, reduced the supply of both mortgage credit and new housing.
- The mortgage industry has been subject to wholesale regulatory reform, whereas the housebuilding industry has not. Arguably state support for the housebuilding sector continued through the availability of Help to Buy (restricted to new build) and planning concessions. The dependence of housebuilders on Help to Buy more than a decade after the GFC is notable.

Findings from second stage interviews

The mortgage industry

The interviewees had expected the pandemic to lead to a significant recession. One senior provider suggested that, "the main predictions were that house price deflation would occur and that unemployment would rise massively… you saw lenders make massive provisions on the assumption that these things would happen." (SP2) Further, a key informant suggested that "… very few people in the industry would have anticipated such a very strong bounce back in demand when lockdowns came to an end…" (KI2)

Reflecting on the reasons for the housing market instead remaining buoyant, interviewees identified the scale of general government intervention (including furlough and monetary policy). "[T]here was not an economic shock because the burden was passed directly to the state…. In effect, we've nationalised the economic impact of the pandemic." (SP1) Indeed "the source of the shock and the government's response to it" were "unique"(KI2).

Whilst the mortgage industry did not experience a conventional recessionary shock, lockdown tested lenders' operational resilience.

Take-up of the mortgage "holiday" was high (because many borrowers wrongly regarded it as being "money for nothing" (SP1)), but lenders were able to cope with it. It was not onerous financially as lenders continued to charge interest and borrowers were able to revert to making payments when the scheme ended: "[A]lmost entirely everybody who was on a payment holiday is paying now…" (SP2)

Government expectations that lenders would exercise forbearance in relation to mortgage arrears and possessions were similarly easily accommodated, as there was so little pressure, one interviewee explaining, "… of course there was much less of a need for that [forbearance] because there wasn't the wholesale unemployment or lack of income that was necessarily expected." (KI1)

Interviewees suggested that the experience of lockdown had accelerated existing trends such as the shift away from branches and the employment of automated valuation tools.

However, interviewees were unable to identify significant ways in which lenders had learned from the pandemic. A significant concern was identified by one senior provider, namely that "they've [lenders] also learnt that the state will step in and protect them when times are bad… I think they may have learnt the wrong things… [b]ecause the state will intervene, and you will be protected if your lending hasn't been good." (SP1)

Government policy was seen as being of vital importance, both in response to the GFC and the pandemic.

In the aftermath of the GFC, mortgage regulation represented "a set of rules that prevented a runaway of leverage, combined with a market where variation has just about been knocked out of it… Mortgage lending has been boring, and it should be boring. (SP1)

General government interventions (e.g. furlough and monetary policy) were regarded as having been very important: "unprecedentedly positive and expensive" (KI2) in the words of one interviewee. The Term Funding Scheme was regarded as having provided a calming effect on the market: "Offer unlimited amounts of money, at reasonable rates and the markets will calm." (SP1) The stamp duty holidays were regarded as having been unnecessary and having "turbo boosted" (SP2) the market. One interviewee described them as having been "an unnecessary and more or less stupid policy intervention" which was "unhelpful for first-time buyers" (KI2).

Interviewees generally thought that it was hard to isolate the impact of Brexit from the pandemic, and it was difficult to identify "any major, major effects" (KI2). One interviewee suggested that its impact on financial services and high-end earnings had made it "an important moderator of London house prices." (SP1)

At the time the interviews were conducted, the rise in inflation was already apparent and the Bank of England was beginning to raise interest rates. Both could be seen as being a legacy of the actions taken to mitigate the impacts of the pandemic, although the war in Ukraine is clearly the major factor in driving up prices.

The interviewees believed that arrears and possessions would likely be contained as interest rates rise because "a significant chunk of mortgage lending has been stress tested and is on much more prudent basis than pre-global financial crisis." (SP2)

Conclusions: the mortgage industry

The interim report suggested that the mortgage industry was strongly supported during and after the GFC, and was also subject to extensive regulatory reforms to reduce risk. Low interest rates were another legacy of the GFC which helped the housing market to recover from the crisis whilst general economic performance was anaemic.

The pandemic threatened the stability of the mortgage industry once more – at least this was the common perception at the outset of the crisis. However, the industry was not tested in the same way as it was in the GFC. Extraordinary state support for the economy (in terms of fiscal and monetary policy) maintained incomes and created an even lower interest rate environment. The principal intervention (the stamp duty holiday) intended to specifically support the housing and mortgage markets was, in this context, at best unnecessary and at worse recklessly fuelling a housing market boom.

A very particular kind of resilience was therefore demonstrated: an industry that had been given a great deal of state support, operating within a risk-averse regulatory framework which also reduced competition, and when the pandemic came, more state support.

The housebuilding industry

Housebuilders had responded to the financial crisis by adopting derisking strategies that placed greater emphasis on large greenfield developments built out relatively slowly.

The early reaction to the COVID pandemic was characterised by the immediate practical difficulties of coping with construction under lockdown restrictions introduced on 23 March 2020. Work was suspended on almost 2,000 sites, but several builders resumed construction in England by the end of the month as the government sought to find ways to allow sites to operate within safety rules. The Scottish Government was more restrictive, but permitted "essential" sites to operate from 6 April, before general construction resumed on 12 June.

When lockdown was announced in March 2020, the industry feared that it would encounter a severe recession as house prices and transactions fell, wiping out much of the value of housebuilders' land banks. Such was the seriousness of COVID, anything seemed possible at the outset. One key informant suggested that "the whole local development industry had huge uncertainty and I think we all thought we were going to fall off a cliff, it was going to go backwards for us big style." (KI3)

Yet, in reality the housebuilders experienced the opposite problem: keeping up with demand. One key informant reported that by the autumn of 2021 "everyone was inundated, the most enquiries ever, the most website hits ever, the most enquiries on land ever, record fees all of last year [2021]." (KI4) Another reflected, "if anyone had said to us at that point, by the way next year you will not be able to build and sell houses quickly enough, we would never have believed it" (KI5). The surprise felt at the strength of the market was widely held, one respondent describing this as having been "totally unexpected" (KI4).

Nonetheless, the housebuilding industry had to deal with strong demand whilst enforcing social distancing on sites and dealing with limits on room capacity which restricted build timescales. Furthermore, other problems emerged, as the cost and availability of labour, materials and energy have risen considerably in line with global trends since the pandemic, probably exacerbated by leaving the European Single Market.

The inflationary environment required "a whole new skillset" (KI4), not least because it was difficult to know the extent to which suppliers faced rising costs: "[A]re they taking the mickey? Or is it genuine?" (KI4) When the interviews were conducted (before the Russian invasion of Ukraine added to further inflationary pressures) interviewees were tending towards seeing the cost rises as being "fairly permanent," (KI5) although uncertainty remained. One respondent speculated that SME builders would be less able to incorporate rising material and energy costs into land valuations than volume housebuilders because "your big boys have got more buying power, we're an SME, so probably there is a risk that the gap widens." (KI4)

In one sense, the housebuilding industry did not have to prove resilience, since the housing market remained buoyant. Housebuilders were quick to explore options on furloughing and subcontracting, raising the question of whether risk has simply been transferred elsewhere in the industry to smaller firms acting as contractors. They have also become adept at controlling supply – and local prices – by managing the "build out rate", even in flatted developments that are by their nature more lumpy. As one interviewee noted, "…their gigs can turn off overnight, but they're also very quick at turning them back on when the market is very good" (KI3).

The industry did have to adapt to the regulations during lockdown, for example on social distancing, and there was speculation that demand was shifting from urban to rural areas, in favour of homes with outdoor space, and towards larger houses that could more easily accommodate home-working. However, this was not universally reported, with brownfield sites in Glasgow and Edinburgh for flatted developments seen as being attractive to one interviewee. It would also appear that the funding arrangements favour SMEs focussing on flatted developments. Banks "don't like peak funding, they like cost and complete funding" (KI4) explained one key informant. 'Peak funding' is a mechanism whereby housebuilders without a revolving credit facility (as tends to be available only to larger builders) loan enough to complete only part of a development, rather than the whole development, aiming to raise revenue to cover loan repayments and further costs from the sale of initial tranches of units. Whereas this is possible for housing developments it is not possible for flatted developments, for which the whole development must be completed before a single flat is sold.

Interviewees were reluctant to take longer-term lessons from the pandemic, and in particular there was uncertainty over whether perceived shifts in demand associated with the "wellbeing agenda" (homes with gardens, working at home, etc) would endure: "[W]ill it stick? I don't know," (KI) said one key informant.

As with the mortgage industry, the effects of government and Bank of England macro interventions dwarfed – indeed rendered unnecessary in the case of the Stamp Duty holiday – policies targeted specifically at the housebuilding industry.

There was a consensus that the stamp duty holiday was unnecessary and helpful, although perhaps understandable given the uncertainty at the outset of the pandemic: "It probably did overheat it [the housing market], but I think anybody probably would've done something similar." (KI3) Moreover, there would have been a benefit to the wider economy through a multiplier effect: "Housing development's really good at recycling money through the economy, giving people jobs, et cetera… " (KI3) However, another key informant suggested that they did not consider it to have been necessary at the time: "Interestingly, [in response to government] we had said, we don't need it just now, let's carry on with where we are but when things begin to slow that's when we need it. That's obviously not what happened…" (KI5).

Although the decision to extend the English version of Help to Buy to 2023 was taken before the pandemic, it had an impact during it. One key informant suggested that the decision to reduce the maximum sales value over time had been beneficial to stabilising the market. They suggested that "there was more of an addiction to it [in England] … whereas in Scotland [where upper limits were reduced over time] we kind of weaned ourselves off it that bit quicker." Another key informant suggested that the lower limit in Scotland (£200,000 from 2017, compared to £600,000 in England) encouraged housebuilders to produce more cheaper houses, or "more of a varied mix" (KI4), whereas in England the incentive was to build more expensive properties.

Whilst it is difficult to isolate the impacts of Brexit, some interviewees believed it to have been an important factor in inhibiting UK access to European supply chains. This was because customers within the EU were prioritised as supply chains were re-established after lockdowns. As one key informant explained, "…it was easier for them [suppliers] to sell their goods there [the EU]. It's just put British businesses down another notch in the scale." (KI5)

Looking forward the principal concern within the industry is of rising costs which risk invalidating assumptions made when they valued the land now in their landbanks. Inflation also increases uncertainty, and the prospect of a

weakening economy is also likely to affect the market, at a time when tighter regulatory standards relating to carbon emissions are being introduced.

Conclusion: the housebuilding industry

The two-stage research process has sought to identify shifts in opinion in a fast-moving environment. Whilst the housebuilding industry has come through the pandemic pretty much unscathed, it has done so in what turned out to be a benign environment. However, the industry experienced rising materials costs before concerns about rising general inflation were realised. Moreover, the interviews were completed before the Russian invasion of Ukraine drove up energy prices and inflation further.

Conclusions

This project was based on the supposition that COVID-19 pandemic would provide a test of the mortgage and housebuilding industries' resilience.

Certainly, the pandemic and accompanying lockdown measures governments took represented a huge shock. In terms of sudden drop in GDP, the pandemic-induced lockdown, which saw one-fifth of the economy disappear almost overnight, dwarfed the GFC. Even though the strong bounce back in the second half of the year made up around half the initial loss, it was far greater than that experienced in the GFC.

The follow-up interviews conducted in 2022 confirm that both industries expected the economic shock to have severe effects on them, and were surprised when instead there was, after the initial lockdown, a strong bounce-back in the housing market. In this crucial sense, the resilience of these industries was not tested in the way that had been anticipated. Indeed, when asked about resilience, respondents from both industries pointed to operational adaptations relating to working at home and relying on technology for on-line sales. Although housebuilders had to adapt to new site safety regulations, they were able to return to site working on 10 May 2020.

The principal reason why both industries did not have their resilience tested in the way it had been in 2007-09 was that the state made unprecedented interventions to support the economy in general and household incomes in particular.

These general interventions show why, for example, the requirements for mortgage lender forbearance and mortgage "holidays" were not onerous. Further, housing-specific interventions, notably the stamp duty holiday and the extension of Help to Buy (in England) were judged to have been unnecessary and helped to fuel a housing market boom.

It is therefore important to ask for whom the mortgage and housebuilding industries were resilient?

Stepping back and examining the decade between the two crises, the consistent policy context has been one of historically low interest rates combined with QE, which has served to support house prices, locking out people unable to assemble large deposits from home-ownership.

Insiders have therefore been well served. Insiders are the existing home-owners, the two industries under consideration and, because it has become embedded in the housing market, the government itself. That the "resilience" demonstrated therefore is of a profoundly conservative variety should not be contentious. It might even be regarded as being reactionary: not only have the insiders been protected by policy, they have been privileged by being given access to cheap money.

The study is therefore instructive not only of the development of the mortgage and housebuilding industries, but their relationship with the state. The nature of the resilience attained is one that can be characterised as being state-led.

1. Introduction

This report provides evidence from a project that seeks to examine the evolution of the housing system between the Global Financial Crisis (GFC) and the COVID-19 pandemic, and the response of two key housing market institutions – mortgage lenders and the housebuilding industry - to the pandemic. It seeks to establish whether these institutions were more resilient during the COVID-19 pandemic than in the GFC, and explores the role of government in their fortunes. The report covers the period up to March 2022, and excludes the economic impacts of the Russian invasion of Ukraine and the rise in inflation to its highest level in 40 years.

Background

The Global Financial Crisis (GFC) was a huge external shock to the UK economy with particularly strong impacts on the housing system. The seizing up of wholesale markets in August 2007 (the "credit crunch") immediately sent the mortgage industry into crisis and the housing market into freefall, and both these factors impacted on the housebuilding industry. The worldwide economic crisis that followed the collapse of the American investment bank, Lehman Brothers, in October 2008 brought about further turbulence in the banking sector as well as a deep recession that, but for co-ordinated fiscal and monetary stimuli internationally would have morphed into an ongoing depression.

Within the UK it led to several long-established mortgage lenders disappearing (e.g. Northern Rock and Bradford & Bingley) and necessitated a series of bank rescues and nationalisations (e.g. RBS, Lloyds) (FSA, 2009). Indeed, the Government still retained a majority share in NatWest (formerly RBS) until March 2022, when the Government sold a 5 per cent stake in the bank to take its share to below 50 per cent. The Government sold shares at less than half the price it paid for them in 2008 (Financial Times, 2022). There was also support for the housebuilding industry, for example the availability of state finance to assist with stalled sites (HCA and CLG 2011).

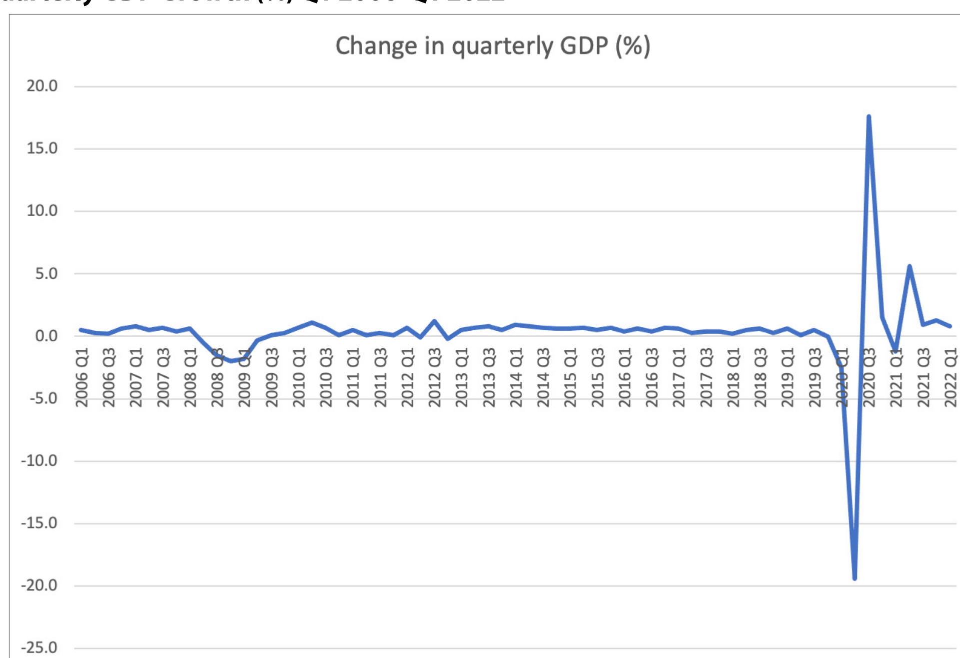
Since the GFC, there has been significant reform of the regulatory framework for mortgage lending and the wider banking system, following the Turner Review (FSA 2009) and Mortgage Market Review (FSA 2010). As a result of these reviews, the Financial Services Authority was divided into two: the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). New micro- and macro-prudential regulation has placed restrictions on mortgage lending, including affordability and interest rate stress tests for would-be borrowers. Interest-only mortgages became very rare and mortgages with loan to value ratios more than 95% also almost disappeared. There was, however, no parallel attempt to reform the housebuilding industry.

Both mortgage and housebuilding industries have also operated within an economic environment of slow growth and weak earnings growth on the demand side. On the other hand, interest rates remained at historically low levels – in large part because the economy has remained weak and lacked inflationary pressure. Monetary policy, including the quantitative easing programme which was not reversed, was intended to support asset prices. The Help to Buy (HtB) shared equity schemes were introduced in England, Wales and Scotland in 2013. Under HtB, governments provide an equity loan to purchasers of newly built properties with a minimum deposit of five per cent, and this continues to be a major stimulus to the market. In 2018, HtB accounted for 36-48 per cent of the total sales of five of the six largest housebuilders (Stephens and Blenkinsopp, 2020).

COVID-19 pandemic

The advent of the COVID-19 pandemic in the early months of 2020 presented another shock to the world economy, as governments were forced to adopt lockdown policies that shut down large parts of the economy. The scale of economic contraction was much greater in 2020 than in 2008. However, in 2020 a contraction in the economy of one-fifth was followed by a sharp recovery, but nonetheless represented an overall contraction of five per cent – compared with a contraction two per cent in the fourth quarter of 2008 (Stephens 2021; see Figure 1). The fiscal stimulus in 2020 was even greater than after 2008 – some 20 per cent of GDP was borrowed in 2020 alone.

Figure 1. Quarterly GDP Growth (%) Q1 2006-Q1 2022



Source: ONS Gross Domestic Product: Quarter on Quarter growth

The Government introduced a series of measures to protect incomes during the pandemic:

The Coronavirus Job Retention Scheme (CJRS, commonly known as "furlough") compensated employers by paying up to 80% of former earnings of employees placed on furlough due to the pandemic. It ran from 1 March 2020 until the end of September 2021. During this period it supported 11.7 million jobs and 1.3 employers. The scheme peaked at 8.9 million jobs in May 2020; this had reduced to 1.16 million when it ended. The total cost of the scheme was £70 billion.[1]

Further, the Self-Employment Income Support Scheme (SEISS) provided grants based on previous trading profits to some 2.9 million self-employed individuals at a cost of £28.1 billion over the period 16 May 2020 to 30 September 2021.[2]

The standard allowances in Universal Credit and Working Tax Credits were increased by £20 per week from March 2020 until the end of September 2021 (having been extended by 6 months). The numbers claiming Universal Credit doubled from 3 million to 6 million in March 2021 and were still at 5.6 million in January 2022.[3] The cost of these measures was estimated by the Treasury to be £9 billion (Winchester, 2021).

[1] HMRC (2021) CJRS Statistical Release, 16 December 2021 https://www.gov.uk/government/statistics/coronavirus-job-retention-scheme-statistics-16-december-2021/coronavirus-job-retention-scheme-statistics-16-december-2021

[2] HMRC (2021) SEISS statistics: December 2021 https://www.gov.uk/government/statistics/self-employment-income-support-scheme-statistics-december-2021/self-employment-income-support-scheme-statistics-december-2021

[3] DWP (2022) Universal Credit Statistics 29 April 2013 to 13 January 2022 https://www.gov.uk/government/statistics/universal-credit-statistics-29-april-2013-to-13-january-2022/universal-credit-statistics-29-april-2013-to-13-january-2022

Monetary policy was also used to support the economy:

The Bank of England Monetary Policy Committee cut interest rates to 0.1 per cent, but this was from a starting point of just 0.75 per cent, in contrast to 5.5 per cent in 2008 (Stephens, et al, 2020). As inflation rose the base rate was increased to 0.25 per cent in December 2021, 0.5 per cent in February 2022, 0.75 per cent in March, 1 per cent in May and 1.25 per cent in June.[4] On the completion of this report (June 2022), the Bank of England forecast inflation to reach 10 per cent later in 2022.

The Bank of England resumed its programme of Quantitative Easing in March 2020, when it purchased £200 billion of bonds. This was followed by another £100 billion of bond purchases in June 2020 and £150 billion in November 2020. The total purchased was £450 billion, doubling the Bank's total bond purchases.[5]

The government introduced two measures to protect mortgage borrowers having difficulty paying their mortgages:

The Financial Conduct Authority (FCA) issued guidance setting out an expectation that lenders would not enforce mortgage repossessions except in exceptional circumstances before 1 April 2021.[6] Thereafter they were expected to occur only when attempts to resolve the problem had failed.

The FCA also issued guidance on payment deferral (popularly – if misleadingly - known as the "mortgage holiday") in March 2020. The final deadline for people already in payment deferral was 31 March 2021, and the scheme ended on 31 July 2021, although "tailored support" was meant to be extended to people still facing difficulties.[7] UK Finance estimated that nearly three million households took advantage of the scheme between March 2020 and March 2021 (Cromarty, et al, 2021).

The mortgage payment deferral scheme had not been employed in this form in previous crises. A voluntary interest deferment scheme was introduced in 2009, which was supported by a government guarantee of the deferred payments (House of Commons CLG Committee 2009). In contrast, there was no government guarantee of deferred payments in the pandemic. The system of state mortgage interest support was made more generous during the GFC, but not during the pandemic.

The government also adopted specific measures to support the housing market:

The England and Northern Ireland[8] stamp duty holiday scheme began in July 2020, and was intended to end at the end of March 2021, but was extended until the end of June 2021 at the full rate (the zero rate band extended to £500,000) and was then extended again at a lower rate (up to £250,000) until the end of September 2021. Savills estimated its cost at £6.4 billion, half of which went to purchasers of houses worth over £500,000, and half of which benefited transactions in London and the South East. The scheme included second homes, although these were still subject to the 3 per cent surcharge Independent, 2021). Scotland and Wales introduced their own versions of the scheme, which were withdrawn earlier than in England and Northern Ireland (see Stephens, et al, 2020, p. 12).

Finally, the Term Funding Scheme with additional incentives for SMEs (TFSME) allowed banks and building societies to access funding for four years at close to base rates. TFSME was launched in March 2020 and closed to new applications at the end of October 2021. The Bank of England records current loans made through the scheme as £192 billion (at 23/3/22).[9] Since the Government expects to receive its money back, it does not score as spending, but rather as financial transactions.

[4] Bank of England Database https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp
[5] Bank of England What is Quantitative Easing? https://www.bankofengland.co.uk/monetary-policy/quantitative-easing
[6] FCA (2021) FCA provides update on support for consumers impacted by coronavirus, 5 March https://www.fca.org.uk/news/statements/fca-provides-update-support-consumers-impacted-coronavirus
[7] FCA (2021) FCA provides update on support for consumers impacted by coronavirus, 5 March https://www.fca.org.uk/news/statements/fca-provides-update-support-consumers-impacted-coronavirus
[8] Stamp duty is devolved to Scotland and Wales, but (curiously) not to Northern Ireland.
[9] https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/results-and-usage-data

Resilience

The project examined the mortgage and housebuilding industries by employing the concept of "resilience." Resilience has a strong intuitive resonance, for example being employed four times in the Turner Review (2009). Although its meaning is assumed rather than stated, it seems to imply an ability to withstand shocks and to recover from them.

A literature review has been conducted in parallel with this report (Earley, 2021), and some of the most significant parts are summarised in this section.

Resilience has also been deployed and developed in academic research. Within the academy, it has been adapted from its use in engineering where it can be characterised as being part of an "equilibrium model" whereby the subject is able to return to a static norm having experienced external stress. Holling's (1973) seminal paper developed the idea of "ecological resilience" in which "ecosystems are based around static equilibrium… ecosystems do not have one static point of equilibrium, but rather a zone of stability that allows for the reorganisation of a system to continually exist and function even in the face of disturbance and change" (cited by Cretney, 2014: 628).

In public policy, adaptation is a crucial component of resilience, because "systems [are] always complex and always in various states of change and transformation," regardless of whether there are "external shocks," (Porter et al. 2018: 388). This conception contrasts with the traditional understanding of resilience in engineering (McGlade et al., 2006; Cretney, 2014). Porter et al. (2018: 389) suggest that a focus on adaptability within "resilience thinking offers a way of thinking about how much disturbance a system can withstand and stay within critical thresholds… how much pressure can be borne, before it breaks?"

Consequently,

> …. resilience is not just about 'bouncing back from adversity' but is more broadly concerned with adaptive capacity and how we better understand and address uncertainty in our internal and external environments. (Gibson & Tarrant, 2010: 8)

In examining the financial system, Dowell-Jones and Buckley (2017) sought to distinguish between "robustness" and "resilience," and argued that "postcrisis financial regulation has sought to build a stronger, more robust system, not a more resilient one…. [by making] institutions too strong to fail" (Dowell-Jones & Buckley, 2017:1). Further, they argue that "this is not self-evident, as the system has fundamentally changed over the last two decades…" (Dowell-Jones & Buckley, 2018:8).

In applying "resilience" to the GFC and COVID-19 crises, we may therefore distinguish between "conservative" and "radical" notions of resilience (Raco and Street, 2012). A conservative conception may focus on the ability of the subject to return to a status quo, whilst a radical notion would place greater emphasis on adaptability, and indeed improvement, whilst maintaining core function.

Methods

The first stage of the research involved a series of semi-structured interviews in the mortgage and housebuilding industries.

Two key informants and two senior providers were interviewed from the mortgage industry, and two key informants were interviewed from the housebuilding industry. Senior providers are people who have, or who recently have, held a senior position within a mortgage lender. Key informants are people able to give an informed overview of the mortgage or housebuilding industries as a whole. The number of interviewees were small, in part reflecting the difficulty in obtaining senior participants, but also the tendency of participants to hold similar views – additional interviews would have been unlikely to yield greatly different insights.

The first round of interviews took place in August and September 2020. They were recorded (with consent), summarised in note form with some sections transcribed. They were analysed manually within the framework of the main questions, and reported with anonymity for both the interviewees and any organisation they worked for.

The Key Informants from the mortgage industry are identified as KI1 and KI2, and the senior providers as SP1 and SP2. The key informants in the housebuilding industry are identified as KI3 and KI4 to avoid confusion with those in the mortgage industry.

In the second stage of the project, the same key informants and senior providers were re-interviewed; an additional key informant (KI5) was interviewed for the second stage interviews regarding the housebuilding industry.

The second stage interviews were originally intended to be conducted in the spring of 2021. However, due to the persistence of the pandemic, these were delayed until January and February 2022 to capture the longer-term impacts of the pandemic.

These questions were designed to capture the aspects of "resilience" identified in the literature review.

Transcription and analysis were undertaken in the same way as the first stage interviews.

Findings from first stage interviews

The semi-structured interviews followed the same five principal questions (which were circulated in advance) across the two industries, with scope for variation within these:

- How well was the industry able to withstand the shock of the GFC?
- How well was the industry and government able to learn from the shock?
- How has the industry adapted to changing markets?
- What has been the initial impact of COVID-19?
- What are the medium and longer term-impacts of COVID-19?

The findings of the first stage interviews were reported in our interim report (Stephens, et al, 2021), but a summary of the conclusions is reproduced here for convenience:

- Both mortgage and housebuilding industries had adopted business strategies that depended on an inflationary housing market, which could not go on forever. The shock that caused the market to collapse, also impacted on mortgage lenders and housebuilders through the availability of finance. Neither sector exhibited resilience, and both have depended on forms of state support to survive.
- Both industries have adopted more risk averse business models since the GFC. In different ways, both derisking strategies have, in the absence of a greater housing market correction, reduced the supply of both mortgage credit and new housing.
- The mortgage industry has been subject to wholesale regulatory reform, whereas the housebuilding industry has not. Arguably state support for the housebuilding sector continued through the availability of Help to Buy (restricted to new build) and planning concessions. The dependence of housebuilders on Help to Buy more than a decade after the GFC is notable.

- Whilst both sectors appear to have been in a much stronger position going into the COVID-19 crisis, the discussion of the concept of resilience, offers the prospect of a deeper analysis of industry strategies since the GFC and the way in which the respond to COVID-19, as its impacts carry on beyond the first year.
- This first stage of the project highlighted the importance of context – and in particular policy context – to the strategies that these industries have adopted.

Follow-up interviews

The semi-structured interviews conducted in January and February 2022 followed the same five principal questions (circulated in advance) across the two industries, with scope for variation within these:

- Looking back at the pandemic, how do you think it panned out compared with what the industry/ you thought it would?
- Reflecting on the pandemic, how resilient do you think the industry has been?
- Has the industry attempted to learn from the pandemic?
- What role has government policy played in shaping industry behaviour?
- Has Brexit had any impact?

Structure of report

The report is divided into three further sections: the interviews in the mortgage industry are reported in section 2 and those of the housebuilding industry in section 3. Conclusions are drawn in the fourth and final section.

2. The Mortgage Industry

In the first part of this project, two Senior Providers (SP1 and SP2) and two Key Informants (KI1 and KI2) from the mortgage industry were interviewed in August and September 2020.

These interviews covered the lead up to the Global Financial Crisis (GFC), which had a strong and lasting impact on the mortgage industry. It led to several long-established brands disappearing (e.g. Northern Rock and Bradford & Bingley) and some banks being nationalised. Indeed, the Government still retained a majority share in NatWest (formerly RBS) until March 2022, when the Government sold a 5 per cent stake in the bank to take its share to below 50 per cent. The Government sold shares at less than half the price it paid for them in 2008.[10]

The lack of resilience displayed by the mortgage industry led to it becoming subject to stricter macro- and micro-prudential rules. Borrowers were subjected to affordability and interest rate stress tests. The general view of interviewees in the Stage 1 interviews was that the industry had become more resilient as a result of these reforms.

At the time of the Stage 1 interviews, the UK had greatly reduced general public health restrictions applied during the first lockdown. The Government had put in place its general supportive interventions, notably the Job Creation Scheme ("furlough"), and the Bank of England had cut interest rates and embarked on a new programme of Quantitative Easing. There were also interventions aimed directly at the housing and mortgage markets, such as the Term Funding Scheme, the mortgage payment deferment ("holiday") scheme, the stamp duty holiday and the requirement for lenders to exercise forbearance towards mortgage borrowers.

The feeling at the outset of the pandemic was that, although it represented a different kind of shock from the GFC, it provided a test of the mortgage industry's resilience.

This section analyses the main findings from the Stage 2 interviews conducted in January and February 2022.

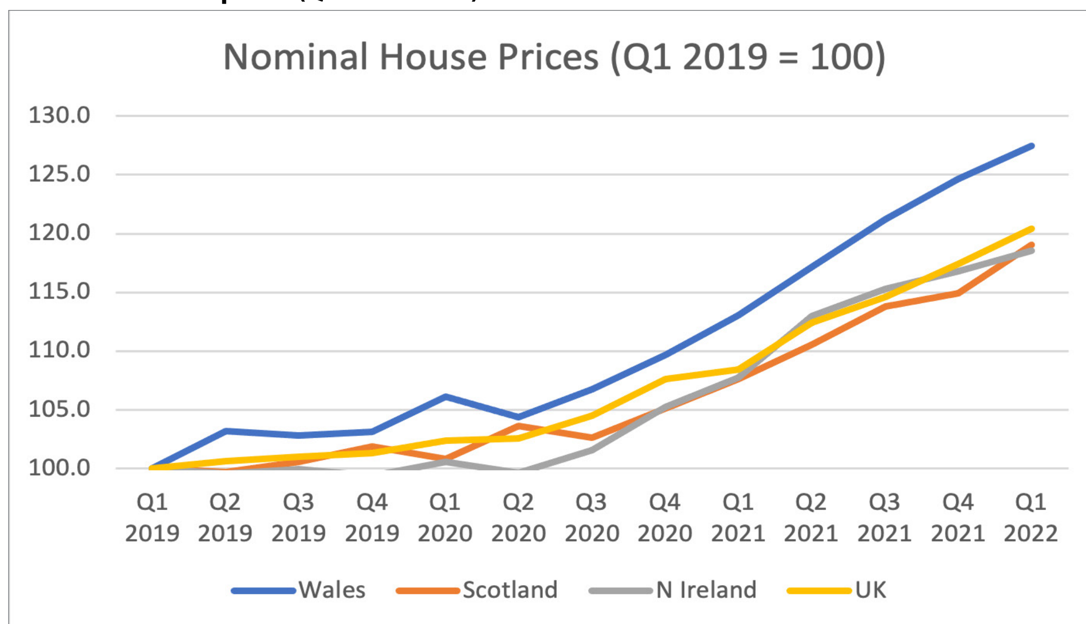
Looking back at the pandemic, how do you think it panned out compared with what the industry/ you thought it would?

Whilst at the outset the mortgage industry and government clearly feared a major recession arising from the lockdown measures taken to control the pandemic, the reality was very different. Instead, there was a boom in house prices and mortgage lending. In the summer of 2020 this was believed by some to be a "mini boom" but proved to be longer lasting.

[10] UK government to cut NatWest stake to less than 50%, Financial Times, 28 March 2022 https://www.ft.com/content/30370567-0785-43cd-bd97-94eb6367d5fc

As Figure 2 demonstrates house prices rose steeply after lockdown measures were eased in 2020. Across the UK as a whole they were one-fifth higher in Q1 2022 than in Q1 2019. The rise in Wales was even higher – prices rose by more than one-quarter.

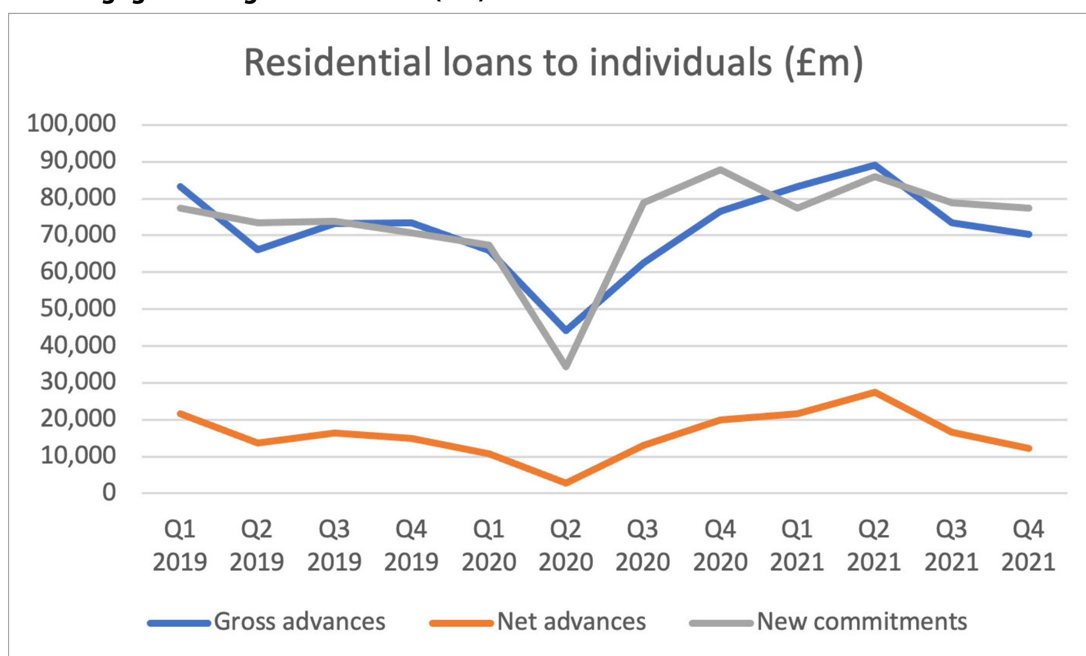
Figure 2 Nominal house prices (Q1 2019 = 100)



Source: author calculation based on Nationwide index

Figure 3 shows how mortgage lending recovered strongly as lockdown was eased and exceeded pre-pandemic levels until the stamp duty holiday (in England) was wound down.

Figure 3. Mortgage lending to individuals (£m)



Source: Bank of England/ FCA MLAR statistics

The interviewees were asked to reflect on how their expectations of the pandemic had unfolded compared with the reality looking back from early in 2022.

It is clear that the industry expected a very strong economic shock, but in reality the mortgage and wider housing market has been very buoyant.

As SP2 explained:

> …when we all came into the pandemic obviously nobody knew what was going to happen, and I think it was a very pessimistic view of what this could do to the housing market. Obviously it closed, the whole market closed for two months, and the main predictions were that house price deflation would occur and that unemployment would rise massively, and who knew what else was going to happen?
>
> … you saw lenders make massive provisions on the assumption that these things would happen (SP2)

That the market instead thrived still takes some experts by surprise:

> … it's unfathomable [that]… such a major economic shock or it threatened to be such a major economic shock, can hit our economy without our biggest single asset that is most highly dependent on employment, being impacted in any adverse way, at all. In fact, to the contrary, creating a level of demand. (SP1)

The severity of the anticipated shock was captured by a key informant who said the industry expected "almost an Armageddon" (KI1). Further,

> … very few people in the industry would have anticipated such a very strong bounce back in demand when lockdowns came to an end…. [N]o sooner really had lenders got to grips with how to cope with pandemic lockdown, working from home… [processing] payment holidays deferrals for many customers, they're then faced with this enormous surge in demand, which hadn't been anticipated… (KI2)

This point was emphasised by SP2, who agreed that the outcome was "completely different" (SP2) to what had been anticipated, "the market bounced back, the demand was there." (SP2)

Interviewees reflected on the reasons for the mortgage and housing markets instead thriving after the most severe lockdown ended.

The main surprise was that unemployment did not rise as anticipated. Further, the people who were most adversely affected economically were less likely to have mortgages:

> [I]t didn't affect the mortgage industry as much is those people who were most directly affected tended not to be mortgage holders, so it would be young people without mortgage, people who rent, those who are on lower incomes, those who were probably furloughed in the hospitality industry or wherever, and the mortgage population is generally not those people. (SP2)

When asked to discuss the reasons for the impact of the pandemic so radically differing from expectations, SP1 emphasised the government's huge general interventions to the extent that:

> … there was not an economic shock because the burden was passed directly to the state…. In effect, we've nationalised the economic impact of the pandemic. (SP1)

SP2 also suggested that the experience had been "non-comparable" (SP2) to other economic shocks, a view shared by KI2 who described it as being "unique in my lifetime" (KI2). They suggested that both "the source of the shock and the government's response to it" were unique, whilst "to some extent, the co-ordinated global response to the shock" (KI2) also helped.

Reflecting on the pandemic, how resilient do you think the industry has been?

Whilst the mortgage industry did not experience a conventional recessionary shock, nonetheless there were several challenges that it had to meet. These related to the operational challenge presented by lockdown measures, and the various forms of forbearance that the regulator expected of mortgage lenders.

Operational resilience

The interviewees believed that the mortgage industry did exhibit operational resilience:

> I think it needed operational resilience. It needed to move people around fairly quickly. I think it did a fairly good job of that. It had some short-term impact on its willingness to take on new lending because of its focus on existing customers. (SP1)

KI2 expanded on this point, suggesting that,

> … lenders have certainly shown significant operational resilience in terms of the ability to very quickly move resource from sales and marketing and all this fluffy stuff that brings in the punters to customer care …

When administrative capacity was constrained by moving staff to working at home and dealing with requests for mortgage payment deferments, demand for new lending was rationed by adjusting loan terms:

> … the most significant part of their decision to retreat from higher LTV loans and higher risk lending more generally, was entirely about managing workflows and being able to, there was a need to devote a huge proportion of the resource that was available to them to servicing existing customers. (KI2)

Lenders suffered "a significant loss in industry capacity to lend and that certainly persisted for a number of months" (KI2) and the tightening of LTV terms "was largely operational necessity in my understanding" (KI2).

Mortgage payment deferment scheme ("mortgage holiday")

SP2 indicated that the mortgage holiday "created calm" and furlough removed the fear of unemployment, so the challenge for lenders became about capacity to deal with the volume of calls from people wanting a mortgage holiday. (SP2)

At the outset it was not clear how onerous the mortgage payment deferment scheme would be for the banks. Certainly, take-up was high because,

> … they [borrowers] thought it was money for nothing, rather than a deferral of a debt that had to be paid… Of course, they were getting cashflow benefit, but they were getting no other benefit, at all. The banks weren't letting them off a penny of interest. The banks were still charging them interest. (SP1)

The scheme turned out not to be too onerous because interest rates were so low, and jobs were protected by the furlough scheme. Now that the scheme is over, SP2 observes:

> [A]lmost entirely everybody who was on a payment holiday is paying now, our arrears levels as an industry and with ourselves a lender are as low as they've ever been, so it just hasn't panned out, people are still paying their mortgage and haven't stopped. (SP2)

KI2 also suggested that the scheme presented few challenges for lenders:

> … I'm not sure it was hugely demanding of lenders. Probably it required more thought once the policy had been introduced in terms of how then to wean customers off that had simply taken out deferral as a just in case basis… I'm not sure it was hugely financially onerous for lenders. (KI2)

Forbearance

Forbearance also turned out to be manageable for lenders.

The number of mortgages in arrears was 172,941 in Q1 2020. Since then, the general trend has been down, so that by Q4 2021, the number was reduced to 155,436 – representing 1.16 per cent of the total. Nor has there been any discernible change in the size of arrears, i.e. there has been no movement towards larger arrears. The number of new possessions fell dramatically from 1,773 in Q1 2020 to just 249 in Q2 2020. Since then the trajectory has been upwards, reaching 853 in the last Q of 2021,[11] still an historically low level.

The moratorium on repossessions (forbearance) did not present lenders with much difficulty, partly because house prices remained buoyant:

> It's only when prices are falling and losses are becoming crystalised and those processes of crystalising those losses reinforces [sic] the losses within your book, that spiral which we probably last saw in the late 1980s and slightly in '97… But those downward spirals just haven't hit the market for a long time. (SP1)

Consequently, lenders didn't have to make difficult decisions:

> … house prices were sustained because of that belief that there was always someone else to take on the debt, however bad it was. I don't think lenders have had to make any difficult decisions, at all. (SP1)

KI1 also pointed to furlough for lessening the need for lenders to exercise forbearance:

> … of course there was much less of a need for that [forbearance] because there wasn't the wholesale unemployment or lack of income that was necessarily expected. (KI1)

[11] FCA/BoE MLAR Summary Table 3 https://www.bankofengland.co.uk/statistics/mortgage-lenders-and-administrators/2021/2021-q4

Lasting adaptations

Unsurprisingly, interviewees considered that lasting adaptation were to be found in operations, in particular the use of technology.

Assessment of the extent of innovation varied. SP2 claimed that

> I think it [the pandemic] has [fundamentally changed], and a lot of things for the good, so the use of technology I think has come to the forefront, what the industry's done is probably progress, I don't know, five or ten years in the space of a year in terms of adoption of technology and how the market works. (SP2)

KI1 also suggested that the experience of lockdown had accelerated existing trends:

I think that [the shift away from branches, technology etc] was probably happening anyhow, I think what COVID has probably done is accelerate some of that. (KI1)

SP1 agreed:

> [T]he single main benefit, has been the acceleration of technology, and remote technology, and the ability to access help and communicate, not through a physical branch environment. That was already underway. (SP1)

SP2 provided more specific examples of change:

> [T]he use of video technology has been significant, what that's allowed the sales teams… for example to do is to become more of a hybrid role, so whereas before they were out on the road four days a week, they're probably out on the road now two days a week, and the other two days they are at home, they are doing meetings via video, and they're able to talk to more brokers because of that, so that's a big change as well… (SP2)

> And I think things like the use of technology for valuations, paperless applications, digital signatures, all those sorts of things have moved on very quickly, to the point when the market was shut the only valuations that could be done were AVMs [Automated Valuation Models] or desktop valuations, and they worked, and now I think it's lenders looking whether they revert back to the old ways of doing it or move on to new technology, and I think it does change that shape of the market as well. (SP2)

Whether such changes are to the advantage of customers is not clear, however.

KI2 believes "that lenders have had to do is develop a much more resilient coping strategy" (KI2) which involved devoting more staff to customer care:

> … what will be interesting to evaluate, I guess, over the next few years is the extent to which they keep larger numbers of staff engaged with customer care or, once again, sort of show stronger recourse to IT solutions. (KI2)

Even SP2 conceded that costumers currently were not receiving a better service:

> … I think the thing that probably customers are still noticing is telephony wait times are longer because that seems to be what people have defaulted to, they now pick up the phone, and we're seeing call volumes way higher than they've ever been… (SP2)

Has the industry attempted to learn from the pandemic?

Analysis of the interviews failed to identify many clear examples of how interviewees thought that the mortgage industry had sought to learn from the pandemic – perhaps because it is too soon to tell.

KI2 thought that lenders might be more wary of lending to self-employed people whose vulnerability was highlighted by gaps in the Self-employment Income Support Scheme during the pandemic:

> I suspect one of the ongoing legacy effects is that there's probably a mixed appetite now amongst lenders in terms of servicing self-employed customers. (KI2)

However, by far the most far-reaching assessment came from SP1, who warned that the wrong lessons may have been learned:

> …the positive has been the resilience in the financial system. I think they will have learnt from that. My worry is they've also learnt that the state will step in and protect them when times are bad.
>
> … I think they may have learnt the wrong things… [b]ecause the state will intervene, and you will be protected if your lending hasn't been good. (SP1)

This represents an exemplar of the classic moral hazard question, which is difficult to resolve.

What role has government policy played in shaping industry behaviour?

The interviews examined the role of government policy, both in the run-up to the pandemic and during it.

Prudential regulation after the GFC

SP1 made the important observation that the prudential regulatory regime for mortgage lending that was introduced in response to the GFC had prevented the competitive erosion of prudential standards:

> …fundamentally, what we've seen is a set of rules that prevented a runaway of leverage, combined with a market where variation has just about been knocked out of it. We haven't had what we saw in 2001 to 2007, which is the people that went to the edges become the stars of the market. We couldn't see people expand the market at the edges very rapidly and create a cycle that drew other people into excessively risky lending. That just hasn't emerged out of it. I think regulation has a lot to… We've got a lot to be thankful out of that. Mortgage lending has been boring, and it should be boring. (SP1)

Consequently, lenders went into the pandemic in a relatively strong position.

General interventions

Interviewees agreed that the Government's and Bank of England's general interventions (primarily furlough, interest rate reductions and Quantitative Easing) to support the economy were more significant than those specific to the mortgage industry or housing-market.

For example, KI2 observed:

> Government policy and if we include the Bank of England in that I think, government policy has been unprecedented and unprecedentedly positive and expensive, but it has been almost universally supportive in a way that I don't think any of us could have imagined before the pandemic. And perhaps, especially, from a Conservative government, it just beggars belief in many respects, you know, it's probably had some of us rewriting what we think about different political parties and governments, you know, it just, phenomenal, really, and that goes for other, you know, you've also had this significant cohesion globally between countries, which, again, is very rare outside of wartime. (KI2)

Term Funding Scheme

The Term Funding Scheme with additional incentives for SMEs (TFSME) allowed banks and building societies to access funding for four years at close to base rates. TFSME was launched in March 2020 and closed to new applications at the end of October 2021. The Bank of England records current loans made through the scheme as £192 billion (at 23/3/22).[12] Since the Government expects to receive its money back, it does not score as spending, but rather as financial transactions.

The Term Funding Scheme was certainly regarded as being important and helpful, SP2 going as far as describing it as having been "an absolute need" (SP2) at the time:

> So the Term Funding Scheme was opened back up again, and that was really helpful, and there's two elements I guess. One is that was very helpful, so therefore capital wasn't generally a challenge for people (SP2).

SP1 pointed to the calming effect the scheme had on markets, and suggested that its benefits during the GFC had been a lesson well-learned:

> I think the government has learnt…. Offer unlimited amounts of money, at reasonable rates and the markets will calm. I think that has been a positive out of 2007. I think that ability to intervene, rapidly, with solutions that are trusted and therefore, prevent panic, I'm going to put that down as a big plus. I think its time was limited but the sheer fact it was there, and ready, and introduced, and everyone trusted it… (SP1)

However, the scheme was not open to non-bank lenders which make up around 3-5 per cent of the market:

> The only lenders where there was a challenge was those who couldn't access the Term Funding Scheme, so there were a number of specialist lenders, non bank lenders who couldn't access that funding, and we saw some casualties in that area so lenders had to pull out of the market, couldn't lend for a significant period of time because the securitisation markets closed, their choice for therefore funding is Term Funding Scheme or deposits, but they had access to neither, so it tended to be the specialist lenders who are funded through securitisation or whole loan sales, they pulled out of the market quite significantly, some didn't come back at all… (SP2)

SP2 also observed that the general climate was remarkably benign as lockdown meant that discretionary spending was highly constrained, resulting in savings deposits rising:

> … what you found is your savings balances increased significantly, so if you have access to savings money, then your balances grew significantly during the period as well, so the whole country spent less, saved more, and balances went up significantly, I'm not sure of the figure but it's in the billions in terms of additional savings. (SP2)

[12] https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/results-and-usage-data

Stamp duty holiday

Interviewees were less enthusiastic about the stamp duty holiday, however.

SP1 regarded it as being unwise given that the government appeared to expect house prices to fall:

> … if you're genuinely worried about the state of the economy… it seems a really stupid strategy to encourage people to buy homes, by giving them a temporary one, two, three percent benefit. [S]urely [the] government were, at the time, modelling quite large falls in house prices. So, why, into that maelstrom, do you really want to encourage people to buy? (SP1)

SP2 was more sanguine, suggesting that it soon became clear that the stamp duty holiday was not needed to prevent the market from slumping. Consequently, it "turbo boosted" the housing market, but it was difficult for the government to withdraw it:

> I think at the time people understood why it was happening, but very quickly would probably realise it wasn't needed in the same way as it was set out. And I think it could've been handled better had it been more selective… it was just too open, and there was no necessity for example to target houses over a certain level or buy-to-let. I think it was a simple scheme that said this is just available to everybody to get the market going, and it probably wasn't needed as much as people thought… So I think the market dynamics would've taken us to a point, it certainly turbo boosted it, and then the challenge was withdrawing it, and in the end the tapering was the best way to do that. (SP2)

Like SP2, KI1 believed that some kind of stimulus was required, but suggested that a more targeted scheme would have been a wiser choice:

> I think that there needed to be obviously some stimulus, which again, would help the bottom end of the market, the first-time buyers and so on. And again, if that's the element of creating confidence in the market and therefore encouraging people to step forward, whether it has had the financial savings impact that, well, obviously it has been, but whether that was as necessary as the confidence side, I'm not sure. (KI1)

KI2 was, however, very clear in their view that the stamp duty holiday was unnecessary, contributed to house price inflation and was therefore disadvantageous to first-time buyers:

> My personal view on the stamp duty is that it was an unnecessary and more or less stupid policy intervention, and, I have to say, especially as it was instituted in England and Northern Ireland and providing similar levels of relief to landlords or to second homeowners. I don't see what the risks to the market were that warranted the stamp duty intervention…
>
> Why was it necessary? We know whenever stamp duty has been used as a policy lever it gives rise to huge distortions in the market… and OBR [Office for Budgetary Responsibility] has told us again and again, when you have these changes, they get capitalised in house prices. So, we've had the nonsense situation where there's been certainly a significant catalyst for the market at a time when the market was reviving quite happily anyway and there was no reason to suspect that it wouldn't revive post lockdown and the policy has been very disadvantageous for would-be first-time buyers because you have this huge extra [inaudible: boost?] to property prices, which has stretched affordability and certainly for the immediate post stamp duty announcement at a time when lenders were not in the ninety-five percent LTV camp. (KI2)

KI2 was keen to emphasise quite how strongly they felt about this issue:

> … virtually everywhere across England, the policy was unhelpful for first-time buyers and has a lasting legacy, because basically house prices have ratcheted up and even with the return of higher LTV, first-time buyers are still seeing that squeeze on affordability. Was that sufficiently unambiguous? (KI2)

Has Brexit had any impact?

The UK left the European Union on 31 January 2020. However, the UK then entered a transition period and did not leave the Single Market and Customs Union until 31 December 2020. The UK was in the transition period when the World Health Organisation formally declared that there was a pandemic on 11 March 2020, and England's legally enforceable lockdown began on 26 March 2020. Arguably the UK was shielded from the full impacts of Brexit during the first and second lockdowns in 2020. However, full Brexit also coincided with the third lockdown in England which began on 6 January 2021.

Generally, interviewees did not have slightly different assessments of Brexit's impact, which is perhaps unsurprising since,

> … I dare say the advent of Brexit in the middle of all this has probably, again, caused an element of impact, which has been difficult to single out, because I think there's some, I would say, convenient confusion between what's Brexit and what's COVID related, but that's more political than anything else. (KI1)

KI2 also suggested that it was difficult to isolate the impact of Brexit from that of the pandemic:

> … I think the effect is there but, whether or not one can actually separate it out, I'm sort of sceptical because the premises have changed so dramatically that then trying to work out what was this little bit over here doing, but, yeah, I wouldn't argue with anyone that said it had an effect, but I'm not aware of any major, major effects. (KI2)

SP2 suggested that since few lenders relied on the European market the impact of Brexit was minimal:

> … it's [Brexit] affected a very small minority of lenders who were looking at things like overseas income, lending to ex-pats, that type of thing, but on the whole no, it's had minimal impact. (SP2)

SP1 made a more specific observation, suggesting that Brexit cooled the London housing market:

> I think Brexit has been an important moderator of London house prices. Secondarily, I think it has helped stabilise the market … it meant that London was not driving and has continued to be relatively weak, in historic terms… [because] lack of certainty about high earners and financial services and the inflow of highly paid talented bankers into the London market. (SP1)

The Nationwide index recalculated so Q1 2019 = 100 shows that house prices in the UK as a whole reached 120.4 in Q1 2022, compared to 110.1 in London, so provides some support for this contention.

Looking forward

At the time the interviews were conducted, the rise in inflation was already apparent and the Bank of England was beginning to raise interest rates. Both could be seen as being a legacy of the actions taken to mitigate the impacts of the pandemic.

KI1 believed that the rise in inflation would lead to more hardship:

> … I think there will be more people sadly experiencing an element of hardship. And of course, that does play through to the lending industry. (KI1)

However, they were less concerned about interest rate rises due to the prudential requirements for stress tests to be conducted before a mortgage is granted:

> … we start looking over any reasonable term, you know, we are at a ridiculously low level [of interest rates]. And again, the stress testing that lenders will have done in the past, although I know that that's under review should mean that the actual ability for customers to maintain payments with some further increases in the bank base rate should on paper be easier. (KI1)

SP2 agreed that the stress tests, along with the prevalence of mortgages that are at fixed rates at least for some time, provide adequate protection against likely interest rate rises:

> Theoretically the stress testing that is done on all mortgages should mean that it's not a major issue because everything's stressed at 7% plus effectively, and mortgage rates are unlikely to be above let's say two, so there should theoretically be plenty of affordability in there and excess affordability for borrowers… I don't think it's going to turn into things like arrears or possessions… almost everybody is on a fixed rate, so you've got about 95% of the market who've got a mortgage have been done on fixed rates, so it has a negligible base rate increase in mortgage rate interest at a negligible effect on payments. (SP2)

KI2 agreed that stress tests provide a high degree of protection for borrowers, although some rise in arrears could be expected:

> I don't think, given that a significant chunk of mortgage lending has been stress tested and is on much more prudent basis than pre-global financial crisis, I don't think this will necessarily mean a huge blowout in terms of arrears and repossessions. We will see the numbers go up over the next few years, partly as some of the temporary measures through the pandemic are lifted and we sort of see that caseloads work through the system. (SP2)

However, KI2 warned that the squeeze on household incomes would not be compensated for by the Government:

> I think the danger is the government feels it's run out of fiscal headroom. The Bank of England, quite understandably, is wanting to re-establish some counter inflation credentials, which it's badly lost over the last year, eighteen months. So, the onus is very much on the central government and I'm just nervous that central government has lost the ability, or lost the willingness, to continue to be generous… [T]here's a danger that the government undoes some of the good work by not having… a sound set of policies to deal with the current problems that are manifesting. (KI2)

They described the combined impact of monetary policy tightening with "fiscal backtracking" as being "a double whammy." (KI2) These might be expected to have "a wearing effect on the housing market." (KI2) However, this would have some advantages because:

> … it will take some of the steam out the housing market, which the sooner that happens the better, really, because it has been inflated quite significantly by the post-pandemic boom. (KI2)

SP1 had a different perspective, warning that the levels of protection provided by the state "creates its own systemic risk":

> … the more challenging thing that I think we'll come to again, is that once again, the second major shock to hit the world economy has resulted in fundamental state protection for individuals, in a way that creates its own systemic risk. Because it basically, says if things go bad in the future, on a large scale, the state will step in. We'll lower interest rates, like we did in 2007 and when we can't do that, we'll pay everyone, like we did in 2020, '21. (SP1)

Conclusions: the mortgage industry

The interim report suggested that the mortgage industry was strongly supported during and after the GFC, and was also subject to extensive regulatory reforms to reduce risk. Low interest rates were another legacy of the GFC which helped the housing market to recover from the crisis whilst general economic performance was anaemic.

The pandemic threatened the stability of the mortgage industry once more – at least this was the common perception at the outset of the crisis. However, the industry was not tested in the same way as it was in the GFC. Extraordinary state support for the economy (in terms of fiscal and monetary policy) maintained incomes and created an even lower interest rate environment. The principal intervention intended (the stamp duty holidays) specifically to support the housing and mortgage market was, in this context, at best unnecessary and at worse recklessly fuelling a housing market boom.

A very particular kind of resilience was therefore demonstrated: an industry that had been given a great deal of state support, operating within a risk-averse regulatory framework which also reduced competition, and when the pandemic came, more state support.

3. The housebuilding industry

In stage one of this report, two Key Informants (KIs) from the housebuilding industry were interviewed in August and September 2020, first on their perception of the resilience of the industry following the onset of the GFC in 2008-09, and second on their sense of how the industry was coping with the initial stages of the COVID-19 pandemic.

The immediate effects of the GFC in reducing credit availability and restricting demand in the wider economy caused a sharp drop-off in house sales which, in turn, led to an oversupply of new homes relative to demand, thereby dampening prices. The effects of the GFC on the housebuilding industry were exacerbated by the interaction of a period of strong economic performance, translated into rising land values, in the decade prior to the crisis, and the lengthy duration of the production process for housing. This meant that housebuilders who had bought land at relatively high pre-crisis values, themselves based on rising house prices, then were forced to develop and sell housing at lower than forecast values.

To the extent that the industry's resilience was shown to be doubtful by the GFC it was in the overexposure of housebuilders to volatile land markets within a necessarily lengthy development process. This is troubling because, while the behaviour of some developers may have been rash in the years leading up to the crisis, the duration of the development process raises the possibility of builders being exposed to changing economic conditions between land acquisition and house sales. Furthermore, that housebuilders responded to the financial crisis by placing greater emphasis on large greenfield developments built out relatively slowly conflicts with a widely perceived need for more, not less, new housing.

The early reaction to the COVID-19 pandemic was characterised by the immediate practical difficulties of coping with construction under lockdown, set out in Table 1, and dealing with drastically curtailed cash flow. This was coupled with a strong sense of uncertainty as to the emerging shape of the crisis. This stage two report summarises how the COVID-19 pandemic has proceeded since the stage one interviews were undertaken, relating the findings from interviews conducted with the same two respondents, plus an additional KI to make a total of three KIs, during February 2022.

Table 1. The Construction Sector: COVID-19 Timeline

Date (all 2020)	Event
23 March	Lockdown announced, but construction in England permitted to continue within Public Health England guidelines. Some sites close.
25 March	UK Government promises to provide clarity on construction site guidance.
27 March	Work suspended on 1,924 sites involving £89 billion of construction work.
30 March	Kier, Bam and Wates resume work.
31 March	UK Government write to construction industry reiterating that they can continue with sites.
6 April	Scottish sites instructed to close unless on "essential" list.
15 April	New site guidance concerning sites where 2m distancing impractical.
29 April	Testing extended to construction works.
13 May	Housebuilding sites in England permitted to work longer hours.
12 June	Construction in Scotland allowed to resume

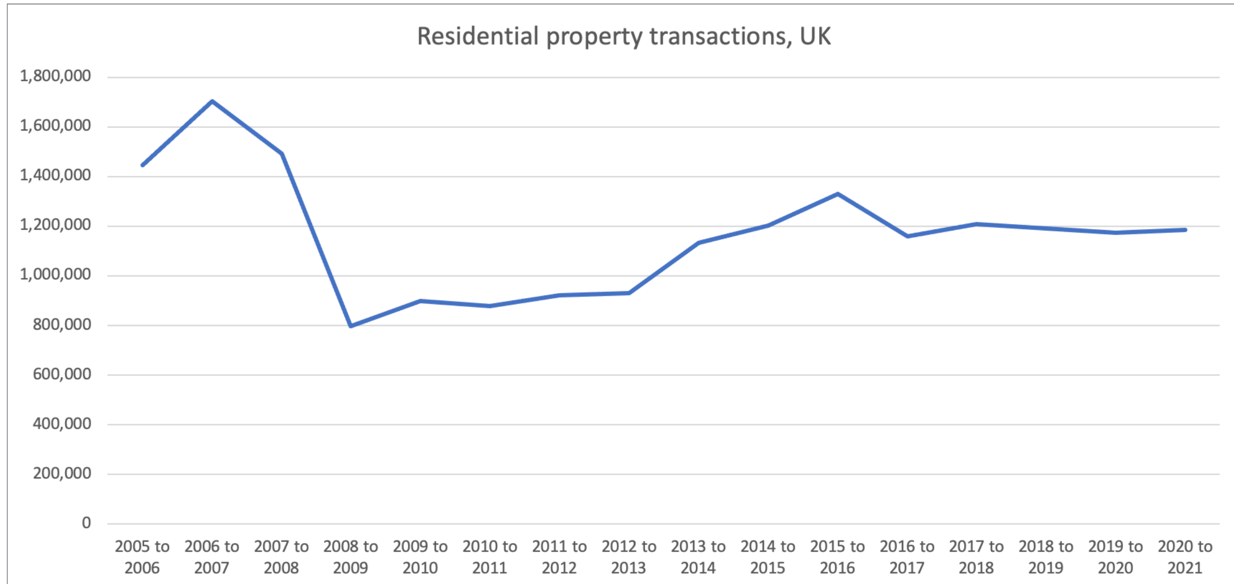
Source: Glenigan UK Construction and COVID-19: Timeline
https://www.glenigan.com/uk-construction-coronavirus-covid-19-timeline/

Looking back at the pandemic, how do you think it panned out compared with what the industry/ you thought it would?

At the inception of the project, in spring 2020, the housebuilding industry was subject to a tremendous degree of uncertainty stemming from the unprecedented and unpredictable global COVID-19 pandemic. The initial response of housebuilders, as outlined in the stage one report, was focused on identifying every possible opportunity to reduce costs and raise revenue and to moderate exposure to risk. Directly employed labour was laid off or furloughed, contracts were deferred or renegotiated with the aim of pushing back payment terms, and a heavy focus on sales was adopted to bring positive cash flow. The key reference point for the industry – and the one adopted for our stage one report – was the Global Financial Crisis, as a similarly catastrophic dent to output that was well within institutional memory. But as the pandemic dragged on into the autumn of 2020 it became clear that this would be a different sort of crisis from that of a decade before, as is revealed by the underlying metrics within the wider economy and the housing market.

UK COLLABORATIVE CENTRE FOR HOUSING EVIDENCE

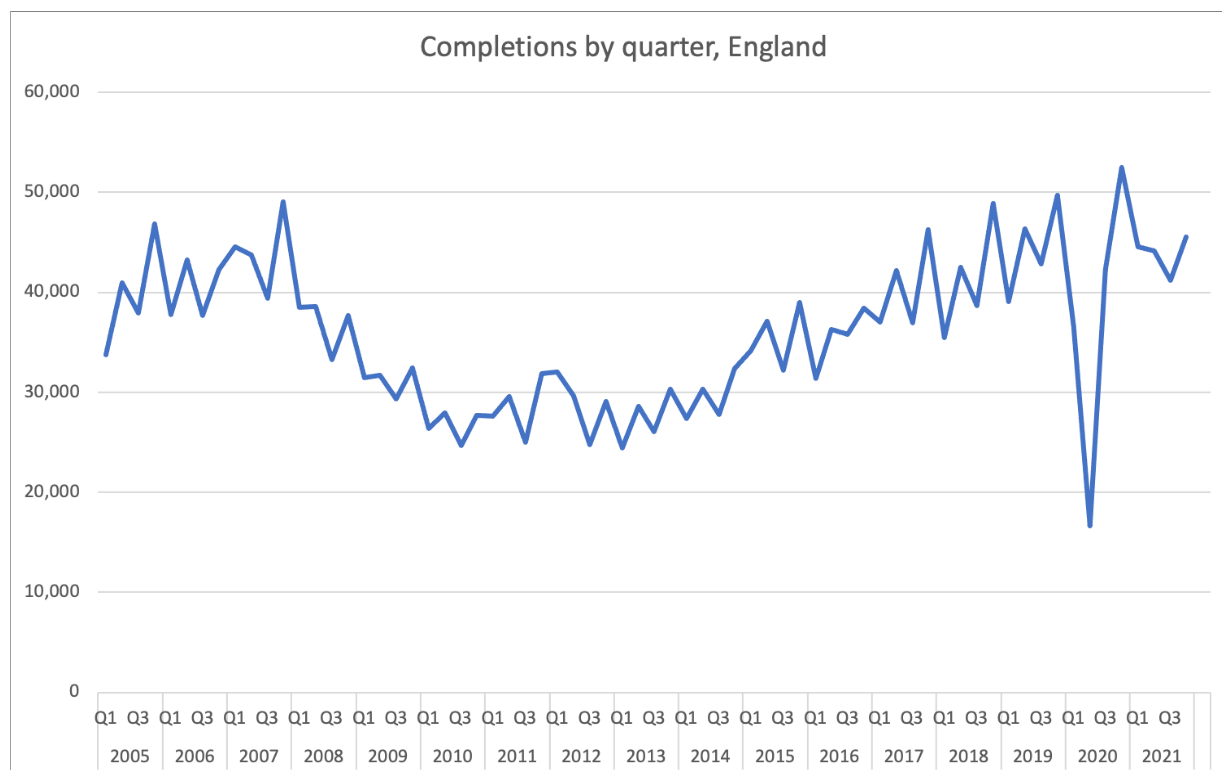
Figure 4. Residential property transactions, UK



Source: HM Revenue and Customs, UK monthly property transactions tables

Whereas the number of residential property transactions halved following the GFC, they have remained stable through the COVID-19 pandemic, as tracked in Figure 4. While this is partly due to a sharp initial drop in completions, housebuilder output was fully restored within 12 months and the overall trend speaks of consumer spending largely remaining unscathed. Figure 4 shows the depth and swiftness of recovery in housing completions in England between Q3 2019 and Q3 2020. It is instructive to compare this to the much more gradual and prolonged decline and eventual recovery that followed the GFC and the peak of completions in Q1 2007.

Figure 5. Seasonally adjusted completions by quarter, England



Source: Department for Levelling Up, Housing and Communities, Live tables on housing supply: indicators of new supply

Driving all of this was the steady increase in house prices (Figure 5), which meant that, crucially, land bought at pre-pandemic prices did not lose value after the onset of the pandemic. Within the residual valuation model used by housebuilders to price residential development land, the price paid for land is the residual of the forecast value of the completed development less the costs and a pre-specified level of risk-adjusted profit. The price of land is, within the model, determined above all by the valuation of the completed development, this being the largest variable. Following the onset of the GFC, heavily dented consumer confidence and a shortage of available mortgage credit reduced demand for housing, which had the effect of suppressing house prices. This in turn meant that developers who had bought land valued according to pre-GFC house prices suffered dramatically reduced profits and were forced to cut development and other costs for several years. However, during the COVID-19 pandemic this has not happened, with market fundamentals having kept housebuilders buoyant. One interviewee neatly summarised the two key factors supporting house price growth:

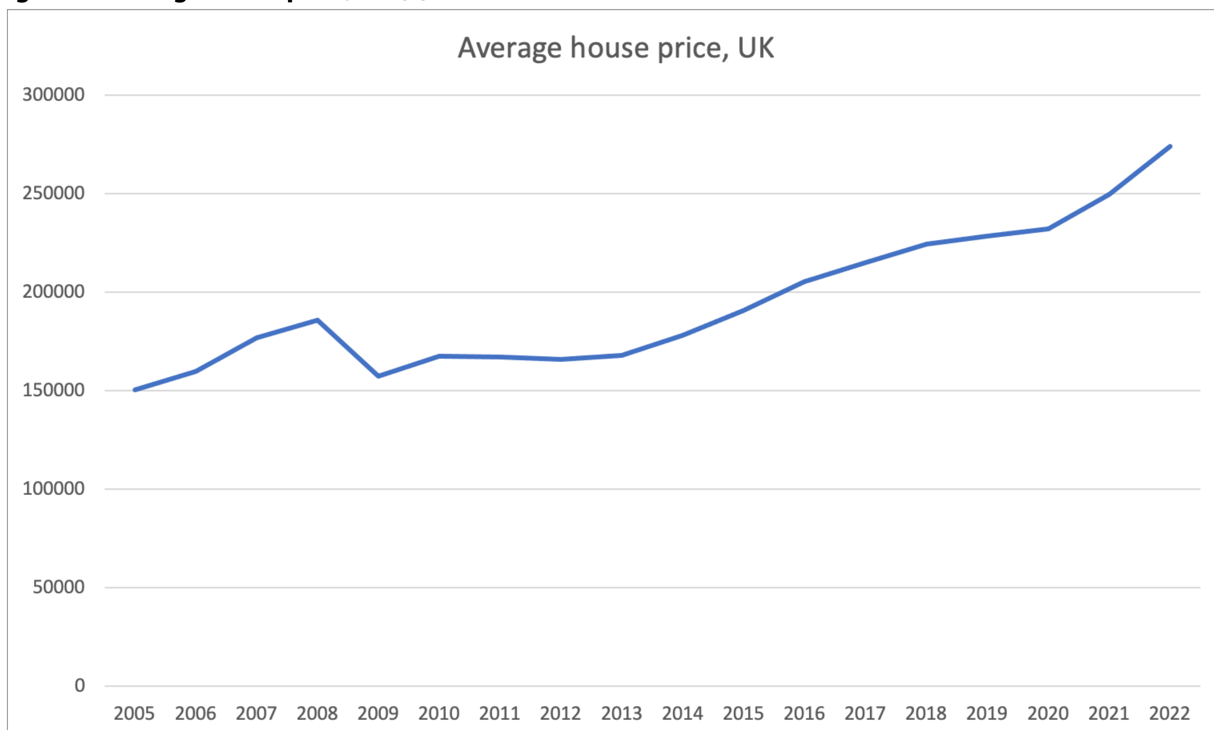
> Money's remained cheap and beneath all of this is strong underlying demand because we haven't met housing need (KI3).

UK COLLABORATIVE CENTRE FOR HOUSING EVIDENCE

A key point of differentiation in the government response to COVID-19 as compared to the GFC is in the approach taken to fiscal policy. Following the GFC government spending increased enormously to recapitalise banks but after 2010 was sharply squeezed, combining with a shortage of private sector investment to stall the recovery. By contrast, when the Covid pandemic struck UK public spending stepped in to fill the void left by the private sector, allowing market activity to continue largely unabated, as related by KI3:

> This time around the public sector did step in and [spend] loads, but the private sector continued almost immediately, they both did it to some degree. Because the market…well, big strategic sites, people bite your hand off for them still (KI3).

Figure 6. Average house price, UK (£)



Source: HM Land Registry, UK house price index

Following the beginning of the first pandemic lockdown across the UK in March 2020, the industry feared that a similar pattern of declining house prices and transactions would ensue, wiping out much of the value of housebuilders' land banks. This would have been mitigated to a degree compared to the GFC as that had been preceded by a hubristic period of land speculation, leaving many developers over-exposed to a downturn. Nonetheless, such was the seriousness of COVID-19, anything seemed possible at the outset. The difference between the GFC and COVID-19 crises was addressed by KI3:

> So having been through both these crashes per se, this one, I would suggest it wasn't just housebuilders, but the whole local development industry had huge uncertainty and I think we all thought we were going to fall off a cliff, it was going to go backwards for us big style (KI3).

As much as the hit to GDP following the onset of the pandemic was more severe than that during the GFC[13], the shortage of mortgage credit and – in the initial stages – spike in unemployment[14] that negatively affected house prices following the GFC were not replicated as the pandemic began. Yet not only did market confidence remain unscathed through the early stages of the pandemic but the existing upward trend of house prices began to accelerate from the onset of the pandemic, shown in stark contrast to the post-GFC situation in Figure 5. The challenge became, in fact, the reverse of that faced during the GFC, as developers struggled to meet demand. Interviewees noted that the recovery in the housing market was perceptible by the autumn of 2020.

> By the September/October time … the resi[dential] market was taking off, everyone was inundated, the most enquiries ever, the most website hits ever, the most enquiries on land ever, record fees all of last year [2021] (KI4).

And:

> If I think back to sitting in my home office in March 2020 and the shock, the panic, the issues that were going on with members at that stage, if anyone had said to us at that point, by the way next year you will not be able to build and sell houses quickly enough, we would never have believed it (KI5).

That the housing market should not only recover but grow at a faster rate than before COVID-19 was a positive outcome of the heightened uncertainty at the beginning stages of the pandemic.

> And that's been the bit that's been most unexpected: that it has been almost business as usual plus almost. And that's the bit, I don't think anybody could foresee that … for the last five to ten years before COVID, the house building market was trundling along at a reasonable trajectory, now and into COVID, it's gone a bit like that with steroids. That bit was totally unexpected (KI4).

Emerging challenges: construction under lockdown regulations and cost inflation

Against such reassuring market fundamentals, the reopening of construction sites did not herald a return to business as usual because pandemic-induced restrictions in construction and sales practices, as social distancing and limits on room capacity restricted build timescales, served to extend constraints on supply while demand remained strong. Furthermore, other problems emerged, as the cost and availability of labour, materials and energy have risen considerably in line with global trends since the pandemic, perhaps exacerbated by the UK's exit from the EU Single Market and customs union at the end of 2020.

KI4 summarised the path of change over the course of the pandemic.

> 2020 was just about working out how to operate in COVID, the middle of 2021 was about getting materials, the end of 2021 was about 'oh shit, we're getting them but it's costing a lot…' (KI4).
>
> Now it's 'Surely the costs are going to come down, oh no they're not, they're going to keep on rising', and the costs that might come down are going to get replaced by other costs that are going to go up, most notably red diesel, glass, windows and labour (KI4).

As well as presenting budgetary challenges, the rise in inflation has been sufficiently steep as to test operational practices:

> Most of us haven't dealt with inflation like this, how do you negotiate with the supplier in an inflationary market, it's a whole new skillset, because are they taking the mickey? Or is it genuine? How do you get to the bottom of that? Can they prove the materials have gone up? Because timber's the number one cost over the whole piece and it's the most expensive part of our house (KI4).

A sense of uncertainty as to the sources and duration of higher inflation was expressed by KI5:

> There are a lot of things that are still very unclear. And what we don't know is how structural they are, or whether they're still short term. Inflation that they're seeing at the minute, is that a permanent change to the cost of materials or is it a short term fluctuation that may pick up and improve in the course of the next few months? We just don't know yet, we're not seeing any signs yet of any particular improvement in that. The cost of timber is up by whatever, 100 odd per cent, we're not seeing any signs of that going back down to what it was two years ago. I think a lot of the cost rises that have come through appear to be fairly permanent (KI5).

It should be noted that the interviews pre-dated the additional inflationary pressures arising from the Russian invasion of Ukraine.

It was suggested by KI4 that rising energy costs may attract consumers seeking better insulated homes to the new build market, though this was caveated by the suggestion that cost inflation must ultimately be incorporated into the price of new build housing.

> [T]he cost of running a new build house is significantly less than the cost of running older stock, so it'll stand us in good stead relative to the market I think which is good so long as it's reflected down in prices, but then the price of everything's, you know, we're dealing with such cost inflation that you've got no choice but to push the pricing up of the houses, you can only absorb so much in margin (KI4).

This points to the difficulty in pricing new homes, with prices reflecting both the total market for housing, comprising new and second-hand homes, and the development costs for new housing. Where construction costs are predictable prior to land acquisition, they are incorporated into the residual valuation and reduce the price paid for the land. Where construction costs increase after land acquisition, however, developers must either raise the price of new homes or accept a lower level of profit.

Rising costs have a differential effect on SME versus volume housebuilders, with KI4 pointing to the economies of scale operating in the industry. While periods of recession have historically tended to drive the mergers and acquisitions that have led to the increasing concentration of market share among volume builders, cost inflation, if sustained, may also contribute to this.

> Well, [the incorporation of rising costs into land valuation] should be industry wide, but obviously your big boys have got more buying power. We're an SME, so probably there is a risk that the gap widens (KI4).

Reflecting on the pandemic, how resilient do you think the industry has been?

The resilience of the industry has, for the most part, not been brought into question, though rising materials prices may be beginning to change this view. This is surprising in the light of such heightened uncertainty at the beginning of the pandemic but follows the trends illustrated in section 2 showing that house prices and demand for housing have in fact increased during the pandemic. That these metrics have remained positive throughout has supported the housebuilding industry in its current form and meant that its resilience has ultimately not been tested. Where the industry has been able to demonstrate its resilience is in its risk management during the initial stages of the pandemic. Housebuilders were quick to explore options on furloughing and subcontracting, raising the question of whether risk has simply been transferred elsewhere in the industry to smaller firms acting as contractors, as noted in our Stage 1 report (Stephens et al., 2021). But more fundamental to the speculative housebuilding model is the ability to control development within sites, known as the 'build-out rate'. This level of control within the development process is primarily aimed at controlling sale prices but also enables developers to manage cash flow under uncertain market conditions, as described by KI3:

> Housebuilders I think will turn themselves on and off really quickly. They only build in small chunks. The risk of building a big pile of flats is you have to build the whole lot, but even then they manage their risk there and sell 50% before they start building, whereas when it comes to housebuilders, they get their presales, but they're only building in blocks of 12, 18, sell them and stop, so they're managing their risk quite carefully, their cash flow. So their gigs can turn off overnight, but they're also very quick at turning them back on when the market is very good (KI3).

While the industry has proven to be resilient through the pandemic, it has been forced to adapt. An initial adaptation was short-lived and relates to construction and sale practices in the early stages of the pandemic, when restrictions on social mixing disrupted standard practices. A further adaptation is ongoing and likely to become only more significant, relating to the increasing cost of materials and, to a lesser extent, labour, as discussed in section 2. COVID-19 may have also brought with it changes to consumer demand in what may yet prove to be a short-term trend as a reaction to the challenges of living through lockdowns without access to outdoor space.

In an associated and perhaps longer lasting trend, home working has changed the shape of demand in two respects. First, it has enabled many white-collar workers to live a greater distance from their workplace, reinforcing an existing trend towards home working such that office attendance has for many become necessary for only part of the week or less. This was seen by interviewees as underpinning growth in both relatively remote rural areas as well as in better connected areas where longer commutes are feasible.

> Nobody wanted to live in cities for x amount of months, they all wanted to move to somewhere further away and they all thought we're going to stick with this flexible living and house prices showed that; London stalled and anywhere that's green has gone up (KI3).

And:

> People sitting at home in their one bedroom, two-bedroom flats thinking hang on I want a house with a garden now. So, I guess all of those questions that we all as individuals re-evaluated during lockdown, began to then translate into the housing market (KI5).

KI4 pointed out that the trend from urban to rural housing was to some degree in train prior to the pandemic, but has been heavily reinforced by it:

> Yeah, we're probably more bullish about the rural market than we were before, we were tentative in the rural market, now we're bolder, because of site performance, so that's pushing us more into the [rural] lifestyle markets which is our brand. That's COVID, that's definitely, to be fair, before COVID there was a move towards lifestyle, and we saw USP, so the timing of that's been good because some of our sites with the contemporary product are performing very well (KI4).

The translation of the changing nature of work and of the working week into the housing market was set out by KI5:

> What we've also seen … a shift up from the South of England. So, the realisation that you could work hybrid, you didn't have to be based in your office in London five days a week, so, they have noticed a definite increase in the number of enquiries coming up from people wanting to re-locate … and maybe only having to commute down and be down in the office for two days a week, and financially it was affordable (KI5).

Second, space for home working is coming to be seen as essential in larger housing, with interviewees indicating that the incorporation of an additional office room is now seen as a necessity in the long term rather than being only a COVID-19 phenomenon. This naturally reflects the nature of remote working as a long-term trend, the need for which under lockdowns is likely to cement its prevalence, related by KI5:

> If you look even at some of the sales particulars now for homebuilders, they will be emphasising that there is that fourth bedroom, come home office, third bedroom, office whatever it might be. I saw one of our members, I can't remember which one, one of the housebuilders advertising that they had now teamed up with a garden office company that you could buy your house, and at the same time you could get a good deal from a posh garden office company that would provide you with a standalone office in the bottom of your garden as well (KI5).

A tentatively articulated shift in sales practices brought up by KI5 was to do with the growth in online sales and marketing, ushered in by the difficulties of viewing properties under lockdowns combined with the short supply of new housing at that time. While 'sight unseen' home purchases may be unlikely to persist as a practice, they stem from the longer standing trend towards growing online sales provision for new, as well as second hand, housing:

> There was a significant increase in the amount of people actually comfortable with buying effectively online without really even seeing the properties, which is quite strange. Now ultimately the final decision still comes in but there was certainly a significant number that were prepared to go much further down the line in terms of commitment before they actually physically viewed the property. So, I don't know whether there has maybe been some longer-term shift in terms of the digitalisation of home sales that you wouldn't have seen previously (KI5).

While the general perspective on urban centres and flatted development more broadly was negative following the consumer reaction to successive lockdowns discussed above, there was a suggestion from interviewees that brownfield markets are perhaps not as troubled as might be expected, with assets beginning to trade from what may prove to be the trough of the market.

> Town centres is a bit harder to see that there's opportunities, but there are beginning to come some. People are starting to buy assets at the bottom of the value curve as such in the view that they'll make money in the future. People are starting to see opportunities there. So yeah, change does create opportunity by the pure nature of it (KI3).

The policy drive towards brownfield development in Scotland was seen to have supported markets there by a mixture of constraining developer decision-making, reinforced by consumer demand:

> I'll tell you the one business shift I'm keen that we embark on is brownfield, so we need to adapt, love it or hate it we need to begin to position towards brownfield … the rhetoric is all about brownfield over greenfield. Actually city centre flats are performing incredibly well in Glasgow and Edinburgh, and we're buying a site at [x], a hundred units, quality product, well designed, open space, balconies, terraces, there is a market for that right now (KI4).

An additional factor predisposing SMEs towards flatted development is the reluctance of banks to factor in revenue from sales of houses in a partially completed development, in what is known in the industry as a 'peak funding' arrangement. Developers would prefer not to borrow the full costs of a development because some of these can be offset until the point at which some of the houses can be sold, raising revenue with which to pay off debt. Banks, however, are reluctant to accept the risk that units go unsold. As such, for SMEs without a revolving credit facility, standard bank lending models – as well as joint ventures (JVs) – were seen as being tailored towards development of flats, for which costs and debt repayment are simpler. This was explained by KI4:

> In some ways it's easier to get funding for flats than it is for houses … but when you're looking at project funding, and we are looking at a couple of JVs, they're actually designed for flats, they're not designed for housing… (KI4)

> [Banks] don't like what's called peak funding, I don't know to what extent, but they don't like peak funding, they like cost and complete funding. I've got a former client of mine, a small builder client, asking for a facility that was twice what he needed (KI4).

Has the industry attempted to learn from the pandemic?

As with the mortgage industry, interviewees were cautious and suggested that it was too soon to say whether the housebuilding industry had learned from the pandemic. This was largely because the market has yet to either return to its pre-COVID position or to settle at a new equilibrium state, with the adaptations detailed in section 2 still regarded as a means to deal with present market conditions.

The hesitancy of interviewees to fully embrace the present set of conditions going forward was summed up by KI3:

> I think there's been a learning process on aspects of wellbeing, if you understand, buyer sentiment, back to that, you know, I'd like a garden, and that's certainly picked up. But what I'm hesitating at is, will it stick? I don't know. We're all told to go back to the office three or four days a week, will it just go back to business as usual? I can't quite tell that yet as such (KI3).

Similar doubts as to the longer-term viability of trends introduced during the pandemic were expressed by KI4:

> My step back is I thought, oh look, COVID brought some really good things, the sustainability issue, more flexible working, and I'd love some of those to stick, but even I'm sort of thinking, I wonder if in six months' time, whether an awful lot of those will have disappeared (KI4).

The potentially conflicting outcomes of what might be termed the wellbeing agenda, outlined in the above quote, in its demands for lower densities and private outdoor space, and the sustainability agenda, with its emphases on urban compaction and public and active transport, was raised with interviewees. KI3 pointed to the fact that housebuilders, as private sector actors, adjust their strategies in response to market conditions, meaning that any conflicts between wellbeing and sustainability must be resolved by regulation rather than by an industry itself committed to change.

> I suppose it's about sustainability as well, has the housebuilder market learnt from it? Probably not. They're being pushed along the line by government in fairness because it's got cost attached to it (KI3).

What role has government policy played in shaping industry behaviour?

Government policy that has influenced the housing market and housebuilder behaviour can be divided into two sets of measures: general measures undertaken by the government and Bank of England to support the wider economy during the pandemic; and measures aimed specifically at the housing market and housebuilding sector. Section 2 outlines general measures to support the wider economy as well as the housing-specific measure of a stamp duty holiday in England and Northern Ireland, and its equivalents in Wales and Scotland, all of which have influenced the housing market as well as the mortgage market.

Consequently, these policies will not be detailed here. The effects of general measures on housing markets and the housebuilding industry are addressed in section 2, where they are used to contrast housing market performance under COVID with that following the GFC. The effects of the Stamp Duty holiday are discussed in this section, alongside those of the Help to Buy policy.

Stamp Duty Holiday

Interviewees in the housebuilding industry responded similarly to those in the mortgage industry with respect to the necessity of the Stamp Duty Holiday. There was a general consensus that the policy was unhelpful and unnecessary. KI3 cited the continuing uncertainty within housing markets as well as more broadly during summer 2020, however, as explanation for its introduction at that time.

> I think it was a first tool out of the bag to stimulate the UK. It probably did overheat it, but I think anybody probably would've done something similar. Actually, you could have taken it away and the market probably would have boomed really well anyway, because more money, et cetera, changing lifestyles, it was driving a whole load of things (KI3).

The multiplier effect of the development industry on the wider economy was further noted by KI3 as an influential factor in encouraging the policy.

> I think it's a fair comment to say it was a bit of a rough and ready tool, but I guess it must be true that one way to stimulate the market is to make the construction industry work, isn't it? … Housing development's really good at recycling money through the economy, giving people jobs, et cetera, et cetera. So it's a really good tool to feed that part of the industry to keep people in jobs (KI3).

KI5 suggested that market confidence was sufficiently high when the policy was introduced, in July 2020, for their response to government consultation to be that it was at that point unnecessary:

> Interestingly, [in response to government] we had said, we don't need it just now, let's carry on with where we are but when things begin to slow, that's when we need it. That's obviously not what happened, and Westminster did it first and then [the] Scottish Government had to follow through. But our plea directly into government had been … let's use this demand side that we've got at the minute and let's keep building and selling when people want to and then when things begin to slow then kick in with it. So, I don't think it was the right time to … but in six months' time we might be glad of it (KI5).

Help to Buy

Help to Buy was introduced in England and Wales in two forms in 2013: a mortgage guarantee scheme in which government acted as guarantor for high LTV mortgages to encourage riskier lending; and an equity loan scheme that allowed buyers to borrow from government against a new build property to raise a larger deposit. Only the latter scheme was available in Scotland. The mortgage guarantee scheme was scrapped in 2016 though the equity loan scheme, originally proposed to close to new applicants in 2017, was continued until 2021. Profits for some volume housebuilders had arguably become dependent upon the scheme by the time its closure was announced (Hammond, 2019), while the UK government Public Accounts Committee argued that it represented poor value for money in achieving housing priorities and exposed government to the risk of house price falls (Public Accounts Committee, 2019). Yet in England and Wales the Help to Buy equity loan scheme was extended to 2023, in spite of positive price growth. While the decision to extend the scheme was taken before the onset of the pandemic, its effectiveness will inevitably be to some extent contingent on housing market performance throughout and perhaps beyond the pandemic.

Interviewees expressed doubt as to the continued necessity of Help to Buy, at least in the same form. KI5 suggested that the approach taken in Scotland in which the maximum property values against which equity loans were made were progressively reduced, was beneficial in stabilising the housebuilding industry in Scotland.

> Because Scotland had a stepped approach [by which price caps were reduced over time] to Help to Buy, it was a much more balanced scheme. I think in England where there were much higher thresholds, there was more of an addiction to it if I can use that word… whereas in Scotland we kind of weaned ourselves off it that bit quicker. There was no huge demand … that we had to keep it (KI5).

But KI4 outlined how setting lower maximum property values for the scheme encourages builders to adjust their product mix to better represent the distribution of demand rather than simply constructing the most profitable house type in any given location.

> I like the idea of a cap. Being fair about it and balanced about it a cap of two hundred grand, it will encourage us to build, to manage market risk, it will encourage us to build houses that are less than two hundred grand, so it's not affordable housing but it's … more of a varied mix. If there's less market risk for us to build big houses we'll build more big houses, do you know what I mean? (KI4).

As with the mortgage industry, the effects of government and Bank of England macro interventions dwarfed – indeed rendered unnecessary in the case of the stamp duty holiday – policies targeted specifically at the housebuilding industry.

Has Brexit had any impact?

There remained a consensus that it was still difficult, at the time the interviews were conducted, to decipher the effects of Brexit from those of the pandemic:

> It's kind of hard to unpick a lot of this, because this was then compounded with the whole supply shortages, labour shortages, COVID, Brexit, Suez canal blockage with all these things combined. So what's causing the problem? The supply chain issue at the minute, is it still COVID related? Is it Brexit related? Is it simply the fact that everybody is demanding it so there's just so much more demand? (KI5)

But for certain materials it appears clear that Brexit is inhibiting access to European supply chains, while the construction industry's disproportionately large share of EU workers is likely a source of difficulty in sourcing labour (Price, 2021). In the longer term the development industry will be likely to need to reassess trade relations with the EU Single Market and customs union:

> The whole lot of it is Brexit related, and we know it's Brexit related. It's not just timber, it's sanitaryware so bathrooms, the bathroom suppliers apparently most of the sanitaryware, a lot come from Italy and tiles, a lot comes from Spain. What our members are being told is that… because obviously they're still being affected by COVID as well, if their production lines were down and we're working at a slower capacity, they were then giving priority to European countries, so within the EU because it was easier for them to sell their goods there. It's just put British businesses down another notch in the scale (KI5).

Looking forward

Materials and labour inflation had already hit builders by the end of 2021 but by the beginning of 2022 there was talk of a cost of living crisis and speculation as to the prospect of a forthcoming interest rate rises. Ongoing uncertainty relating to materials costs was foremost among interviewees' concerns. The lengthy duration of the development process means that where costs are rising, the price of new build houses does not reflect the costs of construction, which in turn risks invalidating assumptions made when they valued the land now in their landbanks. The continuing uncertainty around this was outlined by KI5:

> The homebuilders will start to slow down the amount of homes that they're releasing very far in advance because they don't want to be releasing prices for a home that they're going to be selling maybe in 12 months' time because they don't know what their cost is going to be in 12 months' time so there's a lot of very difficult… it's almost like a very slow step by step process here because there's just so much uncertainty (KI5).

But KI4 noted the uncertainties inherent in forecasting future costs and land values in a dynamic market. Whereas building costs are typically a stable component of the land valuation, under current conditions this is far from the case.

> Today's cost is today's values, we're having loads of debate about this at the moment, [and] that's always the approach, today's cost is today's values, to start forecasting either becomes dangerous (KI4).

Difficulties in forecasting can also impact upon affordable housing provision. Whereas increases in build costs can generally be reflected in selling prices within a rising market, this does not hold for affordable housing. Because prices are agreed with affordable housing providers at the beginning of the development process, where materials prices rise over the course of the development these cannot be reflected in increases in the price of affordable housing.

> The other problem with affordable is you can't get inflation, once the pricing's [agreed, it's fixed] … unlike the mainstream market we can't keep pushing prices to get us out of a hole, because if we weren't getting price inflation at the moment [build cost increases] would be a disaster (KI4).

Interviewees also expressed a concern that the hitherto buoyant consumer confidence may be beginning to wane, as prices rise and pandemic-fuelled savings are exhausted.

> There's very much more of a concern creeping in, combined with obviously consumers... so the savings that people had accumulated during lockdowns when they hadn't been out spending were giving them larger cash for deposits. A lot of those cash deposits seems to have been spent now, or are being spent, things are opening up and we're doing more so will there be a slight weakening in terms of consumer demand there. Obviously inflation is beginning, and rising unemployment, all of these thing kicking through towards 2022/2023, there's that little bit more uncertainty (KI5).

Forthcoming changes to building regulations and energy supply were cited by one interviewee as an impending source of both uncertainty, with regard to how the industry and the energy sector will cope, and difficulty with respect to incorporating these changes into the extended time horizon of the development process. The duration of the residential development process is such that land valued in 2022 would ideally incorporate regulatory costs imposed in, perhaps, 2027. As KI5 noted:

> A lot of this is coming in at the same time as the changes to the building regulations so… changes to the building regulations with regards to energy efficiency, and requirements again for further reductions in terms of operational carbon emissions, and then by 2024 effectively the ban on gas boilers, and again because so much of that is still uncertain, so they're having to look at making decisions now in terms of land acquisition to be building properties in four or five years' time when we still don't know what the building standards are going to be in four or five years' time. What is the ban on gas boilers effectively going to mean? Is the grid going to be ready in five years' time to take this significant increase demand? Will the supply chain… so all of these things are happening all at the one time (KI5).

Conclusion: the housebuilding industry

Our two-stage approach to undertaking interviews was designed around the fact that in such a fast-moving environment research that captures industry sentiment at any given point in time can soon feel out of date. While this has certainly been true of the pandemic, as can be noted in interviewee responses between the stage one and two reports, it can also be said of the relatively shorter time that has elapsed between when we conducted our stage two interviews, in February 2022 and the publication of our stage two report. This is due more to the Russian invasion of Ukraine on 24 February than COVID-related developments and is discernible in the relative lack of attention paid to energy prices in particular and the fact that price inflation more broadly has only become more prominent an issue. 4.

Conclusion

Our interim report noted how both mortgage and housebuilding industries had been exposed during the GFC, and by any definition were not resilient.

We also noted that the mortgage industry had been subject to extensive regulatory reform. Further large parts of the banking industry had been nationalised during the GFC and the government's share in NatWest (RBS) fell below 50 per cent only in 2022. The housebuilding industry has also been supported for a decade by the Help to Buy equity scheme.

These considerations imply that both industries became quasi-market institutions after the GFC. Both became dependent on the state, but their objectives remained those of conventional market institutions – to act in the interests of their shareholders, even when these included the Government. They were not expected to temper the interests of shareholders to wider social goals, so long as they operated within regulatory limits.

Both industries adopted de-risking strategies after the GFC to reduce their dependence on inflationary land and property markets. To an extent de-risking was possible because of the restraints provided by regulation (in the case of mortgage lenders), and the highly concentrated nature of both industries.

This project was based on the supposition that the COVID-19 pandemic would provide a test of the mortgage and housebuilding industries' resilience.

Certainly, the pandemic and accompanying lockdown measures governments took represented a huge shock. In terms of sudden drop in GDP, the pandemic-induced lockdown, which saw one-fifth of the economy disappear almost overnight, dwarfed the GFC. Even though the strong bounce back in the second half of the year made up around half the initial loss, it was far greater than that experienced in the GFC.

The follow-up interviews conducted in 2022 confirm that both industries expected the economic shock to have severe effects on them, and were surprised when instead there was, after the initial lockdown, a strong bounce-back in the housing market. In this crucial sense, the resilience of these industries was not tested in the way that had been anticipated. Indeed, when asked about resilience, respondents from both industries pointed to operational adaptations relating to working at home and relying on technology for on-line sales. Although housebuilders had to adapt to new site safety regulations, they were able to return to site working on 10 May 2020.

Of course, the principal reason why both industries did not have their resilience tested in the way it had been in 2007-09 was that the state made unprecedented interventions to support the economy in general and household incomes in particular. Monetary policy, as in the GFC, saw interest rates cut (although the already low level of interest rates meant that they did not have far to go in 2020). Quantitative Easing focussed on the purchase of government debt, blurring the lines between monetary and fiscal policy to finance the support schemes such as furlough. These general interventions show why, for example, the requirements for mortgage lender forbearance and mortgage "holidays" were not onerous. Further, housing-specific interventions, notably the stamp duty holiday and the extension of Help to Buy (in England) were judged to have been unnecessary and helped to fuel a housing market boom. However, it might be noted that particularly the housebuilding industry thrives when house prices are rising.

It is therefore important to ask for whom the mortgage and housebuilding industries were resilient?

Stepping back and examining the decade between the two crises, the consistent policy context has been one of historically low interest rates combined with QE, which has served to support house prices, locking out people unable to assemble large deposits from home-ownership.

Insiders have therefore been well served. Insiders are the existing home-owners, the two industries under consideration, and, because it has become embedded in the housing market, the government itself. That the "resilience" demonstrated therefore is of a profoundly conservative variety should not be contentious. It might even be regarded as being reactionary: not only have the insiders been protected by policy, they have been privileged by being given access to cheap money. Many took the opportunity to join the Buy-to-Let market; others to take advantage of the short-term let market. All benefited from the growing divide between owners and renters, albeit with pronounced regional variations.

It is more revealing to point to the way in which resilience has been attained – through a legacy of the GFC being that the state has become embedded in the institutions of the housing market. That the interests of the state have become so closely aligned to these industries creates a powerful political economy which is also inclined to privilege households with property ownership. If resilience has been attained, it is state-led in character.

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