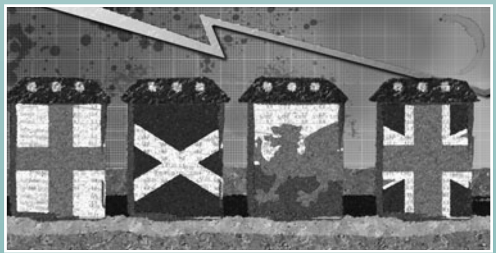
Section 2 Commentary



Chapter 3
Private housing

Home-ownership affordability

The impact of what is now widely described as the 'credit crunch' on the private housing market and the wider economy is discussed in the Contemporary issues Chapter 4. This chapter therefore features the *Review's* regular Affordability Index, and issues related to mortgage repossessions and private renting.

The Affordability Index

It is now obvious that 2007 was the peak year in the latest housing market cycle, and the national and regional downturns in mortgage cost to income ratios in 2008 are shown in the *Review's* Affordability Index (Tables 2.3.1 and 2.3.2). However, it should be noted that the house prices used in the Index are the average for the year as a whole, and this provides a different picture to year end prices which would bring out more fully the decline in prices during the course of 2008. Indeed, as Compendium Table 47a shows, average house prices for 2008 as a whole were only lower than in 2007 in the East Midlands, South West and Northern Ireland.

Nonetheless, the Index tables show that affordability improved in all parts of the UK, with the exception of the North East and Scotland. This is because in all other regions the small further rise in prices was offset by increases in working household incomes together with a decline in interest rates. At this point it should be noted that this year the whole Index has been revised, based on average mortgage lender interest rates prevailing in the last quarter of the

Table 2.3.1 **Affordability Index**

Based on mortgage costs for first-time buyers and average incomes for all working households

Country/Region	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
United Kingdom	100.0	94.3	95.2	110.5	120.0	122.9	133.3	123.8	143.8	139.0	186.7	181.9	185.7	196.2	194.3
North East	100.0	92.8	96.4	103.6	122.9	121.7	128.9	109.6	114.5	116.9	175.9	179.5	189.2	203.6	206.0
North West	100.0	93.9	90.8	105.1	111.2	109.2	123.5	112.2	120.4	108.2	152.0	160.2	174.5	183.7	181.6
Yorkshire and The Humber	100.0	95.8	92.6	106.3	117.9	116.8	126.3	108.4	120.0	116.8	162.1	167.4	181.1	190.5	188.4
East Midlands	100.0	95.7	93.5	114.1	119.6	119.6	128.3	117.4	134.8	140.2	194.6	190.2	185.9	198.9	195.5
West Midlands	100.0	93.6	89.0	98.2	101.8	104.6	112.8	110.1	122.9	116.5	154.1	153.2	155.0	156.9	156.0
East	100.0	94.5	95.5	113.6	118.2	120.0	137.3	136.4	152.7	148.2	185.5	184.5	186.4	195.5	192.7
London	100.0	104.5	102.7	122.5	136.0	148.6	155.9	149.5	163.1	159.5	212.6	203.6	221.6	234.2	229.7
South East	100.0	91.6	91.6	105.0	118.5	117.6	134.5	131.1	152.1	150.4	189.9	168.9	167.2	173.1	171.4
South West	100.0	93.8	93.8	113.3	123.0	126.5	140.7	137.2	158.4	159.3	208.0	192.9	189.4	197.3	189.4
England	100.0	92.7	92.7	109.2	117.4	121.1	130.3	125.7	142.2	140.4	187.2	180.7	184.4	193.6	191.7
Wales	100.0	89.0	91.0	101.0	116.0	116.0	123.0	119.0	125.0	112.0	167.0	171.0	178.0	186.0	186.0
Scotland	100.0	100.0	103.8	115.4	142.3	144.9	143.6	132.1	134.6	121.8	166.7	157.7	167.9	189.7	197.4
Northern Ireland	100.0	115.5	118.3	143.7	170.4	169.0	184.5	167.6	176.1	159.2	200.0	225.4	271.8	362.0	338.0

Sources: Computed from Regulated Mortgage Survey house prices for first-time buyers and household earnings data from the Expenditure & Food Survey.
Note: Mortgage costs assume a constant 82% mortgage advance to house price ratio, in line with the average over the period. They are based on average mortgage lender rates for new mortgages in the last quarter of the year, and assume a standard 25 year repayment mortgage.

Table 2.3.2 **Mortgage cost to income ratios**

Based on first-time buyer house prices and average incomes for all working households

Country/Region	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
United Kingdom	10.5	9.9	10.0	11.6	12.6	12.9	14.0	13.0	15.1	14.6	19.6	19.1	19.5	20.6	20.4
North East	8.3	7.7	8.0	8.6	10.2	10.1	10.7	9.1	9.5	9.7	14.6	14.9	15.7	16.9	17.1
North West	9.8	9.2	8.9	10.3	10.9	10.7	12.1	11.0	11.8	10.6	14.9	15.7	17.1	18.0	17.8
Yorkshire and The Humber	9.5	9.1	8.8	10.1	11.2	11.1	12.0	10.3	11.4	11.1	15.4	15.9	17.2	18.1	17.9
East Midlands	9.2	8.8	8.6	10.5	11.0	11.0	11.8	10.8	12.4	12.9	17.9	17.5	17.1	17.5	17.2
West Midlands	10.9	10.2	9.7	10.7	11.1	11.4	12.3	12.0	13.4	12.7	16.8	16.7	16.9	17.1	17.0
East	11.0	10.4	10.5	12.5	13.0	13.2	15.1	15.0	16.8	16.3	20.4	20.3	20.5	21.5	21.2
London	11.1	11.6	11.4	13.6	15.1	16.5	17.3	16.6	18.1	17.7	23.6	22.6	24.6	26.0	25.5
South East	11.9	10.9	10.9	12.5	14.1	14.0	16.0	15.6	18.1	17.9	22.6	20.1	19.9	20.6	20.4
South West	11.3	10.6	10.6	12.8	13.9	14.3	15.9	15.5	17.9	18.0	23.5	21.8	21.4	22.3	21.4
England	10.9	10.1	10.1	11.9	12.8	13.2	14.2	13.7	15.5	15.3	20.4	19.7	20.1	21.1	20.9
Wales	10.0	8.9	9.1	10.1	11.6	11.6	12.3	11.9	12.5	11.2	16.7	17.1	17.8	18.6	18.6
Scotland	7.8	7.8	8.1	9.0	11.1	11.3	11.2	10.3	10.5	9.5	13.0	12.3	13.1	14.8	15.4
Northern Ireland	7.1	8.2	8.4	10.2	12.1	12.0	13.1	11.9	12.5	11.3	14.2	16.0	19.3	25.7	24.0

Sources and Notes: As Table 2.3.1.

year, to replace the year end Building Society interest rate series that has now been discontinued.

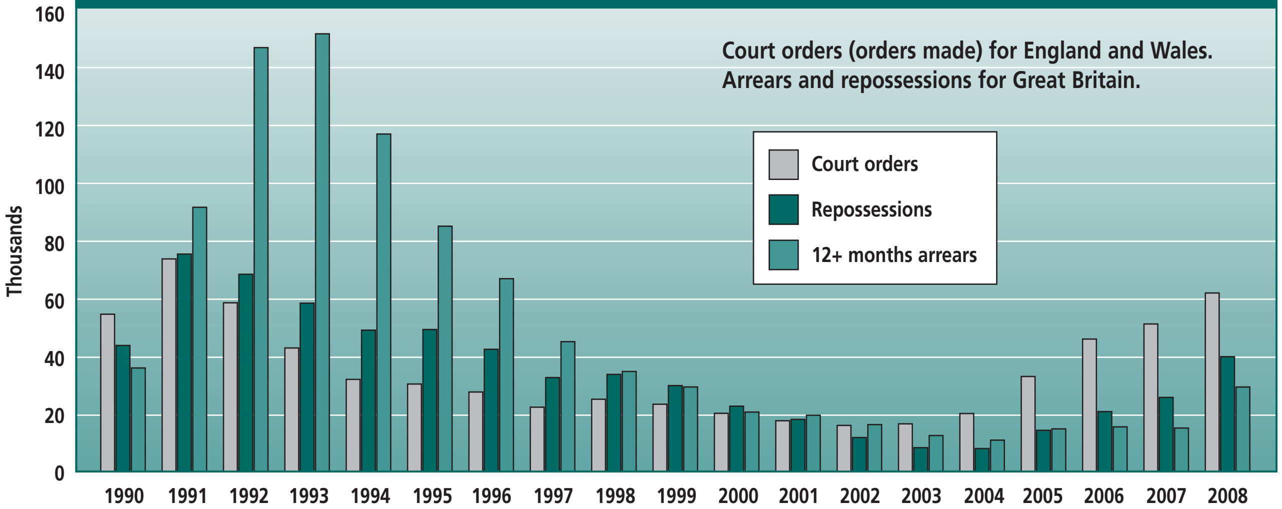
While in practice mortgage advance to income ratios vary from year to year, and have been higher in recent years, the Index applies a constant (82 per cent) assumption over the period so that it represents a single measure of the relative affordability of house purchase by home-buyers.

Similarly, average levels of deposits vary from region to region, but the constant average deposit assumptions enables the Index to provide a single measure of the relative affordability of house purchase between the regions. In practice, however, it must be recognised that there are both wealth and income barriers constraining the ability of households to enter the home-owner sector, and that these apply in a highly variable mix between one home-buyer and another.

The Index starts from 1994; primarily because of difficulties in obtaining compatible household earnings data for standard regions for earlier years. However, if first-time buyer mortgage costs are measured against individual earnings, for which data is more readily available over a long run of years, it is now evident that mortgage cost to income ratios for first-time buyers were higher in 2007 than they were in 1990 at the peak of the last housing market boom (assuming a constant 18 per cent deposit). This is despite the much lower level of interest rates in 2007 (6.1 per cent, compared to 14.5 per cent in 1990).

Figure 1.4.4 (page 44) shows how UK house prices and mortgage costs have moved relative to individual earnings over the longer run of years from 1986. While house prices reached unprecedented levels relative to earnings, in part this reflects the much lower interest rates prevailing now compared to those at the peak of the last housing market cycle. In effect, lower interest rates have now been factored into house prices. The figure shows that by 2007 mortgage costs, even after taking account of higher levels of deposits, had moved very close (at 33.5 per cent of individual earnings) to the level at the peak of the last housing market cycle (34.1 per cent in 1990), before the slight easing in 2008.

Figure 2.3.1 **Arrears, court orders and repossessions rise but remain well below previous peak levels**



Sources: See Compendium Tables 51 and 53.

Mortgage repossessions

The recession and rising unemployment (Compendium Table 1) took their toll in rising levels of mortgage arrears and repossessions in 2008 (Compendium Table 51), and the first half of 2009, but they remain well below the levels experienced in the housing market 'bust' of the early 1990s (Figure 2.3.1).

If repossessions are still much lower than those experienced in the last housing market downturn (in 1991) it should also be recognised that the official statistics do not capture the full picture. In particular, the Council of Mortgage Lenders' repossession data does not include repossessions of dwellings as a result of legal actions by non-mortgage creditors (i.e. credit card providers) who have secured their loans as 'second charges' against the dwelling. Estimates from one local court in London suggest that these could account for some 20 per cent more repossessions than those arising from mortgage defaults.[1]

Nonetheless, while there was a sharp rise in arrears in the first half of 2009 (doubling to almost 60,000 cases in 12+ months arrears by the end of the period), there was a much more limited rise in recorded 'first charge' repossessions, from 21,500 in the second half of 2008 to 24,100 in the first half of 2009.

While unemployment and arrears levels can be expected to continue to rise over the coming year, forecasts of rising repossession levels have been scaled back. Despite the weaknesses in the safety net for home-owners, and in particular the very limited take up of mortgage payment protection insurance policies, the welter of government and industry initiatives introduced over the last year do appear to be bearing some fruit in containing the rise in repossessions.

The government initiatives have included:

- The 'Pre action Protocol' for possession actions on mortgage arrears.
- FSA regulation indicating that repossession should be a last resort.
- Suspending the 9 month delay before support for mortgage interest (SMI) eligibility.
- Deferring reductions in the SMI standard rate of interest.
- Increasing the maximum mortgage eligible for SMI.
- Mortgage rescue schemes across the UK.
- The Homeowner mortgage support scheme to promote 'forbearance'.

In addition, there is no doubt that the reduction in interest rates has played a major part in easing the financial pressures (while at the same time it inflates the number of months' arrears represented by a given cash figure). There is also evidence that while many have been reluctant to sign up to the government Homeowner mortgage support scheme (HMS), lenders have generally adopted policies providing a measure of 'forbearance' (i.e. a period of grace often linked to a short-term switch to interest only repayments).

No doubt lenders have been encouraged in that approach both by the Pre Action Protocol and the FSA regulatory stance, but there is also an element of financial logic in holding back from repossessions at a time when the housing market is very fragile, and where putting more repossessed properties on the market while transaction levels remain low could further weaken the prospects for housing market recovery.

If the adoption of more positive approaches to forbearance by lenders are very much to be welcomed, a recent Shelter report notes that practice remains uneven between lenders, and that despite the regulatory constraints lenders may nonetheless not maintain the same level of commitment to forbearance when the market improves, and repossessed properties can be more readily sold.[2]

Evidence of the unevenness in the mortgage market is also provided by the FSA *Mortgage Market Review*.[3] In particular, it shows the relationship between mortgage type, loan to value ratios, and loan to income ratios and mortgage default. The FSA analysis is based on data from ten of the largest mortgage lenders in the UK, which accounted for just over two-thirds the UK mortgage market in March 2009.

The key results from the FSA analysis are set out in Tables 2.3.3 and 2.3.4. They show only a limited relationship between loan to value ratios and mortgage defaults, and no clear pattern at all for loan to income ratios. More significantly they show a somewhat higher default rate for 'self-certificated' mortgages, and a significantly higher default rate for loans to 'credit-impaired' households. These findings will clearly influence the FSA's stance on the regulation of new mortgage products going forward, and are discussed further in Contemporary issues Chapter 4. One particular conundrum is that greater restrictions on new mortgages for existing credit-impaired home-owners could precipitate earlier repossession against the great majority that do not default despite the higher rates of risk.

If the FSA is clearly thinking about the issues of mortgage risk, there are no such signs as yet of any thinking by government about its longer-term policies once all the short-term initiatives have run their course. Among the most critical issues will be the structure of the safety net for home-owners. In the short term, DWP has suspended the nine month delay before unemployed home-owners can get help with their mortgage interest payments, in recognition of the effective failure of the policy of

Table 2.3.3 **Mortgage default rates by mortgage type and loan to value ratios (LTV) in 2008**
Percentages

Loan to value ratio	Mortgage type					
	Buy to let	Credit-impaired	Self-certificated	Other	Standard	All types
50% or lower	**0.51**	**3.97**	**1.02**	**0.40**	**0.40**	**0.46**
50% - 75%	**0.74**	**5.93**	**1.76**	**0.65**	**0.75**	**0.86**
75% - 90%	**2.08**	**7.57**	**3.42**	**1.30**	**1.24**	**1.65**
90% - 95%	**8.13**	**8.56**	**5.26**	**1.98**	**2.56**	**2.62**
95% - 100%	**6.33**	**8.97**	**9.24**	**2.38**	**2.50**	**2.66**
Over 100%	**3.40**	**16.52**	**6.44**	**1.70**	**5.83**	**4.74**
All LTV Bands	**1.58**	**6.44**	**2.97**	**0.88**	**1.08**	**1.21**

Source: FSA *Mortgage Market Review*.

Table 2.3.4 **Mortgage default rates by mortgage type and loan to income ratios (LTI) in 2008**
Percentages

Loan to income ratio	Mortgage type					
	Buy to let	Credit-impaired	Self-certificated	Other	Standard	All types
2.5 or under	1.54	5.44	3.06	0.50	0.68	1.56
2.5 - 3.5	1.53	7.25	3.24	0.97	1.36	1.35
3.5 - 4.0	1.59	6.07	2.59	1.35	1.19	1.18
4.0 - 4.5	1.72	5.92	2.16	1.46	1.04	1.22
4.5 - 5.0	1.99	5.14	1.42	1.65	0.98	0.88
Over 5.0	2.02	5.18	1.95	1.75	1.07	1.43
All LTI Bands	1.58	6.44	2.97	0.88	1.08	1.21

Source: FSA *Mortgage Market Review*.

using that delay to promote the takeup of private mortgage payment protection insurance policies. But that suspension is only planned to be in place for two years. A new credible safety net policy is needed before that suspension is lifted.

Private renting

The latest figures from the *Survey of English Housing* suggests that the rapid growth in the private rented sector since 2000/01 stalled in 2007/08 (Compendium Table 54a), while 2008 also saw a sharp decline in the numbers of new buy to let mortgage advances (Compendium Table 55). Half year figures show a further sharp fall in new advances, and the full year 2009 figure looks set to be only around quarter of the 2007 level.

The fall in market values has so far had a limited impact on net rental yields. The IPD index shows net yields of 3.5 per cent in 2008, slightly up from 3.0 per cent in 2007, but still way short of the 5.2 per cent net yield in 2001 back at the beginning of the buy to let boom.[4] Moreover, as a result of falling capital values the Index shows total returns on investment falling to −15.3 per cent.

In May 2009, the government published a broadly welcoming response to the Rugg Review on private rented housing and initiated a consultation process on proposed reforms, including a national register of landlords and mandatory regulation of private sector letting and management agents.[5] While the consultation period closed in August the government's post-consultation proposals are still awaited.

However, HM Treasury has not brought forward any proposals to change the tax arrangements for landlords, and the future prognosis for the private rented sector is unclear. While a more regulated mortgage market for home-buyers going forward is likely to increase the demand for private rented housing, the continuing fiscal bias in favour of home-owners (see Commentary Chapter 6 in the 2008/09 edition of the *Review*) and the lower expectations of capital gains in the years ahead will be offsetting factors.

But, if wider tax reforms do not appear to be on the agenda, the Homes and Communities Agency is taking forward its proposals to provide selective funding (and/or land) to promote investment through its Private Rental Sector Initiative (PRSI), and at the time of writing is in discussion with a number of potential investors.

Footnotes

1. Marshall, T. (2008) 'The hidden truth', *Roof*, May/June 2008.
2. Ford J. and Wallace, A. (2009) *Uncharted territory? Managing mortgage arrears and possessions*, Shelter.
3. *Mortgage Market Review*, Financial Services Authority, 2009.
4. *IPD UK Residential Investment Index*, IPD, 2009.
5. *The private rented sector: professionalism and quality: The Government response to the Rugg Review*, Communities and Local Government, 2009.

Key Reading

Compendium of Housing Finance Statistics, Council of Mortgage Lenders, 1997.