

Mortgage market briefing: essential issues for government



Mortgages have been a political hot topic, and will almost certainly feature among the subjects that will concern you and your potential constituents in the run up to the General Election. This brief summary, prepared by the Council of Mortgage Lenders, is designed to give you some key facts, figures and perspectives on the UK mortgage market and the role of government in relation to it.

About us

The Council of Mortgage Lenders (CML) is the trade association for UK residential mortgage lenders. Our 110 members are a mix of banks, building societies, and non-deposit taking lenders. Together, our members account for 95% of all UK residential mortgage lending, and have £1.2 trillion of lending outstanding to around 11 million households.

Our aim is to help to foster a favourable operating environment in the UK housing and mortgage markets. We are the main representative voice for the residential mortgage lending industry, and the central provider of economic, statistical, legal, research and other market information.

Introduction

What happened in the financial, banking, housing and mortgage markets over the past couple of years was unique, and the shocks to the system reverberated across the globe.

The mortgage market was, and remains, dysfunctional. Although there have been definite signs of improvement in recent months, housing market activity is still

considerably lower than what might be considered 'normal'. Funding conditions for lenders remain difficult, and a weak labour market backdrop and equity constraints on borrowers have resulted in the number of housing transactions falling from 1.6 million in 2007 to an estimated 810,000 in 2009. With limited ability and little incentive for borrowers to refinance, overall lending volumes are totalling less than half of the levels seen a couple of years ago. And while exceptionally low interest rates has made it easier for many borrowers suffering payment problems to manage their situation, the weak labour market will continue to put pressure on the level of mortgage arrears and possessions.

Against this challenging backdrop, it is important that policy initiatives reinforce financial stability and do not undermine the tenuous recovery within the housing and mortgage market. So that when 'normality' returns we will still have the sort of competitive mortgage market, serving borrowers' needs at different stages of their lives, that was once the envy of the world.

We would like all the political parties to commit to:

We call on the next government to:

- reform the existing 'slab' structure of stamp duty in favour of a graduated tax structure similar to income tax.

Regulating for the future...

It is easy to forget the successes of the mortgage conduct of business regime which brought statutory regulation to the whole market for the first time in 2004, and the high regard in which the mortgage industry was held in the UK and internationally until funding became more scarce and the economic downturn worsened the financial position of some borrowers.

Before the credit crunch, the vast majority of lenders provided a range of valued products and services and acted responsibly in a highly competitive environment. The financial crisis has resulted in a fundamental change in the mortgage market affecting the availability and price of loans, both now and in the future.

An all encompassing review on the future of mortgage regulation is currently underway by the Financial Services Authority (FSA). While the industry recognises the need for change, the aim should be to encourage a return to competitive conditions, and not inadvertently perpetuate a malfunctioning market in which there are a smaller number of active lenders, fewer intermediaries offering advice, and a funding shortage resulting in mortgage rationing, particularly for those without a large deposit. It is vital to avoid unnecessary regulatory intervention and in particular measures that may constrain a mortgage market recovery.

We call on the next government to:

- avoid knee-jerk regulatory reactions to the global and UK problems in the banking system and in response to mortgage market developments during the recession.
- keep the reform of mortgage regulation as simple as possible and not attempt to fix what is not broken.
- make sure that all of the positive features of the UK mortgage market are retained – a vibrant and competitive mortgage market, encompassing different business models, catering for a wide range of customers, and having the ability to innovate and adapt to changing circumstances.

Improving market participation and funding...

For many years, retail deposits were essentially the only source of funding for lenders. By 2002, however, the scale of outstanding mortgage debt had grown to exceed retail deposits, and the gap between the two continued to widen until 2007.

It was largely filled by new market entrants, often foreign-owned, using wholesale markets to fund mortgage lending. But neither of these sources is currently capable of making a significant contribution to filling the funding gap, and the government and the Bank of England have had to act as a substitute source of wholesale funds.

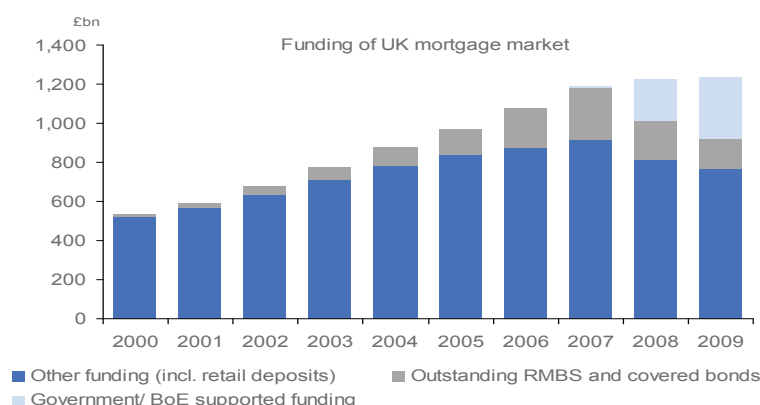
The slow improvement in mortgage market conditions means that cautious lending criteria

will continue. While a shortage of funding persists, the most attractive products will be more readily available to customers with

unblemished payment records and those borrowing conservatively relative to their income or the value of their property. There are also concerns about the unwinding of government funding support. Lenders will have to re-pay £185 billion to the Bank

when the special liquidity scheme comes to an end in 2011. Uncertainty about how these sums will be re-financed will make lenders cautious.

Different types of lending institution, large and small lenders, and firms that rely on different sources of funding, have been affected by the



financial crisis in different ways. The result is that a high proportion of new lending is now being done by large firms. Smaller, deposit-taking firms – many of which are currently writing only a small amount of mortgage business – often face greater regulatory constraints and have benefited less from government support. Many specialist lenders, meanwhile, have been removed from the market by

the closure of wholesale funding options. But the recovery in sentiment both in the UK housing market and in wholesale finance markets may pave the way to a re-emergence of a residential mortgage-backed securities market, allowing specialists to re-enter the mortgage market. It will also help deposit-takers, allowing them to reduce their reliance on retail deposits.

We call on the next government to:

- increase the range of active lenders, and funding capacity in the market overall, to meet consumer needs and enable a return to normal functioning market.
- avoid putting in place unnecessary controls and restrictions on firms. or by regulating the market in a way that deters new firms from entering it.

Simplifying low-cost home-ownership...

Low-cost home-ownership schemes have the potential to increase demand in the housing market, underpin house prices and extend owner-occupation. They can also be targeted at the glut of newly-built property and can provide help for would-be first-time buyers who are currently excluded from the market.

Lenders prefer low-cost schemes based on shared equity – that is, where the purchase is funded by a combination of a conventional mortgage and an equity loan – rather than shared ownership, where the borrower takes out a mortgage to buy a leasehold in a share of the property and continues to rent the rest of it from a housing association or local authority.

Expanding Homebuy Direct (a shared equity scheme designed to help first-time buyers of newly built property) would encourage more lenders to invest in the necessary systems, processes and training to participate, and would provide more help for the beleaguered house-building industry.

At the moment, there are also too many schemes with similar branding. There are at least five Homebuy options, for example. The differences between them are relatively minor but significant. This complexity discourages lenders and confuses buyers, and the problems are exacerbated when numbers for individual schemes are low.

We call on the next government to:

- expand low-cost home-ownership, particularly Homebuy Direct, to increase potential lending volumes and provide more long-term funding commitments.
- simplify and reduce the number of low-cost home-ownership schemes.
- reform existing shared ownership schemes to encourage lenders to participate, and move progressively from shared ownership and towards shared equity models.
- discourage local authorities from imposing onerous restrictions on the occupation of low-cost homes, which deter lenders from participating.