Avoiding peak first-time buyer

By Bob Pannell, Economic Adviser to the Intermediary Mortgage Lenders Association

It struck me as ironic that during the recent general election campaign major political parties pointed to ultra-low interest rates as an opportunity for the state to invest for the future, but in our industry the Financial Policy Committee (FPC) does not apply the same logic to those looking to buy homes.

The FPC's housing tools have prevented our housing market from overheating, but a sane person might reasonably ask whether negligible levels of mortgage arrears and write-downs suggest that its policy risks being heavy-handed.

By limiting the amount of borrowing that a household is deemed able to afford, the FPC's 3% stress test bears down on permissible LTVs in high-priced housing areas such as London, according to a new report[i] from UK Finance and Hometrack. Against the backdrop of a general recovery in mortgage credit risk appetite, first-time buyer LTVs in London, and southern England more generally, have actually fallen back since 2014. In effect, those looking to buy in high-priced areas need to put down a substantial deposit.

As IMLA's recent report[ii] pointed out, the potential opportunity costs for affected households are huge, especially for "rental prisoners" - those who would like to buy and who would find it no more expensive than renting, but are prevented by regulation from getting on the housing ladder.

Although the FPC's rules allow lenders to disapply its stress test when the mortgage has a fixed term of 5 years or more, many lenders choose not to do so in order to guard against conduct risk concerns that a borrower has been led towards higher borrowing.

Perhaps what is needed is a safe-harbour product that would appeal to risk-averse households who need to stretch their incomes beyond the current FPC parameters, for example because they have only a modest deposit, do not enjoy financial support from the Bank of Mum and Dad or simply work/live in an expensive high-demand area?

One idea that surfaced during the general election campaign, in the Conservative Party manifesto document, is for a lifetime fixed rate mortgage. The basic premise - that the borrower fixes the mortgage rate for the duration of the term, and is able to borrow a higher initial amount (higher LTV) than otherwise - was mooted in the Miles Review of the early-mid 2000s, and seen at the time as a rational quid pro quo for the removal of interest rate risk.

Although many of the ideas from the Miles Review were not taken up, the world has changed a lot over the intervening 15 years. Longer-term products are typically more expensive than short-term ones, but crucially the cost difference is likely to have narrowed significantly in today's ultra-low interest rate environment. The flexibility to repay early at little or no explicit cost is a key issue for consumers but this can be built into the overall mortgage pricing. For intermediaries, a trail commission system would be needed to get them on board.

Whether lifetime fixed rate mortgages are viable or not, the industry needs the FPC to show a degree of flexibility.

Even with the benefit of material state support, first-time buyer numbers are only increasing by about 2% a year.

With HTB ISAs now ended, the population of 25-34 year olds (a key first-time buyer age cohort) moving gently into reverse gear and the Help to Buy Equity Loan scheme scheduled to close in 2023, there is a danger that we are close to peak first-time buyer.

Lenders see a clear need for fresh policy action, not least to plug the significant gap that will be left when Help to Buy Equity Loan scheme expires. At this stage, it seems likely that a smorgasbord of proposals will be brought forwards, rather than a single large-scale solution. Increasing lender appetite for higher LTV business will be a core theme, and lifetime fixed rate products could be part of the mix.

While the Bank of England has understandable concerns about the return of high LTV lending, the story in recent years has been one of gentle evolution. The industry sees continuing growth in higher LTVs as important to the future health of the housing market and we need to reassure the regulator that it is also consistent with macro-prudential stability.

[i] *The changing shape of the UK mortgage market*, UK Finance, December 2019
[ii] *The intergenerational divide in the housing and mortgage markets*, IMLA, October 2019