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INTERMEDIARY MORTGAGE LENDERS ASSOCIATION

General Election Wishlist

November 2019

As the UK gets ready for another general election, the Intermediary Mortgage Lenders Association (IMLA) has published its General Election Wishlist for the UK housing market. IMLA has identified a number of key areas of focus which the Association believes should be at the top of the incoming Housing Minister's in-tray when the outcome of the election is known and a new government is formed.

Summary

Getting the mortgage market moving

- Those who are unable to buy property will be significantly disadvantaged financially throughout their adult lives – by as much as £350,000 according to IMLA research. This inequality will persist unless those who can afford to service reasonable debt and purchase property are enabled to do so. Current rules on assessing affordability - compounded by the additional 3% stress test required by the Financial Policy Committee on top of lenders' standard variable rates SVR rates - are simply unrealistic. This is preventing many first-time buyers from being able to access the housing market.

- The over-arching – and significant – challenge for the new government will be to balance measures designed to help first-time buyers and increase the supply of new properties while not fuelling house price inflation (which would merely increase the size of deposits required and put home ownership further beyond the reach of many).

- The whole industry – builders, lenders, regulators and the government – must focus on what will replace Help to Buy. Future schemes need to be robust in terms of consumer protection, while not being unnecessarily constrained by regulatory requirements. There may be scope to extend the existing Shared Ownership scheme but this must be developed in a consistent and coherent way to maximise lender support.

- A thorough review of the impact of stamp duty across the whole range of property values is overdue.

- There is a clear need for more properties which are well-designed for older people who wish to move but do not wish to live in specific retirement developments.

Buy to Let

- The private rented sector is an essential part of the housing market, meeting an increasing proportion of the demand for rented property which was previously met by social housing.

- Government should beware making further changes which may disincentivise landlords from making further investments in the sector. If significant numbers of landlords exit the market, the supply of properties available for rent will decrease, causing rents to rise, which will disadvantage those who are unable to buy and must remain as tenants.

The Mortgage Market Study

- The Financial Conduct Authority's Mortgage Market Study includes measures designed to address perceived detriment to consumers. Some of these measures may have unforeseen consequences. For those borrowers whose loans have been sold to unregulated entities, and who may be suffering detriment, it would be preferable to give the regulator powers to require that such borrowers are treated fairly rather than introduce complex processes for moving them to new lenders.

- In formulating its proposals, the FCA has clearly concluded that there is consumer detriment to borrowers whose mortgage has been sold to an unregulated entity. IMLA supports an extension to the FCA's regulatory remit in order to close this loophole.

1. Getting the housing market moving

A healthy housing market needs movement at all levels. Helping first-time buyers on to the ladder is an important step, but continued progress up that ladder – thereby releasing homes which are suitable for upcoming first-time buyers (FTBs) – is just as important. The market will be severely constrained unless the second steppers and last time buyers are also able to move. Some may not have the financial resources or the practical need to move. Modern work patterns are changing and it may be the case that fewer home moves are dictated by a long-term change in employment requiring relocation.

Where practical, some households may prefer to extend an existing property. This in itself may change the character of significant elements of the housing stock. If, for example, lots of bungalows are extended into two-storey properties it may make them less practical, desirable or affordable for those who specifically require a smaller one-storey property.

Other homeowners may wish to move but be put off by the costs of doing so. Stamp duty, in particular, may present a significant disincentive.

Affordability

Much has been said about the inability of first-time buyers to get on the housing market. Whilst interest rates remain at a historically low level, first time buyers face a number of problems.

Despite much better availability of higher loan-to-value (LTV) mortgages, many buyers must still find deposits of 20% - 25%, which is beyond the reach of many.

More stringent affordability tests introduced by the Financial Conduct Authority

(FCA) mean that more mortgage applicants are being rejected – even though some may be paying more in monthly rent than they would if they were making monthly mortgage repayments.

The Financial Policy Committee (FPC) has raised the bar for mortgage applicants by requiring lenders to stress-test applicants' ability to repay at 3% above the lender's normal Standard Variable Rate (SVR). This appears excessive, because first-time buyers will often be eligible for discounted products – yet they are being subjected to stress tests set at rates much higher than they would realistically be expected to pay.

IMLA has argued that the FPC's 3% stress test on top of lenders' SVR rates is overly cautious and prevents many first-time buyers from being able to enter the housing market.

We have also noted the significant financial disadvantages which may be encountered by those who are unable to buy and accumulate wealth throughout their adult lives. This inequality will persist unless those who can afford to service reasonable debt and purchase property are able to do so.

Help to Buy

The post-financial crisis measures introduced by the financial services regulators have bitten deeply into the housing market, with many aspiring borrowers finding themselves unable to get mortgages of the size needed to buy their target properties (or unable to get mortgages at all). First-time buyer activity has been underpinned by the Help to Buy Scheme, which is due to be phased out from 2021 (by being restricted from that date to first-time buyers) and terminated completely in 2023.

While Help to Buy has undoubtedly played an important role in supporting new house building, it has attracted some criticism – principally, that borrowers have been enabled to "leap-frog" so that their first purchase is not a smaller "starter" home, but a larger one. Builders have met this demand by building more second-movers' homes. Critics also claim that some two-thirds of those who have taken out HTB equity loans could have bought without taking advantage of the scheme, and have been helped to buy more expensive properties than they could otherwise have afforded.

Whatever the merits of these arguments, the fact remains that at least one-third of those who have benefited from HTB would not otherwise have been able to purchase a property and would still therefore be renting or living at home with parents.

Any scheme which features new-build property inevitably requires long lead-times as builders identify and acquire sites for development and then commence build-out. That process will already have started for sites where new properties are expected to be completed by 2023. It is essential that the industry – builders and lenders, together with regulators and the government – focus now on what will replace HTB and ensure that schemes are robust and future-proofed in terms of consumer protection, while not being unnecessarily constrained by regulatory requirements.

We are aware that some lenders are looking at alternatives to HTB, including schemes which could "top up" loans, thereby increasing the LTV for the borrower, whilst not increasing the requirement for the lender to keep additional capital. Such schemes are at an early stage of development and, though they may provide a useful addition to the options available to buyers, are unlikely to fill the gap left by HTB completely.

Potential to expand Shared Ownership

There may be scope to extend the existing Shared Ownership scheme, which has been in place for over 40 years, and is supported by a number of IMLA members. It also benefits from clear and consistent processes which are uniformly adopted by the developers, be they housing associations or private companies. The scheme has the potential to go some way towards replacing HTB for those who cannot afford to buy outright but, in order to be truly effective, requires properties to be built in significant volume.

Stamp duty

Stamp duty remains a significant deterrent to many who might otherwise be considering moving. The government's Stamp duty "holiday" for first-time buyers, whereby the rate was zero for the first £300,000 of the purchase price on any home costing up to £500,000, has assisted some FTBs. However, it may also have had the effect of increasing the prices of the properties they were seeking to buy, as it became clear that they would have more cash to play with.

Stamp duty may also deter older homeowners from moving to more suitable properties because the tax will add extra cost to the process. This was discussed in a report published by IMLA in April 2019 (Last-time buyers: The challenges and opportunities for 55+ home-owners wanting to move home). That report noted that relieving the stamp duty burden for older households might risk concerns about inter-generational unfairness and that piecemeal reform of the tax might result in unintended consequences. Indeed, across the UK there is already significant variance in relation to levels of stamp duty, given that the power to levy the tax in Scotland and Wales is devolved to the Scottish Government and Welsh Assembly respectively.

IMLA believes that a thorough review of the impact of stamp duty, across the whole range of property values, is overdue. It may be possible to make changes which will not significantly affect the tax revenue gained whilst mitigating against the disincentives to moving which are currently causing stagnation in some areas of the housing market.

Building the right types of properties

The IMLA report referred to above also noted that one of the main factors inhibiting older homeowners from moving is a lack of suitable housing. While some homeowners may wish to move into specialist retirement developments, this will not have universal appeal, and there is a clear need for properties which are well-designed for older people but situated within mixed developments. Enabling older homeowners to "right-size" rather than necessarily "down-size" to more suitable properties would help free up some larger housing stock and help reduce the log-jam further down the property chain.

Buy to Let

The private rented sector (PRS) plays an essential role in the housing market – providing homes for 20% of UK households (compared with 17% who are in the social rented sector, 28% who own with a mortgage, and 34% who own their home outright).

Impact of tax and regulatory changes on the sector

IMLA has published two reports: Buy to let under pressure (February 2018) and Buy to let at a crossroads (July 2019). These examine the impact of changes to the tax regime surrounding BTL which was deliberately brought in with the intention of rebalancing the private rented sector with home ownership. These changes have significantly reduced the amount of new investment in the PRS which is vital to the supply of homes for those who don't qualify for public rented accommodation and can't afford to buy. Between 2015 and 2017 there was an 80% slump in new investment – from £25bn to £5 billion.

Some buy to let investors who are higher-rate taxpayers now face tax rates of over 100%. For example, an investor with an average-priced property producing average rents with a 75% LTV mortgage at 4% interest could have expected to see an annual post-tax profit of £212. Once the tax changes take full effect this will transform into a loss of £1,144 – which represents an increase in the tax rate on the BTL property from 40% to 116%.

Landlords' decisions about whether to stay in this market may be influenced by the gross rental yield which they are able to achieve: this varies across the UK with the north of England currently producing the highest yields – 5.1% in the north east followed by 5.0% in the north west. For higher rate tax payers, however, with a 75% LTV mortgage on an average-priced property producing average rents, cash flow after tax will be negative in every region of the country once new taxes fully take effect. Landlords in areas where the rental yield is lower may be more influenced by the potential for house price growth in the area.

Recognition of the importance of the sector

IMLA has consistently argued for the government to resist making further changes which may disincentivise landlords from making further investments in the PRS, which plays an essential role in the housing market, providing homes for around 20% of households. If landlords exit the market and the supply of properties available for rent decreases, rentals are likely to increase, which will disadvantage those who are unable to buy and must remain as tenants.

2. The Mortgages Market Study – changes to mortgage regulation

Making the market work better

The Financial Conduct Authority's Mortgages Market Study: Final Report, published in March 2019, concluded that the market is generally working well. It expressed a view that an estimated 30% of consumers could have got better deals – a position which has been challenged by the industry on the grounds that it requires a great deal of qualification and contextualisation. The FCA has proposed a number of remedies to address the perceived detriment to consumers: we think it should be careful what it wishes for as there are consequences – seen and unforeseen – which may arise from some of its proposed changes.

The FCA claims that a number of borrowers have been "diverted" down the advice route unnecessarily – and states that it is not opposed to execution-only as a sales channel for non-interactive transactions. We caution against upsetting the balance too far in favour of non-advised sales. Many consumers – particularly first-time buyers and those with complex circumstances – will benefit from professional advice and guidance in order to ensure they take out a suitable mortgage product. It would be very regrettable if, in another couple of years' time, the FCA were to conduct a study which concluded that consumers were suffering detriment because they had not taken advice and had consequently bought unsuitable products.

Price should not be the main factor in deciding which product is "best". The focus needs to be on whether the product is appropriate, not whether it is the cheapest. Many factors may influence the final decision, which is why advice is so important.

Without a fully advised process, customers could find themselves unprotected against other possible life events, for example, if they fail to take out critical illness cover, life assurance etc.

The market is generally working well – so it doesn't need a lot of upheaval to make it work (even) better for the minority of customers who might have got a better deal.

Helping consumers who cannot remortgage

A lot of assumptions have been made about so-called mortgage "prisoners" who cannot remortgage and find themselves "trapped" on uncompetitively high interest rates. By its own admission, the FCA has relatively little information about who these customers are and their individual circumstances. This is particularly true of those whose mortgages have been sold to unregulated investors. We understand that the FCA is currently undertaking further research to find out more, and we welcome this. IMLA has, however, pointed out that:

- Not all those who do not switch are necessarily "trapped" – some may choose to stay with their existing lender for a variety of reasons and circumstances. Some may be paying relatively low interest rates and see no urgent need to switch.

- A significant proportion will not be eligible for products with new lenders – because, for example, they are in arrears on their existing loans, or may be in negative equity.

Doing more to protect borrowers whose loans remain with the current owner

The thrust of the FCA's activity has been on helping borrowers to remortgage with new lenders. We have argued that the FCA should also look at the issue from another perspective – that of doing more to help those borrowers by requiring the current owners of the loans to treat them fairly. The obstacle to this approach is that the FCA does not currently have the power to ensure that customers of unregulated owners/investors are protected in the same way as those whose loans are owned by regulated firms. If this situation persists, there will be a permanent risk that future groups of borrowers may find themselves in the same position as those whom the FCA is currently seeking to help.

In formulating its proposals, the FCA has clearly concluded that there is consumer detriment to borrowers whose mortgages have been sold to unregulated entities: it has also stated its view (in its recent Policy Statement PS19/27) that "there is a case for extending the regulatory perimeter to capture all mortgage loans. We would support an extension to the FCA's regulatory remit in order to close this loophole.