Helping more people become First Time Buyers

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About the Author

Dr Gerard Lyons is a Senior Fellow at Policy Exchange. He is one of the UK's leading economists, having been described by *The Times* as "one of the most influential analysts of the global economy". In 2019, Gerard was a candidate for Governor of the Bank of England and over the last three decades he has held senior positions in both the City and public policy. Regarding the latter, Gerard was the Chief Economic Advisor to the Mayor of London, Boris Johnson, 2013-2016. In 2008, he was Lead Advisor on Prime Minister Gordon Brown's Business Council for Britain. He has sat on several councils of the World Economic Forum between 2009-2014, as well as on the International Council of the Bretton Woods Committee between 2008-2016. He has also testified to committees of both the US Senate and House of Representatives, and has spoken at many international fora including the IMF, World Economic Forum and Asian Development Bank among others. In the City, Gerard has held several senior roles with leading international banks. From 1999-2012, he was Group Head of Global Research, Chief Economist and Advisor to the Board at Standard Chartered, which emerged from the global financial crisis as the second most capitalised bank in the world. He also held wider business roles there, as a member of the Executive Forum and Risk Management Committee. Before the 2008 global financial crisis, he was one of two British economists to predict a deep imminent recession. And in 2010-2011, Gerard and his team was ranked the top forecaster globally by Bloomberg. Prior to Standard Chartered, he was Chief Economist and Executive Director for over a decade at DKB International, then the largest bank in the world, and before that was Chief UK economist at Swiss Bank - before beginning his career as an economist at Chase Manhattan. Since May 2016, Gerard has held a portfolio of roles. He is Chief Economic Strategist at Netwealth Investments, which he helped establish in 2016. He sits on the boards of both Bank of China (UK) and BGC Partners, the leading global brokerage company. He also sits on the advisory boards of the Grantham Research Institute on Climate Change and the Environment at the LSE and Imperial College and of Warwick Business School. Earlier this year, he testified to the House of Lords European Affairs Committee on the City and during the pandemic he testified to the House of Commons Treasury Select Committee on the economic impact of the pandemic. He, too, has been the external member on public affairs appointments committees and is a member of the Economy Honours Committee.

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1. Introduction and policy recommendations:

- One of the critical areas for a new Prime Minister is to address the challenges in the housing market, and to help turn Generation Rent into Generation Buy. Addressing the housing crisis should be a central feature of economic policy over the remainder of this Parliament and into the next.
- In October 2019, Boris Johnson committed to helping turn Generation Rent into Generation Buy. Although the number of first time buyers has continued to rise since then, the need to focus on the pandemic has meant that this domestic issue has not been as centre-stage as it might otherwise have been. Now this is changing, following the announcement in June 2022 that there will be a mortgage market review. This review could be transformational in the direction that it takes future housing policy. This issue is likely to feature high on the list of issues facing the new Prime Minister.
- It is widely accepted that addressing the housing crisis necessitates more supply. That is a critical issue. It is about both new properties and increasing the turnover among existing properties. One of the big political battles in recent years has been about planning reform, to remove the restrictions on new supply. This also can link in with issues linked to the green belt. We are not addressing this political hot-potato in this paper, but it would be wrong to write a paper on housing without drawing attention to it. Likewise stamp duty, which has become a significant cost to the buyer and can act as a deterrent to people moving , or even downsizing. But even if it was possible to both increase supply within new and existing properties, and also possible to improve turnover, the housing crisis will not be solved. To do that – in addition to increased supply and turnover - also necessitates addressing the issue that is the focus of this paper: finance. This is an equally important area that often does not receive as much focus in the policy debate – namely there should be a renewed focus on increasing the availability of finance to those who wish to become first time buyers. This is a demand side issue.
- Lenders face a credit risk and an interest rate risk in their lending. Also, with house prices high and the economy facing a difficult immediate outlook, the danger is that such risks could mean lenders could withdraw some of their lending products.

The recommendations are:

- After the success of 'The Right to Buy' and 'Help to Buy' it is now time for the government to encourage and unveil, 'Finance to Buy'. This is not a new scheme of the government's but instead a new approach: to facilitate the market in providing the solution to Generation Rent becoming Generation Buy.
- This is driven primarily by taking steps to ensure the market mechanism works more effectively. It is not about using tax payers' money.
- This requires a need to address directly the three hurdles facing potential first time buyers: the difficulty of being able to get a deposit, the loan to income (LTI) limits on borrowing, and access to high LTV mortgages.

A three- pronged approach is needed.

- The first option is our preferred one. This is aimed at allowing the market to provide its own-solution – such as blended mortgages, which are outlined below - with the government playing a supporting role by:
  - (a) removing unnecessary rules and regulations that may inhibit the ability of borrowers to access finance;
  - (b) ensuring that there is no systemic build-up of risk within the system as regulations are eased;
  - (c) facilitating the ability of people who cannot afford a deposit to access a mortgage. It is possible to have your rent count towards your credit score. This should be made compulsory. Furthermore, it should be a prelude to working with the market to ensure provision of 100% LTV mortgages to this group of potential buyers: those with a long history (say three years) of paying rent on time.
- The second option would not be needed if the first option work. But, given where we are in the economic cycle, it is an approach that warrants serious attention, as house prices could always fall. This is to proceed down the insurance route. Here the UK could look at best practice from other countries – such as Canada, say – as well as to build upon the UK government's Mortgage Guarantee System[1] and to ensure that there is sufficient insurance protection to encourage lenders to lend more to first time buyers.
- Third, to accept that there is no one silver bullet to address this challenge and to both provide policy help and incentives for both insurance products to develop and for the market to provide innovative mortgage products.

The specific policy implications are:

- Recognise that the government cannot micro-manage the mortgage market and should step back to allow the market to provide the greater flexibility that is needed by borrowers.

1. https://www.gov.uk/government/publications/the-mortgage-guarantee-scheme The Mortgage Guarantee Scheme, "Provides background on why the government has introduced a mortgage guarantee scheme, and how it works. The scheme is open to new 95% mortgages until 31 December 2022, with participating lenders offering 95% mortgages under the government guarantee from 19 April 2021."

- Avoiding any build-up of systemic risk remains important. But before the 2008 global financial crisis, the regulatory pendulum was at one extreme, too light, and in the years after it swung to the other extreme, too heavy. There is scope to ease requirements, in the area of housing, without seeing a build-up of systemic risks. Thus, easing but not removing fully the financial regulations placed upon lenders and borrowers is an important step to take. This would be the trigger for the increased innovation that is needed in the mortgage market and see the growth of blended mortgage products.
- Ease the constraints on the amount of lending through high loan to income (LTI) mortgages. This could include increasing the amounts that can be allocated by raising the LTI ratio, and encouraged the provision of market based, blended mortgage products.
- Encourage longer-term fixed rate mortgages to become more widespread. To be clear, this should constitute a move from two- or five-year fixes, to, say twenty, or longer. As we may see as policy rates rise, short-term fixed rate mortgages may not offer much protection to some borrowers.
- Work with the ratings agencies and lenders to ensure that it is mandatory for paying rent to count towards a credit score, in order to allow good credit borrowers who cannot save for a deposit to be able to buy. There is a need to ensure the provision of high LTV mortgages to credible borrowers who have a long track record of paying their rent but who do not have access to enough funds to pay a 5% deposit to be able to buy and take out a mortgage (and in which the monthly mortgage payments may be even less than the rent that they have shown that they are able to pay). This suggests that 100% loan to value mortgages are needed. Yet a 95% LTV is currently seen as a de facto limit and high LTV are often viewed as borrowings above 80%. The aim is not to trigger a build-up of systemic risk, or to see lending conditions become slack, but rather it is to deal with the reality of very high house prices in relation to earnings, and accepting that deposits are too great a hurdle, even for good quality creditors.
- As a further step to prevent buy to let landlords from squeezing out first time buyers, lift the pension cap, so as to discourage people who may have hit the cap from buying properties as an alternative to adding to their pension pot.
- Some government interventions have proved both popular and successful. Schemes such as Help To Buy have achieved success. Also, government schemes where people can share the equity in a new development work. But not everyone wants to live in, or where, such new developments are, so broaden the focus to allow existing successful government schemes to work in tandem with the market, and to phase out official schemes if they are seen as no longer necessary.

- These proposals are not expected to create new, systemic risk. And while it is hard to be precise about how many people could benefit, **the figure could be as high as three million, a huge number.**

2. Overview of the issues

In June, during an important policy speech on housing, Prime Minister Boris Johnson talked of allowing benefit recipients to buy properties, of extending the right to buy for housing association tenants and of a review of the mortgage market.

It is on this latter aspect – the review of the mortgage market - where this paper seeks to add to the policy debate.

Although the PM's intention to have such a mortgage market review did not attract as much attention as some other aspects of his speech, this review has the potential to trigger an important shift in UK housing policy. Housing remains a huge political and policy issue and this is an opportunity to address it.

Furthermore, this is an issue that transcends who is the occupier of Number 10. It is a central issue – for the economy – and also possibly for the electoral success of the existing government. Indeed, as we approach the next general election, expect all the main political parties to focus on the issue of housing – and of Generation Rent – in their manifestos, as they did in the last. This paper, which is politically neutral in its approach, may have appeal across the political spectrum.

In spring of last year, I produced a detailed report[2], looking at this topic and proposed a series of policy recommendations. That research landed well and influenced the debate. It is now time to update that research, particularly as we emerge from the pandemic, and in the wake of the recent announcement from Prime Minister Johnson. That paper covers in more detail some of the issues raised here, such as examples of how the market has provided blended mortgages which combines the ability of lenders with different aims and risk appetites to provide a wider array of mortgage products, including to first time buyers. Over the last year house prices have continued to rise at a rapid pace, the U.K. population has increased significantly partly because of the liberal approach to post-Brexit immigration, but unfortunately planning policy has not been reformed thus making it harder to build in areas where there may be demand and questions have continued to be raised about whether housing supply can keep pace with demand. Many people may, for instance, want to live in London and the south-east. Hence the importance of planning reform.

In fact, the generally accepted view in many discussions on this topic is that supply is the issue. Notwithstanding the issues that need to be addressed on supply and regarding planning, more attention needs to be

2. Gerard Lyons, 'Helping Generation Rent become Generation Buy', Policy Exchange 8/2/2021 https://policyexchange.org.uk/wp-content/uploads/Helping-Generation-Rent-become-Generation-Buy.pdf

focused on the demand side and, in particular, on the issue of finance.

There needs to be a radical change in the mortgage market, with a successful mortgage market review triggering the changes needed to enable first time buyers to be able to access finance and at an affordable level.

Addressing the housing challenge (some call it crisis) should figure prominently in economic policy over the remainder of this government and in the policies announced by the major political parties ahead of the next election. Helping Generation Rent to become Generation Buy is central to future policy success.

After, 'The Right to Buy' and 'Help to Buy' it is now time for the government to unveil, 'Finance to Buy'. The focus should be to help facilitate the ability of borrowers to access finance and the best way to do this is remove any impediments that currently exist.

Addressing problems

What are the problems that need to be addressed in the UK housing market? Effectively these fall into three interlinked categories.

- One, is that house prices are increasingly unaffordable for many people, particularly for those who wish to get onto the so-called housing ladder. This is likely to make lenders more cautious about lending, and thus could lead to a more restrictive approach to lending for mortgages. Policy needs to be mindful of this and help where it is necessary.
- Two, is the whole issue of supply and although the immediate response is to say that we need to build more supply, this supply issue is far more complex than that. It is not just about building new properties. It is also about the need to increase turnover in the secondary market and to improve the utilisation of existing properties. And, when it comes to new-builds it not just about building new properties but also about more supply of affordable properties in places where people want to live and also of the type that people want to live in. Namely such properties need to be good quality and also for some buyers the properties need to look beautiful too[3]. This paper does not argue with the need to build more but that is only part of the solution and is not our focus here.
- The third issue is about financing. This is the focus of this paper, namely how to help ensure that there is sufficient financing available for those people who wish to become first time buyers. It is this area that is of particular importance in terms of helping turn Generation Rent into Generation Buy.

Despite a continuous stream of official interventions in the housing sector, over many years, there is still a large number of people who may wish to buy a property who currently do not have the access to finance to be able to do so.

3. See Jack Airey, 'The Duty to Build Beautiful', Policy Exchange, 9/10/2019 https://policy-exchange.org.uk/publication/the-duty-to-build-beautiful/

The numbers that rent

The latest official data on the numbers who rent is from 2018[4] and showed a sharp rise in the number of households that rent to 4.5 million in 2017, from 2.8 million a decade earlier. This should be no surprise, particularly given the continued upward trend in the UK population and also in the changing nature of UK households, with a rise in the size of smaller households. The 2021 Census also showed that younger households made a large proportion of the private rented sector, and a very small proportion of the social rented sector. For instance, 16-24 year olds made up 12.6% of the private rented sector and 2.7% of social renters, while for 25-34 year olds the respective figures are 30.9% and 15.3% and for 35-44 year olds it is 21.4% and 14.2%[5][6].

The biggest gainers, so far, from government interventions have tended to be property developers. Homeowners too, have fared well, given that house prices have risen for some time. Often though, it is only if they trade down that owners are able to realise their gains. For those who are trading up, rising house prices usually mean paying more too.

The unambiguous losers are those who are renting and who wish to become property owners. They used to be seen as young. Now they are young but getting older.

The average age of the first time buyer has continued to edge up and is now 32. Even working in a well-paid professional job, one's role is no longer a guarantee to be able to afford a property, given how high prices currently are, and given the large deposits required and also the constraints on borrowing through limits on very high low to income (LTI) mortgages.

Also, even though there is considerable uncertainty about the immediate outlook for house prices – and thus prices could fall given the uncertain economic outlook - a continuation of the longer-term trend would suggest that the future outlook will be for prices to rise. If so, this would further exacerbate the challenges facing potential first time buyers. But there is no doubt that, were interest rates to rise, then this would impact borrowers, particularly those borrowing on variable rates and the large numbers that will see their fixed rate deals mature this year, and next.

Risks

Credit risk and interest rate risk, combined with high house prices and where we are in the economic cycle make the current juncture more difficult. House prices could fall. Yet, the longer-term trend has been up. Avoiding highly indebted borrowers and heeding lessons from the 2008 global financial crisis, including the need to avoid financial distress, are important issues. But the importance of these is not to suddenly turn the mortgage taps off – which is the danger in an economic downturn. Rather it is to ensure that risk is being properly assessed, either through an enhanced insurance scheme or through allowing the market to assess and absorb the risk

Currently house prices are high, based on historical metrics such as

4. ONS,'UK Private Rented Sector 2018' https://www.ons.gov.uk/economy/inflationandpriceindices/articles/ukprivaterentedsector/2018#:~:text=1.-,Main%20points,1.7%20million%20(63%25)%20households.
5. Census 2021, https://census.gov.uk/
6. English Housing Survey Data on Private and Social Renters https://www.gov.uk/government/statistical-data-sets/social-and-private-renters

price to income. At the same time, as noted, the immediate outlook for house prices is not clear. While the trend for house prices has been up, there can occasionally be setbacks. The two macro-economic variables that might be seen as negative for house prices are rising interest rates and higher unemployment. Now, interest rates are rising, albeit from low levels. Meanwhile, even though unemployment is low, the economy looks set for a sharp slowdown, and this could change the outlook for jobs. The combination of these factors: high house prices, and the possibility of a correction as interest rates rise and possibly even as unemployment rises too, could reinforce the perception that controls on lending should not be relaxed. It is a perennial feature of the housing market, while prices keep rising, pressure persists to keep controls on lending in place.

This backdrop invariably makes it more difficult for borrowers to access the finance needed, by taking out high loan to income or very high loan to value mortgages. But why shouldn't people be able to take these out? Why should people not be allowed to borrow heavily if they wish – the proviso is that provided that lenders are comfortable to take on this risk – and on the basis that people can afford to service their mortgage?

After all, surely lenders who lend in the housing market are able to assess and price for risk?

Too often first time buyers cannot access the finance that the need to buy. This hurdle is huge and even applies to many people who have a long track record of paying their rent and who should be seen as good potential borrowers.

Hurdles include the deposit required, the limits for many people in terms of loan to income borrowing and also the availability of high loan to value mortgages.

More particularly, though, if someone has a long – perhaps a very long – history of paying rent on time on their rented property, why should they not be allowed to borrow 100 per cent of the value of a property? And even more reason if the amount paid in mortgage payments each month is less than the amount paid in rent – which it may often be?

Why if, as we saw last year, when house prices rose more in a year than annual average earnings, should renters be forced to sit back and see prices move more out of their reach?

Also, in deprived areas, why, if they can afford to make the monthly payments, should people not be allowed to buy more than the price of a property – say a 110% loan to value, where the extra 10% can help renovate the property – and also in the process add to its value?

The argument is that government intervention is needed if there is a market failure. Yet, all too often government interventions in the housing market to help people to buy, have led to higher prices. Temporary periods of cuts in stamp duty are just one example. Thus, interventions that boost prices should be avoided.

Also, the unintended consequence of government intervention is that it might deter or prevent market solutions from being found. So, as welcome and successful as measures such as Help to Buy have been, there is now a need to think differently and to seek a market solution first through removing rules or regulations that may hinder the growth of first time buyers.

The issue here is what can be done – from a policy perspective – to facilitate the ability of first time buyers to access the finance that they need to buy? The number of first time buyers continues to rise. This is good. But the continued rise in house prices poses a significant challenge for first time buyers, particularly in terms of having sufficient funds to afford a deposit or even be able to borrow enough because of regulations on loans to income that may limit access to borrowing.

3. First time buyers

The numbers

The data on first time buyers can be interpreted in two ways. Progress is being made, but there is still much to do.

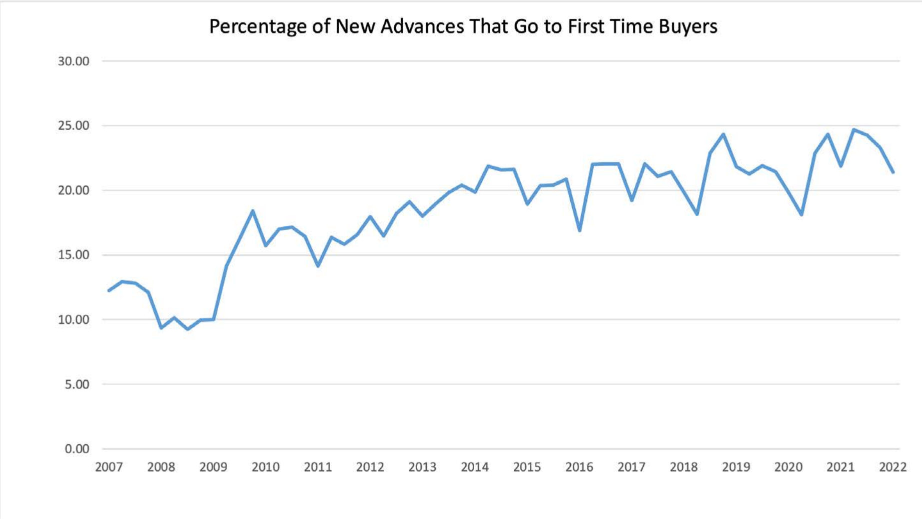
Latest data, released in June, on the state of the mortgage market suggests that the government still has its work cut out in terms of turning Generation Rent into Generation Buy.

It goes without saying that the scale of the mortgage market is huge. Total outstanding residential mortgages were £1.63 trillion (or £1,630.5 billion). Gross mortgage advances were £76.9 billion in the first three months of this year. Although this was up on the previous quarter, it was 7.5% lower than a year earlier. Furthermore, first time buyers account for less than one-quarter of gross mortgage advances. This is far too low to deliver upon a new Generation Buy. This ratio and the amounts allocated to first time buyers needs to increase considerably

As the table below shows, in column three, the ratio going to first time buyers has been below one in four of overall advances during the last couple of years. While this may be lower than ideal, as the graph indicates, the trend has been upward. The case for official intervention exists if one felt either that this trend was about to level off, or that even if it was to continue, it was still leaving far too large a number who were not accessing finance. The push-back, of course, might be that the market would do more if the uncertainty of possible government intervention was removed.

Category	Total (LHS) £ (billions)	Remortgage (RHS) %	First time buyers (RHS) %	Buy-to-let (RHS) %	Home movers (RHS) %
Q2 2020	44.2	37.8	18.1	14.4	23.4
Q3 2020	62.5	25	22.9	12.5	32.9
Q4 2020	76.6	18.5	24.3	11.1	39.6
Q1 2021	83.2	18	21.9	11.7	42.3
Q2 2021	89.1	16.5	24.7	11.4	41.7
Q3 2021	73.4	22.9	24.3	11.9	34.6
Q4 2021	70.2	28.1	23.3	11.8	29.7
Q1 2022	76.9	29	21.4	13.4	29.3

Source: FCA



Source: Constructed using FCA data

A positive development – and a sign that recent developments have proved successful – is that there has been a significant rise in the number of first time buyers over the last decade. This would suggest that both the market and government measures have proved successful. Yet, as good as the recent trend is, it is perhaps not good enough.

According to the Halifax First Time Buyer Review[7] last year saw a rise in the number of first time buyers to 409,370. This represented 48% of all home purchase loans – by number but not by amount lent.

Similar figures in 2020 were 303,970 and 50%. While, in 2009, the year after the global financial crisis, for instance, the figures were 193,940 and 39%. Because the amounts borrowed by first time buyers are less than by those already in the market who are purchasing more expensive properties this helps explain why the total amounts borrowed by first time buyers are far lower than this 48% figure.

One of the issues over the last decade has been whether first time buyers have been crowded out by buy to let buyers. As taxes on buy to let buyers has increased that should dampen down this effect. Last year the number of buy to let completions was 14,500[8], above the recent average.

Another area raised has been the impact of the pension cap being limited in size, and that as more people hit these limits there may be a tendency to purchase properties for buy to let. Thus, one option may be to remove those limits on pension cap to remove the unintended consequence of another incentive for people to buy to let. Of course, there has been a recent change in legislation impacting landlords, and while it is too early to tell what the implications are, it is possible that this may impact, possibly by deterring, new landlords from buying properties to rent.

Another reflection of the challenges faced is the increasing age of first time buyers, as noted earlier. In 2021, according to Halifax, the age of the average first time buyer was 32 years. Over the last decade, between 2011 and 2021, this average age has risen from 29 to 32. This has risen across

7. Halifax, First Time Buyer Review 2021, 22nd January, 2022 https://www.lloydsbankinggroup.com/media/press-releases/2022/halifax/halifaax-first-time-buyer-review-2021.html#:~:text=The%20average%20age%20at%20which,30%20in%20every%20UK%20region.&text=Esther%20Dijkstra%2C%20Mortgage%20Director%20at,home%20buying%20decisions%20in%202021.
8. https://greassets.co.uk/news/outlook-for-the-uk-rental-market-in-2022

all regions of the UK, from 29 to 31 in Scotland, from 28 to 31 in Wales, from 30 to 32 in Northern Ireland.

The hurdles faced by first time buyers

First time buyers often face three inter-related hurdles, any one of which can prevent access to mortgage finance and these are: a deposit hurdle, a loan to income challenge and access to high loan to value mortgages.

The deposit constraint

The key recent turning point for the UK economy was the global financial crisis in 2008. Since then, monetary policy has been exceptionally loose, with policy rates being low. This has fed rampant asset price inflation – particularly of UK property prices. Since 2008, the UK has also witnessed much weaker economic growth than before the 2008 crisis, with low productivity. As a result, wage growth has not kept pace with the growth in property prices.

Latest data from the Office for National Statistics shows that in April, the average UK house price reached £281,000. This was £31,000, or 12.4%, higher than a year earlier. Average prices (and year on year rises) varied from £165,000 (up 10.4%) in Northern Ireland, to £188,000 (up 16.2%) in Scotland, to £212,000 (up 16.2%) in Wales to £299,000 (up 11.9%) in England.

If one views a property price of four times average income as the threshold for affordability it is remarkable to note that there are only fifteen local authorities where the average first time buyer home is below this threshold[9].

The average price to earnings ratio ranges from a high of 12.3 in Brent, to 3 in Clackmannanshire in Scotland. In fact, all the least affordable are in London, as well as Brent, this includes Camden 12.2, Harringay 11.4, Waltham Forest 10.9 and Hillingdon 10.6, while the most affordable are in Scotland and also include West Dunbartonshire and East Ayrshire, both where the price to earnings ratio is 3.2.

The southeast also sees the local authorities that have experienced the biggest deterioration in the ability of first time buyes to be able to buy, over the last decade, and these are shown in the table.

Local Authority	Average price 12 months to Dec 2021 (£)	Ave earnings 2021 est (£)	P/E ratio 2021	P/E ratio 2011	Deterioration in affordability
Merton	513,811	51,880	9.9	4.8	108%
Reigate and Banstead	386,719	47,929	8.1	4.1	97%
South Kesteven	250,788	36,152	6.9	3.6	94%
Westminster	682,361	67,962	10.0	5.2	94%
Ashford	298,239	35,216	8.5	4.4	92%

Source: Halifax

9. See Halifax, First Time Buyer Review

As property prices rise, first time buyers face a major price constraint so that they have to raise a higher deposit.

In recent years there has been a tendency to increase the deposit requirement. But this may prove to be too big a hurdle for many people, especially if house prices continue to rise. For instance, let's use a hypothetical example to highlight how first time buyers are hit if either the deposit or house prices rise. If say your income was £25,000 and the flat was £100,000 then a five per cent deposit means you need to save 20% of your annual income to meet the deposit threshold for a 95% LTV. If, however, the deposit required is higher, then to achieve the deposit for a 90% LTV you need to save £10,000 or 40% of your annual income.

Of course, people may save over many years, and this example is just illustrative, but over many years house prices would likely rise. Say now, the price of the flat is £150,000. In this case a five per cent deposit requires £7,500 or 30% of your annual income, a 10% deposit for a 90% LTV is a massive 60% of income.

In his research, Graham Edwards[10] attaches the blame to, "regulatory rules which have driven up required deposits and made it harder to meet the income qualifications for a mortgage." As just one example, he outlines that in 2018, when the actual mortgage cost was 2.35% the average rate used in affordability tests was 7.26% meaning first time buyers would be denied a mortgage if they could not afford to repay at these rates over the first five years of the mortgage.

According to the Nationwide Affordability Special Report[11] in November 2021, "One of the consequences of high house prices relative to earnings is that it makes raising a deposit a significant challenge for prospective first time buyers. Indeed, at present, a 20% deposit is now equivalent to 110% of the pre-tax income of a typical full-time employee, a record high and up from 102% a year ago."

According to the latest English Household Survey, the mean size of a deposit for a first time buyer in 2020-21 was £44,294 and the median size was £25,000. This survey, which was based on a sample of 957, showed that 22.1% paid 1%-9% of the purchase price, 50% 10%-19%, 10.7% paid 20%-29%, 12% paid between 30%-99% and 4.8% paid the full purchase price. Almost two in three (61.9%) took out a mortgage of over 30 years, one in three (33.2%) of 20-29 years and 4.9% below 20 years maturity.

For the whole UK, the annual Halifax First Time Buyers survey shows the average house price last year was £264,140 and an average deposit of £53,935 around 20%. Hardly surprisingly the highest average deposit was in London, at £115,759 or 24%. Even in those regions of the UK where the deposit required was lowest in cash terms, the amount required is still high in relation to average earnings: £26,769 in the North East, £29,199 in Northern Ireland, £33,622 in Wales and £33,983 across the North West.

Government policy has tried to address this, by proving assistance. One example is that since April 2021 first time buyers have been able to save up to £4,000 per year and receive a 25% government bonus on their

10. https://cps.org.uk/research/cps-launches-resentful-renters/
11. https://www.nationwidehousepriceindex.co.uk/reports/affordability-special-report-raising-a-deposit-still-the-biggest-hurdle-for-first-time-buyers-despite-affordability-becoming-more-stretched

savings and use the Lifetime ISA (LISA) as a long-term savings product to save for their first home. Also, first time buyers who already hold a Help to Buy: ISA can continue to save into their accounts until November 2029 and have until December 2030 to claim up to a maximum £3,000 government bonus towards the purchase of their first home.

A Nationwide Local Affordability Report[12] at the start of this year noted a similar trend, "there has been a noticeable increase in the proportion of local authorities with higher house prices to earnings ratios (HPERs) over the last five years. Around 45% of authorities now have a HPER of six or more, compared with about 35% in 2016.

Only 14% of localities now have a HPER below four, down from 22% five years ago." And in that report concluded that, "This helps to illustrate the challenge that many first time buyers across the country face, in terms of raising a deposit to purchase their first home." Further, the cost of servicing a mortgage as a share of take-home pay is now above its long-run average in the majority of regions across the UK.

Loan to income

The loan to income constraint is often overlooked, but it is a key factor that can impact first time buyers, particularly in areas where house prices are very high relative to average earnings. A cap was introduced on high LTV mortgages in the wake of the global financial crisis. In the wake of that crisis a host of measures were introduced globally, aimed at reducing the risk of financial instability. The thinking was that highly indebted people and households would be more likely to default on loans and cut consumption. It was seen as a pro-cyclical feature, that added to economic momentum but was at risk of exacerbating it during a downturn.

Thus in 2014 the Financial Policy Committee of the Bank of England initiated a new policy, which limited the amount lenders could allocate in high LTI mortgages – the 'LTI flow limit'. For lenders issuing mortgages worth over £100 million per year, they had to in future limit to no more than 85% of their lending, mortgages to high LTI – where this was defined as being 4.5 times or more a borrower's (person or household) income.

As noted in a study hosted by the FCA, "…the study found a shift among lenders towards borrower types that are more likely to have higher income, such as home movers, and joint income applicants, and away from first time buyers."[13]

The total amount allocated to high LTI did not shift that much, at around 10%, but the market's dynamics changed, with lenders who previously had low LTI lending increasing, and those who previously were close to the new limit, decreasing them. And the incomes of those with high LTI increased. But the numbers of first time buyers with high LTI suffered.

Last year house prices rose by more than average national earnings. This further put owning a property out of the reach of many people, including those who are trying to save for a deposit. On this basis, the mortgage market should be prepared for higher loan to income (LTI) mortgages.

Loan to Income ratios used to be a much greater consideration in

12. Nationwide Local Affordability Report, January 2022,
13. https://www.fca.org.uk/insight/high-loan-income-mortgages-if-cap-fits

the mortgage market. But it is possible that these could become more important, especially as interest rates rise, and as micro-prudential regulations that stress test borrowers' potential ability to repay are eased.

In addition to introducing the LTI flow limit in 2014 the Financial Policy Committee also introduced a second constraint, the 'affordability test', which specified a stress interest rate for lenders for assessing prospective buyers but which also impacted people remortgaging. The Committee viewed both constaintsts as necessary to prevent what they saw as a loosening in mortgage underwriting standards. Sensibly, the affordability test was withdrawn by the FPC this July, effective 1st August[14]. This welcome step fits with the narrative of this paper. Unfortunately, the LTI limit has remained in place.

Let's take the last two years to get an idea of how this ratio has evolved, as shown the table below. The key in terms of high LTI is shown in column two, where a single person borrows a multiple of four times their income (11.8% of the total in the first quarter), or a joint mortgage where the borrowing is three times or more of joint incomes (and this category totalled 37.8% of all gross advances in Q1).

This table shows the breakdown of mortgages by LTI. There has been, as noted above, a constraint that limits the amount that banks can lend over a LTI of 4.5.

Category	Single Other and Joint Other	Single 4.00 or over and Joint 3.00 or over	Single 3.50 < 4.00 and Joint 2.75 < 3.00	Single 3.00 < 3.50 and Joint 2.50 < 2.75	Single 2.50 < 3.00 and Joint 2.00 < 2.50	Single less than 2.50 and Joint less than 2.00
Q2 2020	14.9	43.1	9.3	8.5	9.6	14.7
Q3 2020	13.2	48.2	9.2	7.8	8.6	13
Q4 2020	12.2	50.2	9.2	7.9	8.3	12.2
Q1 2021	12.7	49.6	9.6	7.9	8	12.3
Q2 2021	12.3	51.5	9.4	7.6	7.7	11.5
Q3 2021	13.2	48.5	9.7	8	8.2	12.4
Q4 2021	13.7	50.2	8.8	7.2	8	12.2
Q1 2022	15.8	49.7	8.1	6.8	7.7	12

Source: Nationwide

Loan to value

But it is loan to value (LTV) that often attracts the most attention.

The share of mortgages advanced in 2022 Q1 with loan to value (LTV) ratios exceeding 90% was 3.9%, 2.8% higher than a year earlier but a 0.2% decrease compared to the previous quarter[15].

Graham Edwards talked of "resentful renters" and claimed that 3.57 million had been locked out of the housing market since 2008. This is a very significant figure and is indicative of the massive impact progress on such a policy area could achieve.

According to the 2021 Census, there are 28.1 million households. This includes 19.3 million families. Interestingly, the Census shows that 3.6

14. Financial Policy Committee confirms withdrawal of mortgage market affordability test | Bank of England

15. See, Mortgage lending statistics - June 2022 | FCA Mortgage lending statistics – June 2022, 14/06/2022, FCA. And also Mortgage Lenders and Administrators Statistics - 2022 Q1 | Bank of England

million 20- to 34-year-olds live at home, which is 28% of this age-group, compared with 24% a year ago. In what was described as a nationally representative survey earlier this year by Wayhome[16], **42% of tenants said they would like to buy the home they were renting, and this ranged from 38% for social tenants to 45% for private tenants**.

Edwards, too, argued that it was not just supply constraints. He blamed high deposit rates as the biggest problem. Yet he still believes in 95% LTV mortgages, so 5% deposits are still needed. Edwards's main thesis is for the government and financial sector to, "promote long-term, fixed-rate mortgages" to be offered with 95% LTV mortgages. It is hard to disagree with one of his key conclusions that this, "locked a group of otherwise financially secure people out of home ownership." He blames regulations, and while they have played a role, not letting the market mechanism develop has been vital, too.

A theme of my 2021 paper was the need for product innovation, and it is worth repeating here a point that I made then. In an extensive report in December 2019 that looked at emerging themes in the mortgage market, UK Finance noted, as the main point, that "The expansion in gross lending has been achieved with limited mortgage product innovation." Yet, such product innovation is necessary in ensuring that sufficient appropriate mortgage products are available and to achieving the government's aims of boosting the numbers of first time buyers.

Mobility too

While access to finance is the dominant issue, it is important that finance be available for existing as well as for new properties. Financial help to first time buyers must not be linked only to new developments. Many of these for a start may not in the places where people want to live.

The secondary market is critical to future success. Mobility, too, needs to be improved, by increasing turnover in the second-hand property market. Stamp duty is effectively a tax on mobility. The need to replace or improve stamp duty is a point that cannot be made enough.

Rising house prices and ageing populations may add to the challenge. The overall net effect is an under-utilisation of existing properties, with many properties where households may have spare bedrooms being under-occupied. In the OECD, the UK is number one of the thirty-eight countries in terms of how heavily it taxes property, and as noted in my previous paper on this subject, the Mirrlees Review on tax system reform described the taxation of housing as "a mess". Occasionally one sees references to the need for a wealth tax, without much substance. The last thing housing needs is further ill-thought through taxation, and one thing that is required is a reassessment of the present system, with a view to improving turnover and utilisation of the existing stock of properties.

16. https://www.financialreporter.co.uk/nearly-half-of-uk-renters-want-to-buy-out-their-landlord.html#:~:text=In%20a%20nationally%20representative%20survey,to%2038%25%20of%20social%20tenants

4. Solutions: why finance is key

There has been a schizophrenic approach in terms of mortgage lending and financial stability. A range of regulatory constraints have been aimed at deterring lending to high LTI or high LTV mortgages in the aftermath of the 2008 global financial crisis. Yet, at the same time, since the financial crisis, lax monetary policy has contributed to rampant asset price inflation, including that of property prices. As prices have risen out of the reach of many buyers, this has in turn prompted a succession of official interventions, aimed at increasing the share of first time buyers.

Systemic risk

In the wake of the 2008 financial crisis, the issue of avoiding systemic risk in the future was cemented in policy thinking. It also heavily influences how lenders, and perhaps informed observers, view the property sector. There is sometimes unease that we may see a repeat of 2008 if lending conditions are relaxed. Indeed, in the wake of Prime Minister Johnson talking of a benefits to bricks policy, memories were triggered of a similar approach in the US that led to the growth of what became known as Ninja mortgages – these were taken out by people with no income, jobs or assets, with little regulatory oversight. Well intentioned, these went horribly wrong, precipitating a sub-prime crisis ahead of the 2008 crisis. It is important to still retain a focus on this.

The risks facing lenders

In the debate about finance two issues are frequently identified. These are:

- Credit risk
- And interest rate risk

Both are critical to understanding how the present policy approach is evolving and also why the UK has looked overseas, to Canada and elsewhere, for insights.

At the same time, two other important issues, not necessarily seen as risks, which can sometimes be overlooked are also important from the perspective of lenders. These are:

- Appetite for term, namely the length over which lenders may be prepared to lend. This is an important consideration to bear in mind as one considers market solutions.

- And pre-payment risk. This is rarely mentioned, but when borrowers take out fixed rate longer-term mortgages there are transparent penalty clauses for those making early pre-payments, which compensate the funders in lieu of receiving the expected future interest. Note, these are different to the products where people have the flexibility to over-pay and repay early. The penalty on the longer-term mortgages reflects that - along with the appetite over which people wish to lend – a lower interest rate might be set on the basis that it will be paid over a longer period and so if it is repaid early then the difference can be met.

Nonetheless, it is the first two – credit risk and interest rate risk - that figure prominently at this stage of the economic cycle. UK house prices are high, relative to recent history. They could, of course, go much higher, but the fact that they are high plus the fact that interest rates are now rising is likely to focus renewed attention on credit and interest rate risk.

Credit risk is the danger for the lender that they may not be able to recover the full value of the loan, if the borrower(s) defaults. This was a problem in the recession of the late 1980s and early 1990s. Interest and mortgage rates soared in the late 1980s leading to falling house prices and negative equity, where the value of a property was less than the loan taken out on it. But since then, it has not been an issue in the UK.

Indeed, if one takes London as an example, house prices have fallen only twice in nominal terms in recent decades, in 1990-92 and in 2008-09 when they declined temporarily after the global financial crisis. Also, mortgages are full recourse in the UK, meaning that borrowers still owe the remaining debt to the lender, even after the house is repossessed, and hence default rates in the UK have been very low, so lenders have rarely actually encountered the credit risk problem. Credit risk may thus be as much of a perceived risk as an actual risk – and as a result some borrowers, and in particular first time buyers who need a mortgage with a high LTV have had to pay the price. Because of this credit risk, lenders limit lending to first time buyers and charge a premium for doing so. Thus, there is both rationing and a higher price. This creates a huge hurdle for first time buyers.

Interest rate risk is that higher interest and mortgage rates lead to the servicing of the loan becoming a problem for the borrower. Also, with fixed rate mortgages where the lender's income is fixed over time, where a lender's borrowing costs rise due to an increase in interest rates, making the mortgage unprofitable. Lenders usually pay for swaps to mitigate this, and this cost is ultimately passed to the borrower.

In qualitative terms it is clear that these risks will increase in current economic conditions, but are we able to quantify them?

The annual English Household Survey provides a good insight and is likely to be representative of the whole UK.

Over the last decade, from 2010/11 to 2020/21, there has been *no* change in the proportion of household income spent on mortgages.

According to the English Household Survey, mortgagers spend 18% of their household income on mortgage payments. In contrast, as a proportion of household income, rent payments represented 27% of household income for social renters and 31% for private renters. For private renters, this ratio has fallen from 35% over the last decade. It is unclear what might be the impact of recent changes by the government which have given more rights to tenants and where there is much speculation that this might restrict the supply of rental properties, and thus might reverse this downward trend.

Given the focus on credit and interest rate risk, "the proportion of mortgagers reporting being in arrears has remained at or below 2% since 2010-11." Amongst renters, in the latest year, which admittedly may be impacted by the pandemic although the figures appear little different from previous years, 25% of private renters and 23% of social renters reported it being fairly or very difficult to pay rent.

According to the FCA, "The value of outstanding balances with arrears (defined as the borrower failing to make contractual payments equivalent to at least 1.5% of the outstanding mortgage balance or where the property is in possession) decreased by 1.1% on the quarter and 11.3% on a year earlier, to £13.3 billion, the lowest it has been since recording began in 2007. The proportion of total loan balances with arrears decreased on the quarter from 0.84% to 0.82%, also the lowest since recording began."

Thus, credit risk appears low. It would thus seem fair to argue that this should *not* be the dominant issue influencing the approach taken in the mortgage market review.

Meanwhile, as for interest rate risk, the best solution is long-term fixed rate mortgages. These are common in, for instance, the US. In the UK, while fixed rate mortgages have risen many are of short-term maturity.

Approaches to take

Three approaches appear to stand-out:

- First, allow a market solution, where the government shows increased faith in the market to deliver upon increasing lending to first time buyers. This requires looking at any regulations and rules that may impede the market. In particular this will reinforce the message from my earlier Policy Exchange paper, based on the blended mortgage approach that would likely draw in more lenders and better match risks between borrowers and the mortgage providers.
- Second, in view of the credit risks alluded to above, allow an insurance approach, based on the approach that the government has adopted to date, and adopting best practice from elsewhere.
- Third, or a combination of the two above. While these could each be adopted in isolation, it may be more likely that they are implemented in unison.

A market driven approach focused on blended mortgages

An immediate question when one talks of market solutions is this, why if there is a market solution ready to be unveiled then why has it not already been seen? Naturally, it is a very valid issue, but in the mortgage market, of all markets, it is possible to identify a plethora of official interventions which over recent decades have distorted the market.

Incentives matter for mortgage lenders, as they do for people who may wish to take out mortgages. If there is a danger of continuous government intervention, then it may weaken some incentives for lenders to develop new products.

One of the key areas of my previous report – which is still relevant now – is that point about the lack of innovation mentioned earlier. In looking at emerging themes in the mortgage market, UK Finance noted that "The expansion in gross lending has been achieved with limited mortgage product innovation." Yet, such product innovation is necessary to ensure that sufficient appropriate mortgage products are available and to achieving the government's aims of boosting the numbers of first time buyers. Blended mortgages, which we highlighted then as an example of such market innovation, would be one such route that is possible.

The point is that innovation is already possible, but more is needed, and thus the case to facilitate the market by removing rules and regulations that hinder the market. This could include relaxing the constraints on high LTI mortgages. There may even be scope to ease prudential regulations that deter banks from high LTV. But even if such prudential regulations are not changed, the capital markets have the solution with blended mortgages.

Investors and more financial firms from across the globe that have different appetites for risk and maturity can join the high street banks in providing funding for mortgage lending.

The retail banks prefer low risk and short-term lending in the mortgage market, pension funds would like low risk and long-term, investment banks like higher risk but shorter-term. If funding is blended from each of these parties, then mortgages can be matched to the borrowers' needs. There are enough lenders who will lend to UK buyers.

People would still get their mortgages in the same was as now without complexity - by going to one provider. The borrower, as now, takes out a single, homogenous mortgage, say a standard repayment over an agreed term; the mortgage provider that originates and provides the mortgage will most likely be a retail bank or a building society. But it is behind the scenes that all the innovation occurs.

The blended mortgage provides more flexible and efficient mortgages for the borrower. It identifies different risk and term profiles for individual mortgages. For example, it can safely deliver more lower or no deposit mortgages to help more people move onto the housing ladder. Or more long-term reducing rate mortgages, giving people the certainty of monthly payments in the knowledge they will fall each year of the mortgage.

It is the mortgage platform that would help provide the innovation, with the blending of the funding behind the scenes. This can be in the mechanics of the mortgage, with the lending provided by an array of funders who are repaid over different time frames. The net effect is that this can allow high LTV mortgages to be available to first time buyers, whether they wish to buy new homes or homes that are not new builds.

So, while for the buyer, he, she or they borrow as usual, the funds are provided through the lender in a different way. And the different components of the mortgage could be repaid at different times, to reduce borrowings for the buyer, and risks for the lenders. An example might be that there are three providers of the funds. To meet their own balance sheet requirements, they provide funds over different maturities and thus at different rates. They absorb different risks. The interest rate that they receive reflects the term and the risk of their lending.

Thus, over time, the rates at which people repay may naturally fall, reflecting that the finance provided has, ultimately emerged from different providers. The gap between the 85% and 95% LTV or even up to 100% LTV becomes the primary risk – covered by the investment bank, say, or the non-deposit taking institution. The secondary risk, say between the 60% and 80% LTV of this mortgage (again more a perceived risk, but the rigorous and necessary Bank of England stress tests on banks suggest in exceptional circumstances that it would materialise as a risk) would be borne by the existing retail lender. The tertiary risk on the reminder of the mortgage, which is long-term but low risk, may be absorbed by the pension fund. The issue is the need for increased availability of such high LTV loans.

Such an approach may also raise the possibility of 100% LTV mortgages. Such a high mortgage may, initially, make some observers wary of this approach. The reality is that if we rely on low-risk lenders to provide the bulk of mortgages then there will be a natural constraint on who can borrow. Given the low proportion of 95% or even 90% LTV mortgages, this implies that 5 or 10% deposits will be needed.

Many people – who have a proven record of paying their rent over a lengthy period – are often denied access to mortgages because they do not have a deposit. Even for those who save, the ability to reach the deposit becomes more difficult as property prices rise. A track record of paying rent should allow people to access mortgages without deposits.

Also, as lengthening the period over which people repay their mortgages is a natural policy response too. In this the average maturity of a mortgage could be extended from twenty-five years, to much longer. It could also tie in with other market innovations.

In researching this paper, one of the most interesting observations made frequently was the distorting influence of potential government involvement. While individual government schemes, when viewed on a stand-alone basis, appear sound, they can have a distorting influence on the market finding a solution to the Generation Rent problem. That is, it is not always possible to predict when government schemes may happen, and how long they may last for, and indeed whether they are replaced, or not, when they finish. It is not that these may crowd out the private sector, but they distort the development of the market.

A range of existing government schemes can be found here: https://www.ownyourhome.gov.uk/. These include the following. A Mortgage Guarantee Scheme, launched in April 2021 that helps first time buyers and existing owners who have a 5% deposit. A Help to Buy Equity Loan where the government lends up to 20% of the price for a first time buyer to buy a new build. Shared Ownership for first time buyers where there is a part rent, part buy for a new build. First Homes discounts for first time buyers and key workers, and also Right to Buy for eligible council tenants.

Alongside this observation about the impact of government schemes, it is interesting to note the range of private home ownership schemes that address different issues, suggesting that, left to its own devices, the market can solve different problems in the housing space, on the demand side. For instance, lender structured schemes appear as standard 95% LTV products, but these are supported by the builders. These appear to be available with Deposit Unlock[17] involving various building societies and Market Mortgage[18]. Shared Equity schemes, meanwhile, are available with a combination of banks and building societies and examples include Proportunity[19] Even[20] or Ahauz[21]. Another market focused area is Rent to Own schemes, or gradual home ownership as they are sometimes called, such as Wayhome[22] or Keyzy.[23] Indicative of how a healthy housing market incentivises new productions, a recently launched one is a first time buyer shared ownership scheme by Stride Up[24]. Of course, one wants to encourage the structural shift towards the market driven solution, but as in all markets one needs to expect there to be cycles.

The insurance approach

A different approach that could be taken is via expanding a mortgage insurance scheme. It is important to appreciate why there is such a focus on insurance. Like all such systems it can be viewed in two ways:

- one, as protecting the lender from perceived credit risk.
- two, it would help ensure that high value mortgages are provided, albeit with the cost of the insurance being passed onto the borrower.

The idea would be along the lines of ensuring that if a mortgage with a high LTV was taken out then the borrower would have to take out an insurance in case they were unable to pay the mortgage. This would be more costly for the borrower, but the idea is that this approach would ensure that lenders were able and willing to provide high LTV mortgages.

The government has already unveiled a Mortgage Guarantee Scheme, as noted earlier. Following the 2008 global financial crisis there was a shortfall in high LTV mortgages and so the government launched the Help to Buy: Mortgage Guarantee Scheme from 2013-16. It was seen as successful, in that the number of high LTVs increased, as did those who took advantage of it, although this may well have happened anyway,

17. https://www.hbf.co.uk/deposit-unlock/
18. https://marketmortgage.co.uk/
19. https://www.proportunity.com/
20. https://www.joineven.com/
21. https://ahauz.com/
22. https://www.wayhome.co.uk/
23. https://www.keyzy.com/
24. https://strideup.co/?utm_source=google&utm_medium=cpc&utm_campaign=loan-to-income&gclid=EAIaIQobChMI6Oi10Keu-QIV2-vtCh3SYwuQEAAYAyAAEgKRxvD_BwE

without this scheme.

There is now a new scheme with runs until the end of 2022. It is interesting to note the overarching principles of this scheme, as described by the Treasury, is, "a scheme that: is focused on helping borrowers and is simple for the customer; is as administratively straightforward for lenders as possible; does not incentivise irresponsible lending; contains the level of risk being borne by the government and; can be put in place rapidly and effectively."

Such principles make sense. The issue now is whether to build upon this and to extend this – and even whether to expand its reach.

Although, as outlined below, and reiterating the main point from my previous paper, if this route were taken it also makes sense for it to be alongside the market mechanism being allowed to provide the solutions needed to boost lending without the government bearing any of the risk.

However, with a LTV mortgage of 95% now being talked about as if it is the acceptable maximum, such an approach would not overcome the challenge of reaching a 5% deposit that is faced by many. Hence other current existing schemes where the buyer shares some of the equity in the property may persist. However, those schemes may only sometimes apply to specific new build properties, and while welcome may not provide buyers with the flexibility they seek in terms of location.

In an interesting comparison of international markets, Mulheirn[25], Browne and Tsouklais note that, Canada, Australia and the Netherlands focus on addressing credit risk through the use of mortgage insurance for lending with high value loan to values. Denmark, meanwhile, tries to address interest rate risk by increasing the availability of long-term fixed rate mortgages. Given all this, and as touched on in their paper, Canada has often been cited as an example to follow. A concern, though, is that its insurance system is expensive for the borrower, being around 4% of the total borrowing.

Yet if there is to be an insurance premium attached to high value mortgages, the question, naturally, is whether it should be mandatory or not, and also whether it should be provided by the government or instead by the private sector?

Given where we are in the economic cycle – it would perhaps not be a surprise if the mortgage market review focused on an insurance related approach.

It certainly protects those lenders, such as UK retail banks, who are comfortable with a high market share and who do not wish to take on additional risk, through high LTV mortgage lending.

The main purpose of an insurance scheme is to cover the loss-risk and to ensure that high LTV mortgages do not disappear if economic conditions deteriorate and if house prices fell.

The push back in recent years is that lenders have demonstrated they are comfortable with this risk. Currently there are many lenders engaged in 95% lending. The worry though might be that the market is pro-cyclical, providing such high LTV when the housing market is rising

25. https://institute.global/sites/default/files/articles/Bringing-It-Home-Raising-Home-Ownership-by-Reforming-Mortgage-Finance.pdf

See also, https://housingevidence.ac.uk/publications/tackling-the-uk-housing-crisis-is-supply-the-answer/

and economic conditions are good, to withdrawing them if economic or market conditions deteriorate.

The price of high LTV mortgages has, in the past, been an issue. An important influence on price is competition. Since ring-fencing, a few of the big lenders have vast amounts of very cheap cash to put to work, increasing competition at low margin, hence lender margins are already thin. The small and medium sized lenders, who don't have access to this ring-fenced cash, would find it harder to compete.

The table below shows that there still is intense competition across all LTVs, with the price of high LTV mortgages not much higher than lower LTV. A question though, is whether such an insurance scheme is needed to encourage lenders to provide high LTV mortgages? The table shows that four of the top five lenders use the government insurance scheme, but importantly the lender that does not, still appears to be competitive versus the others.

	Mortgage Guarantee Scheme?	60%	75%	85%	90%	95%
Nationwide	No	3.44%	3.49%	3.54%	3.59%	3.59%
HSBC	Yes	3.39%	3.44%	3.54%	3.59%	3.84%
NatWest	Yes	3.45%	3.45%	3.54%	3.59%	3.87%
Halifax	Yes	3.52%	3.56%	3.57%	3.66%	3.86%
Barclays	Yes	3.38%	3.45%	no product	3.49%	3.95%

Source: Websites of the big lenders, 1st July, 2022 (2-year fix, fee free mortgages)

The cheapest 95% loan and also the one with the smallest price differential between low and high LTV, is Nationwide, the only lender here that isn't using the government's insurance scheme. Meanwhile, those that use the scheme have to price in the up-front cost to take account of this insurance. High LTV lending does not, based on these figures, appear to be much more expensive than lower LTV lending, then perhaps this isn't a problem that needs to be solved.

The additional argument against insurance is that a central feature of being able to provide mortgages is that lenders can price their own mortgage risk, as that is central to their business models.

A point that is raised is what might happen if the government's mortgage insurance scheme expired, without a replacement? If one of the large lenders is able to provide high LTV mortgages without such insurance then why could not others – echoing the point about the distorting influence that the government may play.

In addition, one issue is whether with a government insurance scheme the taxpayer ends up with part of the bill. Without such government intervention, it is the builders who may pay the cost. As one example, highlighted during research for this paper, Nationwide use Deposit Unlock, an insurance scheme in which through the builder paying some of the cost this provides Nationwide with insurance cover on medium to high LTV mortgages. In contrast, Halifax launched a competing 95% LTV new build product, backed by the government insurance scheme, where the builder doesn't pay but the taxpayer would underwrite the insurance. The challenge is whether this is the optimal outcome for the market or for borrowers. My preference is for the government to step back and facilitate the necessary innovation in mortgage products.

A combined approach

The third approach is combination of the two above.

While these could each be adopted in isolation, it may be more likely that they are implemented in unison. Accept a private sector driven insurance approach as one way to entice lenders to provide higher LTVs, but accept that there is a cost to this, borne by the borrower or even by the house builder in the case of some developments. This would be preferable to the taxpayer underwriting the insurance cost.

But, as noted above, this insurance approach should not be seen as the ideal or only way to proceed. And thus, there should be a focus on helping facilitate the innovation that the market needs and of which the blended mortgage approach is just one important example, removing rules and regulations that would not threaten financial stability but that may hold back the market and limit first time buyers' ability to access finance.

5. Conclusion

Addressing our housing challenge is not just about supply, as important as supply is, but it is also about addressing the demand side and in particular the availability of finance to people who wish to become first time buyers.

This paper has not focused on the supply issue, but it is worth stating that naturally we need more housing supply - particularly given population growth. The usual mantra is to build more supply. The property developers clearly support this idea. It is deeply engrained in popular perception too. Supply does matter. Yet it is not just how many properties are built. It is where they are built and how they look and feel. Quantity, place and quality matter – as well as affordability, all matter when it comes to supply. It is not just new builds but redevelopments and allowing better turnover and greater occupation of existing properties. Turnover matters but high stamp duty is a problem for that. The common mantra that it is only supply is wrong.

Finance is a critical part of the solution, especially for first time buyers. This paper has focused on the vital area that is also critical to addressing the housing challenges that we face: the finance issue and ensuring the availability and affordability of finance for potential first time buyers.

Ahead of the pandemic Prime Minister Johnson talked of turning Generation Rent into Generation Buy. In June 2022 he unveiled a mortgage market review. The changes that it could trigger could be transformative.

Consider some of the numbers highlighted in this paper:

- The number of first time buyers has increased from 193,940 in 2009, the year following the global financial crisis, to 303,970 in 2020 and to 409,370 last year. This is good news, but there is much more to be done.
- First time buyers used to be seen as young. Now they are young but getting older. The average age of the first time buyer has continued to edge up and has risen over the last decade from 29 to 32. Even working in a well-paid professional job, one's role is no longer a guarantee to be able to afford a property, given how high prices currently are, and given the large deposits required and also the constraints on borrowing through limits on very high low to income (LTI) mortgages.
- Over the last decade there has been a sharp rise in the number of households that rent from 2.8 million to 4.5 million. Younger households make up a large proportion of the private rented sector. 16-24 year olds account for one-eight of the private rented sector,

25-34 year olds three-tenths and 35-44 year olds one-fifth. While the recent Census showed that 3.6 million 20- to 34-year-olds live at home, which is 28% of this age-group, compared with 24% a year ago.
- The unambiguous losers from a failure to address this problem are those who are renting and who wish to become property owners. Research elsewhere and noted above shows that four out of ten tenants wish to buy the property they live in.
- If one views a property price of four times average income as the threshold for affordability it is remarkable to note that there are only fifteen local authorities where the average first time buyer home is below this threshold. Last year the average deposit was £53,935, around 20% of the value of the average property.
- Over the last decade, there has been no change in the proportion of household income spent on mortgages. Mortgagers spend 18% of their household income on mortgage payments. In contrast, as a proportion of household income, rent payments represented 27% of household income for social renters and 31% for private renters.

Government help has been successful in areas such as help to buy, but it cannot always step in, using taxpayers' money. Also, interventions such as temporary cuts in stamp duty often push prices higher, out of peoples' reach. That aspect is widely recognised. Perhaps not appreciated enough, and highlighted here, is the distorting influence that government schemes may help, not allowing the market to develop fully.

The first approach, and the one favoured here, is to facilitate the market by removing rules and regulations that hinder the market. This could include relaxing the constraints on high LTI mortgages. There may even be scope to ease prudential regulations that deter banks from high LTV. But even if such prudential regulations are not changed, the capital markets have the solution with what I would call blended mortgages.

Investors and more financial firms from across the globe that have different appetites for risk and maturity can join our high street banks in providing mortgage funding.

Our retail banks like low risk and short-term, pension funds like low risk and long-term, investment banks like higher risk but shorter-term. If funding is blended from each of these parties, then mortgages can be matched to the borrowers' needs. There are enough lenders who will lend to UK buyers.

People would still get their mortgages in the same was as now without complexity - by going to one provider. But it is behind the scenes that all the innovation occurs.

The blended mortgage provides more flexible and efficient mortgages for the borrower.

A second approach, which we do not believe should be at the expense of the first approach, is via expanding a mortgage insurance scheme. Yet it merits consideration.

It is important to appreciate why there is such a focus on insurance. Like all such systems it can be viewed in two ways: one, as protecting the lender from perceived credit risk; two, it would help ensure that high value mortgages are provided, albeit with the cost of the insurance being passed onto the borrower.

The third approach is combination of the two above. While these could each be adopted in isolation, it may be more likely that they are implemented in unison. Accept a private sector driven insurance approach and help facilitate the innovation that the market needs and of which the blended mortgage approach is just one important example.

Specific policy recommendations outlined above, include:

- Ease the constraints on the amount of lending through high loan to income (LTI) mortgages.
- Encourage longer-term fixed rate mortgages to become more widespread.
- Work with the ratings agencies and lenders to ensure that it is mandatory for paying rent to count towards a credit score, in order to allow good credit borrowers who cannot save for a deposit to be able to buy. There is a need to ensure the provision of high LTV mortgages to credible borrowers who have a long track record of paying their rent but who do not have access to enough funds to pay a 5% deposit to be able to buy and take out a mortgage.
- As a further step to prevent buy to let landlords from squeezing out first time buyers, lift the pension cap, so as to discourage people who may have hit the cap from buying properties as an alternative to adding to their pension pot.
- Phase out official government schemes if they are seen as no longer necessary.

After the success of 'The Right to Buy' and 'Help to Buy' it is now time for the government to unveil, 'Finance to Buy' where it is the market, not the taxpayer, that provides the financial solution.

These proposals are not expected to create new, systemic risk. And while it is hard to be precise about how many people could benefit, the figure could be as high as three million, a huge number. This would be a significant step for a new Prime Minister and government in helping turn more of Generation Rent into Generation Buy.

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