

United Kingdom

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Macroeconomic overview

Amidst the continuing global financial crisis, 2009 began as another hard year for the UK. The recession which began in Q2 2008 continued through to Q3 2009, making it the most protracted recessionary period in the UK since records began. However, despite this recession, the rise in unemployment was comparatively modest. By the end of 2009 the unemployment rate stood at around 8% (a little under 2.5 million unemployed), up from 2 million at the end of 2008. Although a substantial increase, it fell far short of the 3 million predicted by many at the start of the year. Whilst there is no conclusive data on the subject, it appears much of the reduction in labour costs in 2009 was achieved through reductions in working hours and/or salary cuts, meaning that far fewer became unemployed than would otherwise have been the case.

Inflation fell in 2009, averaging a little over 2%, less than half that seen in 2008. This was largely expected, given that the relatively high inflation in 2008 was primarily due to a spike in energy prices. Early in 2009 the Bank of England continued to cut rates aggressively, so that by March 2009 the bank rate was just 0.5%, and has been unchanged since then.

Housing and mortgage markets

With supply of mortgages restricted due to the ongoing closure of the securitisation markets, and demand suppressed by the negative macroeconomic environment, 2009 overall saw a very sharp decline in lending levels, compounding the contraction seen in 2008. Gross lending in 2009 totaled GBP 144 billion (EUR 161 billion) and net lending was GBP 11.5 billion (EUR 12.9 billion) – falls of 44% and 72% respectively. But in fact the market appeared to have bottomed out in Q1 2009, whether measured in terms of prices, lending volumes or transaction numbers. From Q2 onwards the UK saw a slow improvement in housing market activity, albeit from a very low base. The very low interest rate environment and the government's temporary exemption on stamp duty for purchases of properties valued at up to GBP 175,000 (EUR 196,422) to last to the end of 2009, improved initial affordability and so provided a stimulus for new purchases. As a result, transaction and lending volumes rallied somewhat, and with this also house prices. There was a particularly strong increase in the final months of the year, as borrowers for lower-priced properties rushed to complete purchases before the stamp duty exemption expired on December the 31st, 2009.

But on the other side of the gross lending equation, 2009 saw a collapse in remortgaging activity, driven by two key factors. Firstly, as funding lines were restricted and house prices declined, the industry tightened lending criteria. Higher LTV loans became harder to find, and those that were on offer were at substantially higher rates than for borrowers with greater deposits. However at the same time the aggressive bank rate cuts meant that those borrowers coming off of initial fixed and discounted rate deals and onto lenders' Standard Variable Rates have found that these reversion rates, normally linked to bank rate, are less penal than they would have been before. With these parallel brakes on supply and demand, remortgaging fell by over 50% on 2008.

In this downturn the fall in house prices, like the contraction in lending, was substantial and rapid. From peak (Q3 2007) to trough (Q1 2009) house prices (as measured by the Halifax index) fell by 22%. This compares to a fall of around 13% in the previous downturn in the early 1990s, which took place over a considerably longer period - around 4 years. But since then, echoing the trends in lending and transaction volumes, prices have begun to increase. By the end of 2009 prices were 6% up on their trough value.

The dramatic interest rate cuts, coupled with the lower than expected rise in unemployment, meant that 2009 saw considerably fewer arrears and possessions cases than initially predicted, although both saw a rise in 2009. At the end of 2009 just under 200,000 mortgages were in arrears representing 2.5% or more of the mortgage balance, around 8% higher than in 2008. 47,800 mortgaged properties were repossessed in the year, up from 40,000 in 2008. In addition to low rates and unemployment numbers, borrowers facing payment problems in this downturn have benefited from a much wider range of coping strategies, compared to previous arrears cycles. Some of these arose through increased lender forbearance (e.g. payment holidays, other temporary concessions and formal arrangements to capitalise arrears). Others came from government – the homeowner mortgage support scheme (essentially a deferred interest scheme with government guarantee) and Mortgage Rescue, a scheme whereby certain types of borrower at risk of imminent possession through default could effectively become social tenants but remain in their own privately bought residence.

Funding

The private securitisation markets began a tentative reopening from Autumn 2009, but not as yet on a scale that fully offset the rate of repayment of funds to investors through bond redemptions. The UK residential mortgage-backed securities (RMBS) market was the first securitisation market to reopen with two large lenders launching new issues, but both carried a put option whereby investors were guaranteed the option of selling the bonds to the lenders after 5 years. This form of recourse to the lender made these deals more akin to a covered bond than a traditional securitisation.

The Bank of England's special liquidity scheme (SLS) closed to new usage in January 2009 and Treasury's credit guarantee scheme (CGS) later in the year. The two schemes together have provided banks and building societies with approximately GBP 310 billion (EUR 348 billion) of funding support. In March 2009 the Bank of England also announced that it would begin a policy of quantitative easing, using newly created money to buy bonds, mainly gilts, to support the money supply to directly increase the banking system's wholesale deposit base.

It is not possible to assess the extent to which these government measures have played a part in maintaining lending in 2009, however they were clearly necessary to maintain confidence in the banking system in the face of a systemic loss of confidence in wholesale markets. Given the tentative nature of the subsequent recovery in these markets and the future profile of lenders' bond redemptions, there are still concerns that lenders will, collectively, find it difficult to repay the support provided through the SLS and CGS on the timetable stipulated by the government unless support is maintained in some other form.

	EU27, 2009	UK, 2009	UK, 2008
GDP growth (%)	-4.2	-4.9	0.5
Unemployment rate (%)	8.9	7.6	5.6
Inflation (%)	1.0	2.2	3.6
% owner occupied	68.2	69.5	69.7
Residential Mortgage Loans as % GDP	51.9	87.6	80.3
Residential Mortgage Loans per capita, EUR thousand	12.37	22.21	23.86
Total value of residential loans, EUR million	6,125,727	1,372,659	1,459,858
Annual % house price growth	-6.8	-7.8	-0.9
Typical mortgage rate (euro area), %	2.71	4.34	5.85
Outstanding Covered Bonds as % outstanding residential lending	23.2	14.7	14.0

Notes:

- Typical mortgage rate in the euro area refers to the APRC (Source: ECB)
 - EU owner occupation rate average derived from EMF calculations based on latest available data.
- United Kingdom=2007

Sources: EMF, Eurostat, ECB, Bank of England, Council of Mortgage Lenders, Communities and Local Government

