United Kingdom

By James Tatch, UK Finance

IN A NUTSHELL

- → Benign labour market conditions and low interest rates continue to underpin housing market resilience.
- → Regional disparities continue, with activity and prices in the south and London beginning to moderate.
- → First time buyer activity regained 2007 levels, but home movers have been left behind.
- → Regulation and taxation have had a significant negative effect on buy-to-let activity.
- → Arrears and possessions continue to fall and are at historic lows.

MACROECONOMIC OVERVIEW

Economic growth in the UK notched down slightly in 2017, growing by 1.8%, compared to 1.9% in 2016. Despite the fall this still exceeded the public forecast of 1.5% produced by the Office for Budgetary Responsibility. Towards the end of the year growth was boosted by the service sector and production, however the construction sector saw a modest contraction.

The labour market continued to perform strongly in 2017; the unemployment rate fell from 4.7% at the end of 2015 to 4.3% by the end of 2017. In level terms, there was a fall of some 127,000 employed people lowering the total to 1.45 million. Employment numbers rose by a little over 400,000 over the course of 2017, leading to an employment rate of 75.4%, up from 74.6% at the start of the year. This employment rate is the highest in half a century.

Inflation started the year at 1.8%, but in February it breached the government's 2% target rate and rose fairly steadily throughout the rest of the year, reaching 3.0% in December, Sterling depreciation has exerted steady pressure on import costs, which has fed through to store prices.

In November 2017 the Bank of England raised interest rates from its record low of 0.25% back to 0.5%, where it had been since 2009, whilst reiterating its previous statement that future interests would be both gradual and limited.

The government continued in its push to reduce public borrowing. At the time of the Spring 2018 Statement the Office for Budget Responsibility (OBR) was projecting that the government will reduce its net borrowing position to below 2% of GDP by the end of 2018-19, and that borrowing will continue to fall to under 1% by 2022-23.

HOUSING AND MORTGAGE MARKETS

MORTGAGE MARKETS

The UK housing market remains unbalanced, with the long term gap between demand and supply of housing continuing to place upwards pressure on prices and rents. There has however been a pick up in construction, boosted by government initiatives focused on new build. In the homeowner sector, the Help to Buy Equity Loan scheme for home buyers (FTBs in particular) has provided a boost to purchases of new build properties, although the evidence of any additionality to homebuilding is mixed. In the rented sector, the Build to Rent scheme has helped stimulate construction activity across a range of property types, for both affordable housing and market rent.

Against this background construction has increased such that there were 190,000 housing starts in the UK last year, the strongest numbers in a decade. This level is still short of the levels needs to start closing the supply gap, with around 250,000 additional households projected per year on average.

Following the housing market downturn of the late 2000s, prices overall recovered relatively quickly. At the UK level prices had recovered to their pre-downturn levels by 2014. However regionally there are, as always, some quite substantial differences in markets. The southern areas of England, and most significantly London, grew strongly. The average price in the capital, as measured by the Land Registry index, was GBP 481,000 in 2017, 67% above its previous (2007) peak. However, in those regions that saw the most pronounced negative economic impacts in the downturn, prices have yet to recover. Most significantly prices in Northern Ireland, which saw the greatest housing boom and bust across the UK, remain some 40% below their peak levels.

Responding to the growth in prices, affordability in the Southern regions has become more restrictive and, in 2017, price growth has slackened off. Throughout 2017, house price inflation in London fell from 5% to under 2% by the end of the year, the lowest growth rate across all UK regions. However almost all other regions were still showing growth better than twice that rate.

MORTGAGE MARKETS

Market dynamics

The mortgage market remains dominated by fixed rate lending, with over 90% of new lending (both residential and buy-to-let) at fixed rates. Historically, UK borrowers have tended to opt for 2 and 3 year fixed rates, however there has more recently been a significant shift towards lending fixed for 5 years or more (but predominantly at 5 years). Lenders are not required to assess borrowing at a stressed interest rate for loans where the rate will be fixed for 5 years or more, however it is also relevant that the lower cost of funding longer term fixed rates has driven down pricing, and so five year fixed rate deals are historically very favourably priced.

With the continuing benign labour market and ultra-low interest rate environment, mortgage arrears and possessions have fallen year on year since 2009. In 2017 there were 88,000 mortgages in arrears of over 2.5% of the mortgage balance, and 7,400 possessions. This is the lowest arrears number since this measure was first collected in 1995, and the lowest annual number of possessions since 1980.

Non-market led initiatives

There was a significant diversion of trends within house purchase activity in the UK in 2017. The homeowner sector continued to grow and, in particular, the number of mortgages for first time buyer purchases reached 363,000, a level not seen since 2006. But although mortgages for home movers also increased, the 375,000 loans in 2017 was still only around half the level seen in 2006.

Buy-to-let saw a markedly different path. The sector has been the subject of a number of government and regulatory measures aimed at moderating BTL activity, which have made a significant impact.

Since Spring 2016 all buy-to-let purchases are subject to an additional 2% Stamp Duty on the property value. In 2016 this had the effect of bringing forward a significant volume of activity into the first three months, with a compensating drop off thereafter. In 2017 however, with the surcharge in effect for the full year, there was no such bunching of activity at the front end.

Secondly, since January 2017, BTL mortgages have been subject to underwriting requirements set out by the Prudential Regulation Authority. These stipulate that the majority of BTL loans must satisfy affordability requirements, both at the initial interest rate and under a higher stressed rate. In Q3, additional requirements came into place with respect to BTL loans to portfolio landlords (borrowers with 4 or more mortgaged BTL properties).

Finally, in fiscal year 2017-18, the government began its staged phasing out of interest rate relief for BTL mortgages. This process, which will complete in fiscal year 2020-21, reduces the long-term profitability of BTL as an investment and is probably the most powerful brake on activity of the three measures.

As a result of these measures, BTL activity fell dramatically in 2017. There were 75,000 BTL house purchase mortgages, down 27% on 2016.

MORTGAGE FUNDING

The Bank of England's Term Funding Scheme continued in 2017, enabling lenders to continue to access cheap finance and pass on the low price in lending to the real economy. This, as well as continuing relatively healthy levels of retail deposits, have resulted in muted levels of funding required from capital markets outside the TFS. The end of the TFS, in February 2018, will likely result in a commensurate increase in access to these markets.

	UK 2016	UK 2017	EU 28 2017
Real GDP growth (%) (1)	1.8	1.7	2.4
Unemployment Rate (LSF), annual average (%) (1)	4.8	4.4	7.6
HICP inflation (%) (1)	0.7	2.7	1.7
Outstanding Residential Loans (mn EUR) (2)	1,546,503	1,539,979	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	29,985	29,673	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	94.7	98.7	73.8*
Gross residential lending, annual growth (%) (2)	-1.5	-2.6	3.5
Typical mortgage rate, annual average (%) (2)	2.3	2.0	2.4**
Owner occupation rate (%) (1)	63.4	n/a	66.4*
Nominal house price growth (%) (2)	7.0	4.6	6.0

* The aggregate EU figure is from 2016.
** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

UNITED KINGDOM FACT TABLE

Entities which can issue mortgage loans:	Monetary and Financial Institutions (MFIs), which includes banks and building societies. Other specialist lenders (non-bank, non-building society UK credit grantors, specialist mortgage lenders, retailers, central and local government, public corporations, insurance companies and pension funds). Other (anything not covered elsewhere).
The market share of the mortgage issuances:	**MFIs** – 92% **Other specialist lenders** – 7% **Other** – 1%
Proportion of outstanding mortgage loans of the mortgage issuances:	**MFIs** – 87% **Other specialist lenders** – 9% **Other** – 4%
Typical LTV ratio on residential mortgage loans:	77%
Any distinction made between residential and non-residential loans:	*[We have taken non-residential loans to mean commercial in this context]* The distinction is based on the property being purchased and the purpose it will be used for. A residential loan is used to purchase a property that a person will live in. A commercial loan is one that is used to purchase commercial land or buildings.
Most common mortgage product(s):	Initial fixed rate products
Typical maturity of a mortgage:	25 years
Most common way to fund mortgage lending:	Retail deposits and wholesale funding
Level of costs associated with a house purchase:	**Stamp Duty Land Tax** – ranges from 0% to 12%, depending on property value **Valuation fee** – ranges from GBP 150 to GBP 1,500, depending on property value **Surveyor's fee** – ranges from GBP 250 to GBP 600 **Legal fees** – ranges from GBP 500 to GBP 1,500 **Electronic transfer fee** – around GBP 40 to GBP 50
The level (if any) of government subsidies for house purchases:	There are no subsidies which apply to house purchase on the whole, there are however some subsidies for specific parts of the market, such as those who live in social housing.