INTERMEDIARY MORTGAGE LENDERS ASSOCIATION

Mortgage borrowers and higher mortgage rates

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As economic growth and trade prospects around the world have improved, the extraordinary stimulus measures put in place a decade ago to mitigate the adverse effects of the global financial crisis are starting to look less necessary.

Even in the UK, where the vagaries of Brexit negotiations complicate matters for policy-makers, the focus has been shifting slowly in favour of taking the foot off the gas.

Despite the Bank of England keeping rates on hold in May, the longer-term direction and speed of travel for rates is still clear. Barring the unexpected, we are likely to see successive quarter-point increases in base rates, generously spaced apart over the next 3-4 years, until we are in the 2-2½% territory.

How might such changes affect UK mortgage borrowers?

In earlier periods, the mortgage industry would be pre-occupied with what rising interest rates mean for arrears and possessions.

But not this time round.

Because the good news is that the vast majority of households should cope.

A number of factors contribute, starting with the gentle trajectory for rate increases that seem likely over the next few years.

Plus, monetary policy does not take place in a vacuum. The backdrop to higher rates, when they occur, is likely to be a stronger economy and healthy jobs market, both of which enhance the range of coping strategies that households have for dealing with financial strains.

Critically, the mortgage market has also changed for the better:

- a substantial portion of today's mortgages have been subject to greater regulation and the more stringent affordability assessments adopted in response to the global financial crash

- about 60% of mortgage assets are now on fixed rates, FCA figures show, and although these are mainly 2-year products, they provide useful breathing space by shielding borrowers from higher payments immediately

- most recent borrowing has been repayment mortgages – as well as lowering loan-to-values over time, their design means that mortgage bills increase by less than a comparable interest-only loan when interest rates go up

Taking all the above factors into account, we are optimistic about the prospects for household finances. Reassuringly, the latest survey of household finances commissioned by the Bank of England[1] corroborates our view, identifying few instances when modest mortgage rate increases would require households to change their behaviour or push their debt-service obligations dangerously high.

While the story is a favourable one, we cannot afford to be complacent.

Unsecured borrowing has grown significantly over recent years. According to the Bank of England survey, 60% of households with a mortgage have at least some unsecured debt. With much of this on variable rates, those holding such debt might be affected sooner and more directly by higher interest rates.

More generally, last year's *Financial Lives Survey* from the Financial Conduct Authority reminded us that the financial circumstances of households vary considerably.

Given the rich tapestry of people's lives, whilst one or two base rate increases are unlikely to have a profound impact on overall household finances, they may well be sufficient for pockets of greater payment stress to show.

We are also likely to see a more challenging environment for buy-to-let. Not least, because higher interest rates would come on top of income tax changes that already threaten to undermine the future cash flows of some landlords.

Industry arrears and possessions have been at record low levels over recent years. As interest rates trend higher, inevitably so too will mortgage debt problems. But both look set to follow only a gentle upwards trajectory.

[1] See *The financial position of British households: evidence from the 2017 NMG Consulting survey*, Bank of England Quarterly Bulletin 2017 Q4.