The new ‘normal’ – prospects for 2024 and 2025

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Executive summary

- **We estimate that gross lending fell to £225.5 billion in 2023, down 28% on the previous year.** Within the total, lending for house purchase fell 30% to £135 billion and remortgaging by 24% to £82 billion. Higher mortgage rates were the main factor driving the downturn.

- **The buy-to-let market experienced a steeper contraction, with gross lending estimated to have fallen 48% to £30 billion in 2023.** Buy-to-let house purchase lending was down 51% to £8.5 billion and remortgaging by 46% to £20.5 billion with deteriorating affordability hitting the buy-to-let market harder than the owner-occupied market.

- **We expect gross mortgage lending to fall further to £205 billion in 2024 before recovering slightly to £210 billion in 2025,** with house purchase lending of £120 billion and £122 billion respectively and remortgaging of £78 billion and £80 billion. We expect net lending to turn negative in 2024, at -£3 billion before also recovering in 2025 to £5 billion. This followed a dramatic decline in net lending in 2023 to an estimated £1 billion.

- **We forecast a further fall in buy-to-let lending in 2024 to £27 billion before it recovers slightly in 2025 to £29 billion**, as interest rates start to come down. Pressure will continue to grow on government to reverse some of the adverse tax changes that have impact landlords. Of particular concern is the replacement of the tax deduction for mortgage interest with a basic rate credit, which has hit higher rate taxpaying landlords operating in their own name especially hard.

- **We expect arrears and possessions to continue to rise sharply in 2024 and 2025**, as more borrowers move onto higher interest rates as their fixed-rate deals come to an end. We forecast that arrears of 2.5% of the loan balance or more will reach 140,000 by Q4 2024 and 160,000 a year later (1.6% of outstanding mortgages).

- **2023 saw a sharp rise in the share of cash in house purchases. We estimate that buyers spent a total of £295 billion on property purchases in 2023. A record 54% of that was financed by cash.** We believe that both cyclical and structural factors favour cash and predict that its share could rise further to 58% in 2024 and 59% in 2025.

1. The market in 2023

1.1 Normality reasserts itself

After the shocks that buffeted the global economy in recent years - lockdowns in 2020 and 2021 and the Russian invasion of Ukraine in 2022 - 2023 saw a welcome respite and a partial return to normality as the disruption from supply chain and war related dislocation eased considerably. The improving picture was evident from world commodity prices (see Chart 1), which fell 16% up to mid-December after having climbed by 21% in 2022. This allowed inflation to fall back across western economies, although commodity prices remain 6% above their level of mid-2021.

Chart 1 – S&P GSCI Index of global commodity prices in sterling

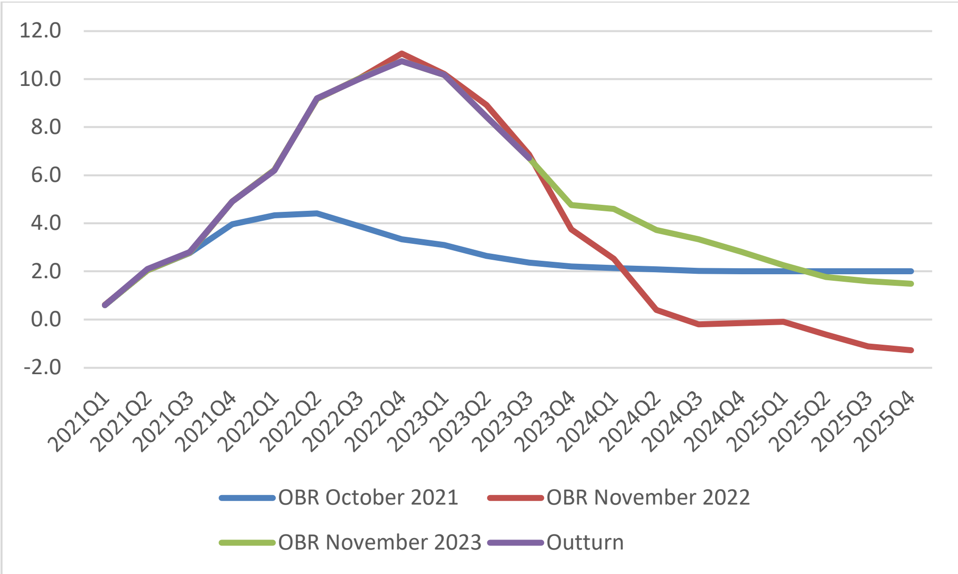
Source: S&P

While global shocks pushed up inflation in 2022, it is the domestic economy's response that has the largest effect on interest rates. If higher commodity prices can be absorbed by firms and workers taking cuts in their profit margins and wages respectively, inflation can be contained and central banks will not need to respond too aggressively with higher interest rates. However, if an external shock to inflation pushes up domestic prices, in so-called second round effects, the central bank will generally need to respond to slow demand to weaken firms' and workers' pricing power.

One notable feature of the recent surge in inflation was that central banks in general, and the Bank of England in particular, initially saw it as a transitory effect and therefore failed to react quickly. CPI inflation reached 5% before the Bank raised Bank Rate from 0.1% to 0.25%. Indeed, government and Bank of England forecasts have systematically under-estimated inflation since the post-pandemic reopening.

For example, as Chart 2 shows, as recently as October 2021 the government's Office for Budget Responsibility (OBR) was forecasting that CPI inflation would peak at 4.4% in 2022. A year later, the OBR's November 2022 forecast expected negative CPI inflation (falling prices) by the second half of 2024. The latest OBR forecast, published in November 2023, sees a much slower reduction through 2024, with inflation at 2.8% by Q4, still above the Bank of England's 2% target rate. And it seems to have been the scale of inflationary pressure coming from domestic sources that was missed. For instance, the November 2022 forecast expected average earnings growth to fall to 2.6% by Q4 2023. Indeed, the official view on the outlook for inflation may still be overly optimistic as we discuss in Section 2 below.

Chart 2 – OBR CPI inflation forecasts and outturn



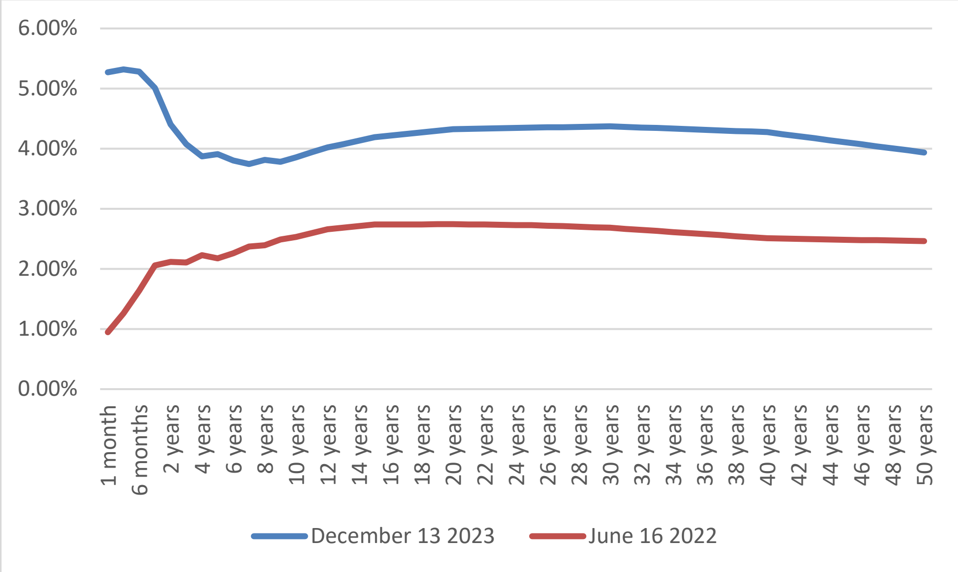
Source: OBR, ONS

1.2 Interest rates settle down

Not all of the shocks that have hit the UK economy were generated abroad. Kwasi Kwarteng's September 2022 mini-budget of unfunded tax cuts and spending created panic in the government bond (gilt) market and as this market largely determines interest rates for fixed-rate borrowers, the disruption had an immediate and substantial impact on mortgage rates. As confidence began to be restored by a return to a more conventional approach to fiscal policy, government bond yields, swap rates and fixed rate mortgage pricing all eased back.

However, poor inflation figures for April and May (announced in May and June) precipitated another bond market sell-off, pushing up yields and fixed rate mortgage pricing to above the level reached in the wake of the mini-budget. In the meantime, short-term interest rates had been rising in response to Bank of England Bank Rate decisions, which took it from 2.25% in September 2022 to 5% by June 2023. As a result, interest rates are still substantially higher across the yield curve than they were prior to the September 2022 mini-budget (see Chart 3), a change that has had serious implications for the housing and mortgage markets and we turn to these next.

Chart 3 – Sterling yield curve

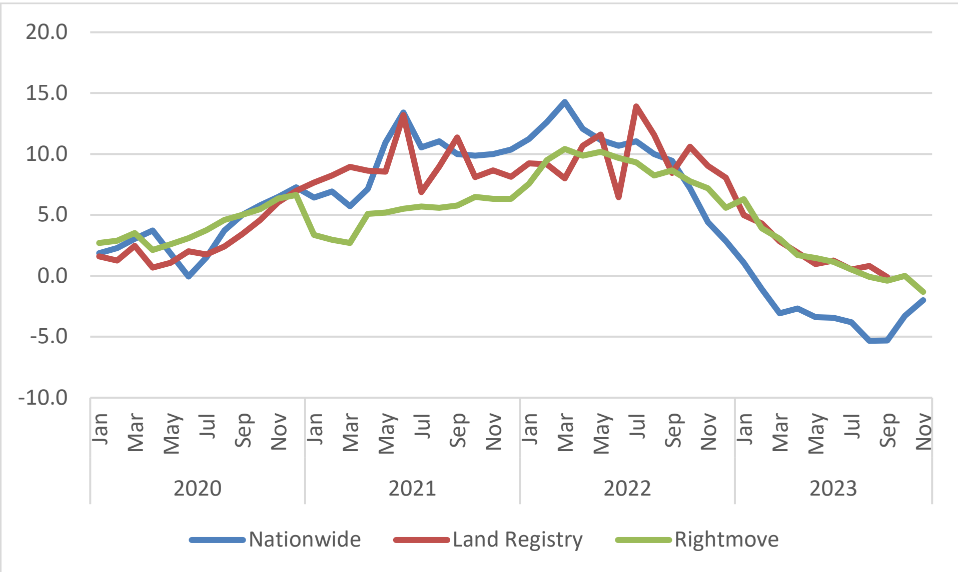


Source: World government bonds.com

1.3 The housing market's unexpected resilience

Just over two years ago Bank Rate was at 0.1%. Had you predicted, at that point, a war in Ukraine, a mini-budget which created turmoil in the financial markets and that Bank Rate would be 5.25% two years later, few commenters would likely have believed that the economy and housing market could remain as resilient as they have. Two of the three house price indices shown in Chart 4, the Land Registry and Rightmove, have only recently recorded any year-on-year falls. Indeed, house prices have firmed in recent months. Comparing the latest 3 months to the previous 3 months, the Land Registry index is up 2.6%.

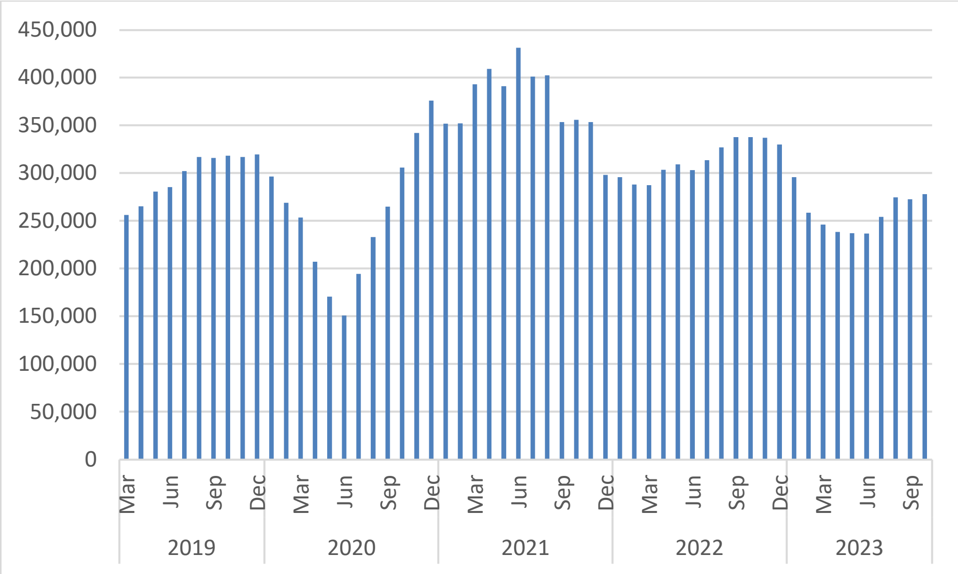
Chart 4 – UK house prices (12 month % increase)



Source: Nationwide Building Society, Rightmove and HM Land Registry

What accounts for the continued strength of house prices following shocks that have seriously impacted mortgage pricing and affordability? One factor is the strength of household balance sheets coming out of Covid lockdown. Retail deposits rose by £350 billion in the 18 months to August 2021, an average of £5,200 for every person in the country. Undoubtedly, a portion of these funds have supported housing transactions. Another is the structural shortage of housing in the face of high net immigration and population growth. A lack of distressed sellers due to the conservative lending of the post-financial crisis era is another.

Chart 5 – UK property transactions (3 month rolling average)



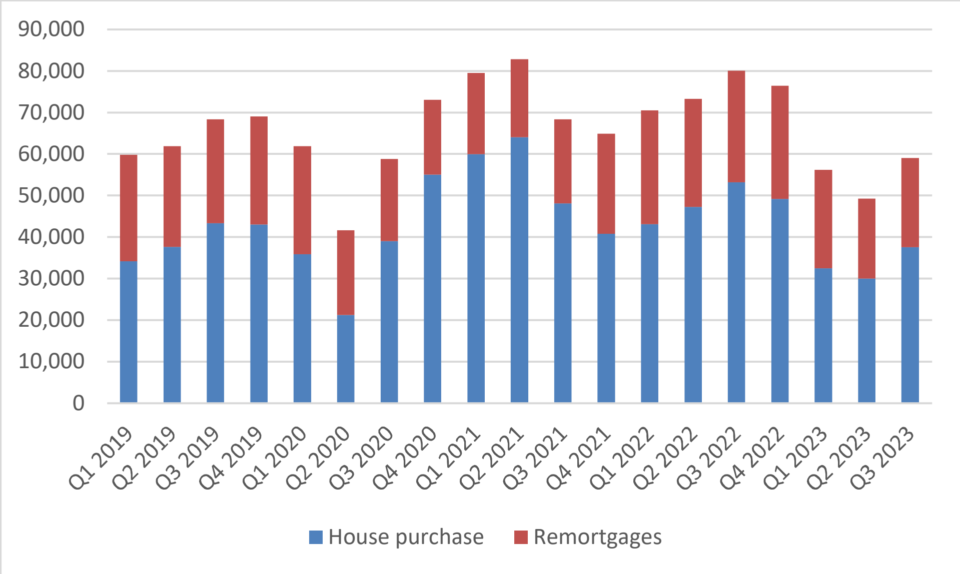
Source: HMRC

As is normal in housing downturns, turnover has absorbed most of the lower demand, falling more significantly than prices. In the year to October, housing transactions fell 18%. Unless they need to sell quickly, buyers are often reluctant to cut their asking price in the face of lower demand, leaving a stand-off between buyers and sellers that slows turnover. But transaction levels had been abnormally high in 2021, when generous stamp duty breaks were available and even 2022 was above the average of the last decade. Turnover in Q3 2023 was up 15% on the previous quarter and above the level of Q1 2019, a sign, along with firming house prices, that the market has stabilized at least for now.

1.4 Higher mortgage rates take their toll

Despite the relative resilience of the housing market, mortgage lending was markedly weaker in 2023 in the face of significantly higher mortgage rates (see chart 6). For the year as a whole we estimate that house purchase lending was down 30% to £135 billion and remortgaging down 24% to £82 billion. Product transfers were, in contrast, up 28% in the year to September to £178 billion, as affordability pressures encouraged more borrowers to take a new deal from their existing lender.

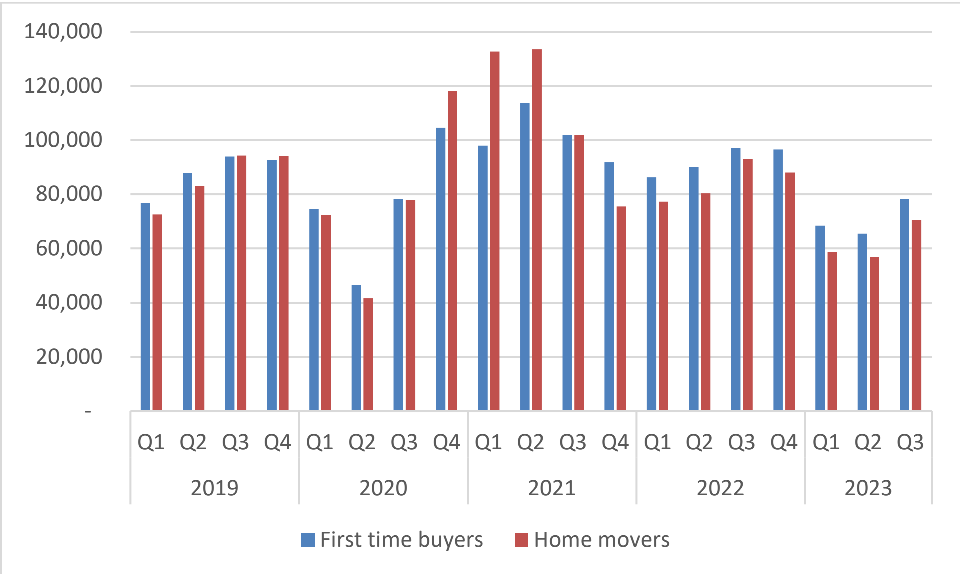
Chart 6 – Gross lending for house purchase and remortgage (£ million)



Source: Bank of England

The contrasting performance of the housing and mortgage markets resulted from a rise in the prominence of cash in transactions. We estimate that for the first time since current records began, more than half of the funds (54%) used to purchase residential property came from buyers' cash resources. This compares to only 29% as recently as 2006. Although exacerbated by the rise in mortgage rates last year, the rising use of cash is also a structural phenomenon, reflecting the fact that an increasing proportion of the private housing stock is owned by older people who have paid off their mortgages. We discuss the shift to cash in more detail in Section 4 below.

Chart 7 – Number of mortgage advances by type of purchaser



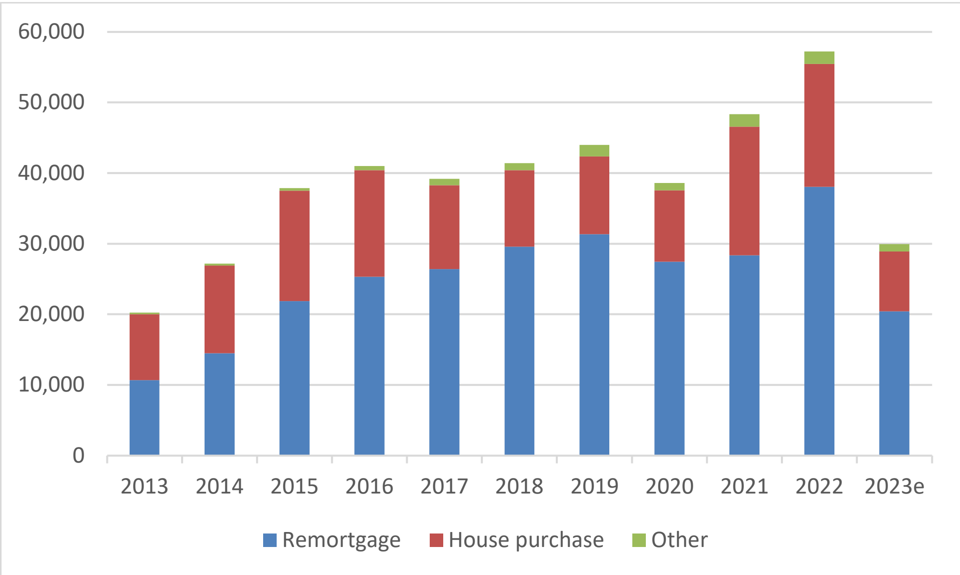
Source: UK Finance

Affordability pressures might have been expected to have a greater impact on first time buyers but the number of home movers fell slightly more, by 26% over the first three quarters of 2023 compared to the same period in 2022, against a 22% fall in the number of first-time buyers. This was despite the termination of Help-to-Buy, which had been restricted to first-time buyers since April 2021 and closed to new applicants on 31 October 2022. And in value terms, home movers were responsible for 63% of the decline in lending for house purchase over this period as they borrowed an average of 7% less while first-time buyers borrowed 1% more. But the greater reduction in home-mover lending is not that surprising considering the slower housing market, which makes it more difficult for those with a property to sell to complete a home move.

1.5 A challenging year for buy-to-let

In 2023, mortgage affordability pressures had a more significant impact on buy-to-let lending than on the owner-occupier market. In the year to September, buy-to-let lending for house purchase was down 52% on the same period in 2022 and remortgaging was down 46%, albeit from a record year in 2022. Chart 8 illustrates the scale of the fall using our estimate for 2023 as a whole. Lenders report that many borrowers struggled to meet affordability requirements at the rates on offer, which called into question the sustainability of some operations if the current interest rate environment endures. An uncertain outlook for house prices no doubt also acted to reduce demand for house purchase loans.

Chart 8 – Buy-to-let lending (£ million)



Source: UK Finance

During the first nine months of 2023, the weakness in lending resulted in a fall of 38,000 in the outstanding number of buy-to-let mortgages, 2% of the stock. 41,000 new buy-to-let house purchase loans were advanced and 79,000 were redeemed. The percentage of outstanding buy-to-let mortgages being redeemed each year was very low prior to 2021, averaging between 1-3%. This increased markedly in 2021 to nearly 5% and 2023 is likely to have seen a still higher figure, supporting the claim that more landlords are leaving the sector, although it would be overstated to call this an exodus as some media coverage has presented it and some buy-to-let redemptions are the result of landlords paying off their loans rather than selling the properties.

Lenders report that many of those selling are so-called amateur landlords with one or two properties with the main buyers being professional or portfolio landlords. Professional landlords are better placed to deal with increased regulation and are more likely to use a corporate ownership structure, which is generally more tax efficient. Rising rents are also helping to offset rising costs. The agreed price on new rental contracts rose by 8.9% in the year to November according to Homelet, although this falls far short of the mortgage cost increases faced by many landlords.

Falling numbers of buy-to-let properties is a worrying development, particularly in view of the rising number of people depending on the private rented sector to put a roof over their heads. Concerns are such that there are now a growing number of industry voices calling on government to intervene to roll back some of the punitive tax changes that have impacted landlords in recent years.

The removal of the interest deduction for landlords operating in their personal name has been the focus of particular attention. This may be because the impact of this measure rises in line with mortgage rates and is therefore creating more financing stress now that mortgage rates have increased. Although lenders report that a majority of new purchases are being made through limited companies, which like any other business can deduct interest for tax purposes, a recent survey of landlords by IMLA[1] showed that 90% of the stock of private rented properties is still held in personal names, including 83% of the mortgaged stock, and transferring these to a corporate structure can trigger capital gains tax and stamp duty. So, a significant cohort of landlords (higher-rate taxpayers operating in their own name with sizeable mortgage balances) face real pressures, with many likely to have little choice but to sell up if the tax rules on interest are not reversed.

[1] IMLA landlord survey: understanding today's private rented sector providers (December 2023)

2. The mortgage market outlook for 2024 and 2025

2.1 Broader economic environment in 2024 and 2025

Table 1 shows our forecast for key macroeconomic variables, which underpins our housing and mortgage market predictions. We expect the economy to continue in its current pattern of slow growth, gently rising unemployment and moderately easing inflation. Higher interest rates are a major factor behind this slow growth but it is unclear whether monetary policy is now contractionary enough to bring about a fall in CPI inflation to the Bank of England's 2% target within the forecast period. Domestic cost pressures have now replaced imported price inflation as the main driver of inflation. Wages are likely to be the most visible manifestation of stubbornly high domestic cost pressures but other components such as private rented sector rents are also likely to show significant increases.

Although the consensus of private forecasts is that Bank Rate has now peaked, if wage growth does not slow rapidly over the course of 2024, the case for higher Bank Rate is likely to grow. Given the relative tight labour market we are forecasting, with unemployment still at an historically low 5.2% in Q4, we take the cautious view that wage pressures will ease only slowly in 2024 and therefore think that the Bank of England may feel the need to tighten monetary policy. The decision in December to hold the Bank Rate at 5.25% was voted for by 6:3, indicating that there was support, albeit minority, for a raise. It is therefore entirely plausible that the Bank might decide to raise rates during 2024 – and we have therefore included the possibility of two additional rises of 0.25% in our forecast in Table 1.

Higher short-term interest rates should slow the economy, indeed that is their purpose. So, we expect muted growth and rising unemployment in 2024. By 2025 however, a cooling economy should start to lessen domestic cost pressures, allowing the Bank to cut interest rates. But even then, we believe that the market should not expect rates to fall very quickly unless wage pressures abate rapidly. However, as Table 1 shows, we think that longer-term interest rates (which affect fixed-rate mortgage pricing) will rise by less than Bank Rate in 2024 and fall by more in 2025, as Bank of England action reassures the financial markets that inflation will be successfully brought down.

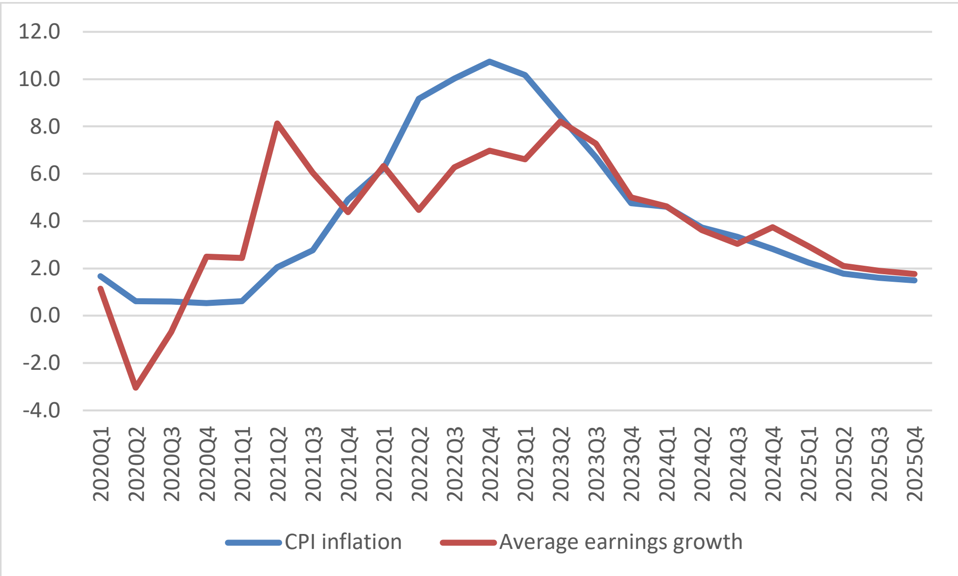
Table 1 – key forecast assumptions

	Past values		Forecast values				
	2022	2023e	2024f	2025f	2023/22e	2024/23f	2025/24f
Real GDP (£bn)	2,271	2,285	2,295	2,313	0.6%	0.4%	0.8%
Unemployment rate (Q4)	3.7%	4.6%	5.2%	5.5%	24.3%	13.0%	5.8%
CPI inflation rate (Q4)	10.5%	4.6%	4.4%	3.2%	-56.2%	-4.3%	-27.3%
Earnings growth (Q4)	6.0%	7.1%	5.5%	3.9%	18.3%	-22.5%	-29.1%
Current account (£bn)	-78	-75	-50	-55	-3.8%	-33.3%	10.0%
House prices (average for year)	283,500	287,500	284,000	283,000	1.4%	-1.2%	-0.4%
Housing transactions (UK, thousands)	1,258	1,025	1,000	1,040	-18.5%	-2.4%	4.0%
10-year government bond yield (Q4)	3.7%	4.3%	4.7%	4.0%	16.2%	9.3%	-14.9%
Bank Rate (Q4)	3.50%	5.25%	5.75%	5.50%	50.0%	9.5%	-4.3%

Source: IMLA, ONS and HMRC

Chart 9 shows the OBR November 2023 forecast for earnings and inflation. By Q3 2024 the OBR expects wage increases across the economy to have fallen to 3.0%, against CPI inflation of 3.3%, leaving wages down in real terms once again. If wage pressures ease this quickly a rise in Bank Rate is much less likely, but we feel that earnings growth will slow more gradually from its latest reading of 7.2% in the year to October 2023 given the background of a tight labour market, stubborn inflation and a 9.8% increase in the National Living Wage announced in the 2023 Autumn Statement (which takes effect in April 2024).

Chart 9 – OBR projections for earnings growth and inflation (November 2023)



Source: OBR

Inflation fell sharply to 4.6% in October 2023 as the energy price spike from the previous year fell out of the 12-month comparison. However, over the next three months the average increase dropping out of the comparison is less than 0.1% a month, suggesting that CPI inflation could remain close to its current level at least up to January. Against a background of persistent inflation, low unemployment and with the large rise in the National Living Wage, we believe that employers will find it difficult to resist wage increases of at least 5-6% so we expect earnings growth to slow to 5.5% by Q4 2023 (see Table 1).

With productivity growth having been around zero in recent years, 5.5% earnings growth is incompatible with the Bank of England's 2% inflation target. Inflationary pressures will therefore remain uncomfortably high going into 2025, so we do not expect Bank Rate to come down by much over the course of that year. But, rising unemployment and increasing slack in the economy should reduction inflation and help to moderate wage settlements, setting in place the conditions for more substantial cuts in Bank Rate in 2026.

2.2 Outlook for the UK housing market

The resilience of house prices in the face of higher interest rates over the past year has surprised most forecasters including ourselves. However, the current combination of Bank Rate at 5.25%, wage growth of 7.2% and unemployment of 4.3% does not seem like the kind of conditions that would exert much downward pressure on house prices, so the relative strength of the market may not be that remarkable.

In 2024, we anticipate that this constellation of factors will become a little more negative, with higher interest rates (Bank Rate at 5.75% by Q4), lower wage growth (5.5% by Q4) and higher unemployment (5.2% by Q4). But the changes in these variables will not be significant enough to induce a sharp downward adjustment in house prices not least because a number of other factors are at play:

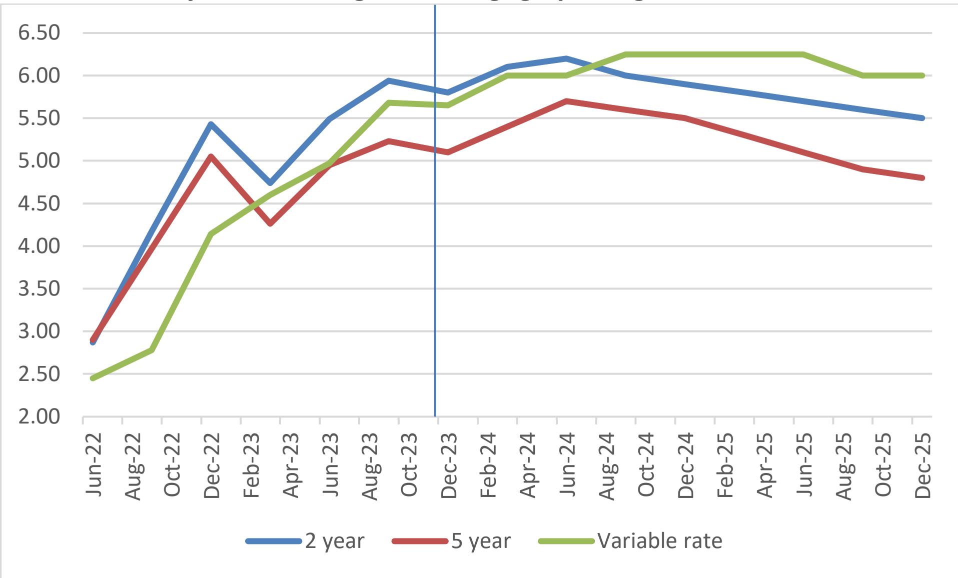
- Real wages are now rising and will continue to do so over the forecast horizon while high nominal income growth against the background of modestly falling house prices will improve affordability with the house price to earnings ratio falling from 10 in 2023 to 9.4 in 2024 and 9.0 by 2025.

- The shift to longer fixed rate mortgages over the past few years extends the period over which borrowers are impacted by higher payments. A significant cohort of borrowers will still not have seen their monthly mortgage payment rise by the end of 2024 and a smaller group will still be unaffected by end of 2025.

- We have seen a marked shift towards cash in housing transactions in 2023 which we expect to continue in 2024 (see Section 4 for a fuller discussion).

- Higher Bank Rate does not necessarily translate into higher fixed rate mortgage pricing. Indeed, if a rise in Bank Rate convinces the financial markets that the Bank of England will be more effective at controlling inflation, it could lead to lower fixed-rate pricing. We forecast that 10-year government bond yields will remain below Bank Rate, providing mortgage borrowers with fixed-rate options that will prevent them from having to feel the full effects of changes in short-term rates (see Chart 10).

Chart 10 – Projected average % mortgage pricing



Source: Bank of England, IMLA

As a result of these factors, we see house prices falling only modestly in 2024 to an average of £284,000 across the whole year, down 1.2% on the average price for 2023. In 2025 we see prices slipping slightly to £283,000, a further fall of 0.4%. In December 2024, house prices will be 3.4% below their level of a year earlier but up 2.6% in the year to December 2025.

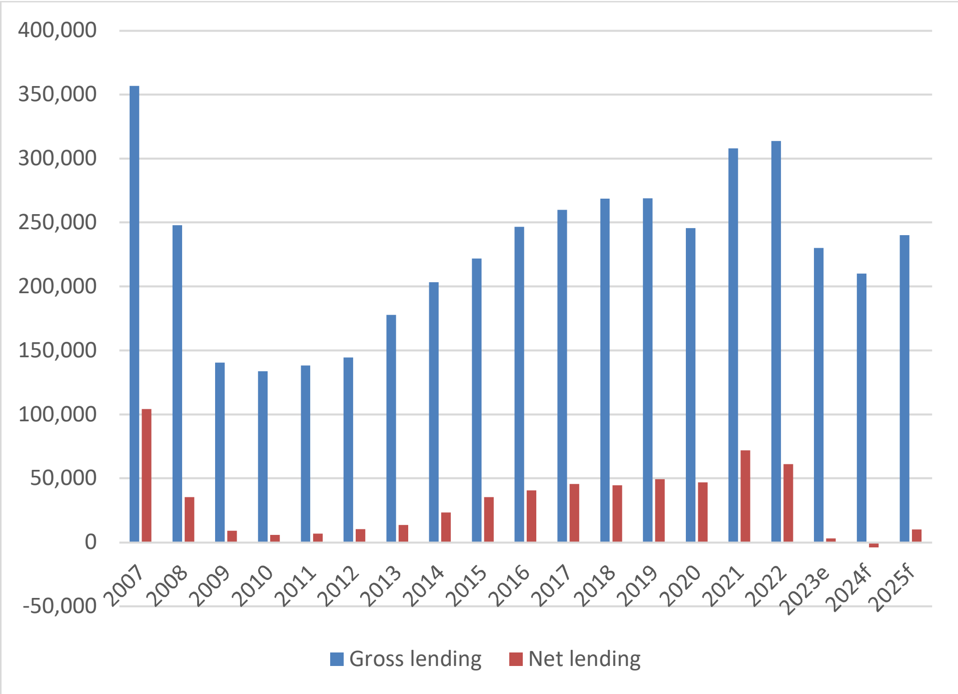
2.3 Mortgage outturn relative to previous year's forecast

In last year's report, IMLA forecast gross mortgage lending of £265 billion for 2023 including £165 billion for house purchase and remortgaging of £88 billion, with net lending of £48 billion. By way of comparison, UK Finance forecast gross lending of £275 billion (£144 billion for house purchase and £119 billion of remortgaging) and net lending of £41 billion while the November 2022 OBR report did not contain a projection for net mortgage lending.

The estimated outturns were gross lending of £225.5 billion, of which house purchase was £135 billion and remortgaging of £82 billion, with net lending of £1 billion. Last year, IMLA and UK Finance forecast buy-to-let lending of £47 billion and £43 billion respectively for 2023. The outturn was an estimated £30 billion.

2.4 Mortgage market forecast for 2024 and 2025

Chart 11 - Forecasts for gross and net lending (£m)



Source: Bank of England and IMLA

We expect total gross mortgage lending to fall again in 2024 to £205 billion before recovering slightly to £210 billion in 2025 (see Chart 11). After the unexpectedly weak net lending figures recorded in 2023, we believe that net lending will turn negative in 2024, at -£3 billion before staging a modest recovery in 2025 to £5 billion. Low net lending reflects the rising importance of cash in the housing market, reflecting both cyclical and structural factors, as discussed in more detail in Section 4 below.

As Table 2 shows, the fall in gross lending in 2024 is driven by a 11% decline in house purchase lending and a 5% retreat in re-mortgaging. The fall in house purchase lending is driven by lower housing turnover and a further increase in the cash share financing house purchases. The fall in remortgaging reflects a further shift towards product transfers as borrowers find it harder to pass the affordability assessment required for a remortgage.

We expect mortgage intermediaries' share of lending to keep rising to 89% in 2024 and over 90% in 2025. However, the rise in share of business is not enough to prevent the value of lending arranged by intermediaries falling 6% in 2024. 2025 should be a better year and we predict a 4% rise in broker business volumes.

Table 2 – Mortgage market forecast

Gross mortgage lending (£m)

	2022	2023e	2024f	2025f	2023/22e	2024/23f	2025/24f
House purchase	192,764	135,000	120,000	122,000	-30.0%	-11.1%	1.7%
Remortgage	107,466	82,000	78,000	80,000	-23.7%	-4.9%	2.6%
Other	13,428	8,500	7,000	8,000	-36.7%	-17.6%	14.3%
Total	313,658	225,500	205,000	210,000	-28.1%	-9.1%	2.4%
of which:							
Buy-to-let lending	57,200	30,000	27,000	29,000	-47.6%	-10.0%	7.4%
of which for house purchase	17,417	8,500	8,000	8,500	-51.2%	-5.9%	6.3%
Buy-to-let share of total	18.2%	13.3%	13.2%	13.8%	-27.0%	-1.0%	4.9%
Lending via intermediaries*	211,084	162,000	152,000	158,000	-23.3%	-6.2%	3.9%
Share of total*	84.3%	87.0%	89.3%	90.6%	3.2%	2.7%	1.5%
Net lending	61,012	1,000	-3,000	5,000	-98.4%	-400.0%	-266.7%
Product transfers	198,334	240,000	250,000	245,000	21.0%	4.2%	-2.0%
2.5%+ arrears (thousands Q4)	81,230	110,000	140,000	160,000	35.4%	27.3%	14.3%
Possessions (thousands)	3,920	4,700	8,000	13,000	19.9%	70.2%	62.5%

* Regulated loans only
Source: IMLA, Bank of England, UK Finance

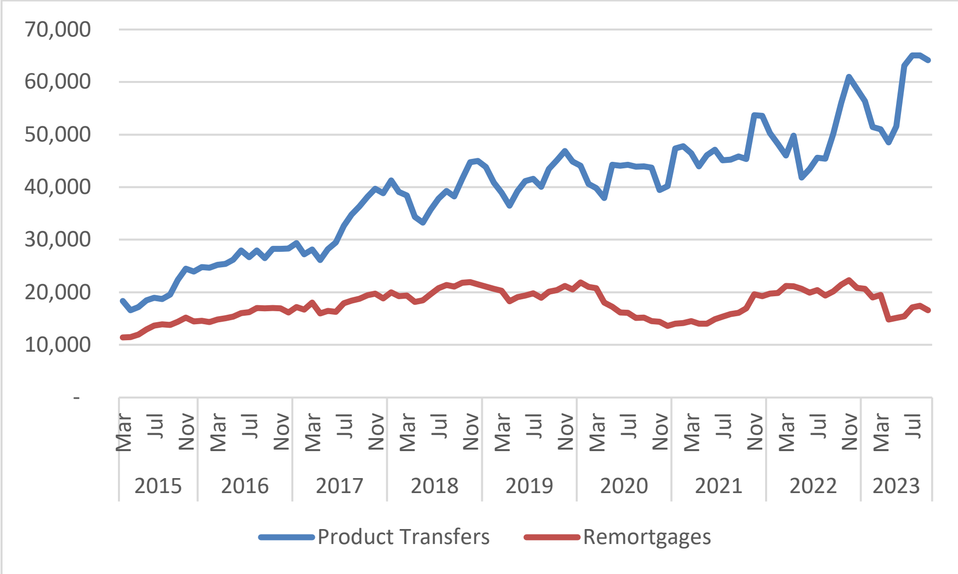
Turning to arrears and possessions, we estimate that for the first time since 2015, more than 1% of mortgage accounts had arrears balances of 2.5% or more at the end of 2023. We expect a further sharp rise in arrears in 2024 and again in 2025, despite the fact that we expect interest rates to be coming down by then. The lags from changes in market interest rates to arrears partly reflects the longer lags in the system resulting from more borrowers being on longer-term fixed-rate deals. We expect the buy-to-let market to have the fastest pace of increase in arrears in both 2024 and 2025, as it has been hit harder by loan affordability pressures as rates have risen, not least because most buy-to-let mortgages are interest-only, where the impact of rate changes on monthly payments is greater.

We also expect mortgage possessions to rise further in 2024. These have been at exceptionally low levels in recent years as a result of a combination of low mortgage rates, low unemployment, enhanced forbearance on the part of lenders and, since the Covid pandemic, a backlog of cases in the courts. Heavy arrears (over 10% of the mortgage balance) have been rising in recent years, pointing to higher future possession levels.

2.5 Product transfers and remortgages

As Chart 12 shows, the rise of product transfers continued in 2023, driven in part by the stretched affordability that many borrowers faced which restricted their options in the remortgage market. We expect this pattern to continue in 2024 with remortgage volumes down 5% and product transfers up 4%. The average amount of a product transfer was £160,200 during the first three quarters of 2023 against £209,300 for remortgages, showing that borrowers with larger mortgages are more likely to find an advantageous option by switching lender.

Chart 12 – Value of product transfers/remortgages (£billion 3 month rolling average)



Source: UK Finance

2.6 Buy-to-let mortgage market forecast

After the sharp fall in buy-to-let lending from £57 billion in 2022 to an estimated £30 billion in 2023, we forecast a further decline in 2024 to £27 billion followed by a modest recovery to £29 billion in 2025. Higher interest rates is the main factor behind these lower lending volumes for the following reasons:

- Landlords who have spare cash may choose to change the balance of debt and equity in their properties in response to higher rates. When rates of 2-3% were available, landlords could generate positive gearing i.e. boost cash returns by carrying more debt. Most landlords face negative gearing over the forecast period (see Section 3 for a fuller discussion of buy-to-let mortgage affordability).

- More landlords will struggle to meet lender affordability requirements. Lenders require an income cover ratio (ICR) of at least 125% i.e. gross rental income must be at least 125% of mortgage interest payments.

- Following the replacement of the mortgage interest tax deduction with a basic rate tax credit, lenders require higher-rate taxpayers owning properties in their own name to have an ICR of at least 145%. This will make it hard for affected landlords coming off lower-rate fixed-rate mortgages to meet affordability requirements, effectively excluding some from the remortgage market.

Table 3 – Buy-to-let and wider mortgage market forecasts compared

	2022	2023e	2024f	2025f	2023/22e	2024/23f	2025/24f
Whole market							
Outstanding debt (£bn)	1,627	1,628	1,625	1,630	0.1%	-0.2%	0.3%
House purchase lending (£m)	192,764	135,000	120,000	122,000	-30.0%	-11.1%	1.7%
House purchase % churn	12.1%	8.3%	7.4%	7.5%	-31.3%	-11.1%	1.6%
Remortgage	107,466	82,000	78,000	80,000	-23.7%	-4.9%	2.6%
Remortgage % churn	6.7%	5.0%	4.8%	4.9%	-25.2%	-4.8%	2.5%
Total % churn	19.7%	13.9%	12.6%	12.9%	-29.5%	-9.0%	2.4%
Buy-to-let market							
Outstanding debt (£bn)	302	304	300	302	0.8%	-1.3%	0.7%
House purchase lending (£m)	17,417	8,500	8,000	8,500	-51.2%	-5.9%	6.3%
House purchase % churn	6.0%	2.8%	2.6%	2.8%	-52.9%	-5.6%	6.6%
Remortgage	38,038	20,500	18,000	19,500	-46.1%	-12.2%	8.3%
Remortgage % churn	13.0%	6.8%	6.0%	6.5%	-47.9%	-12.0%	8.7%
Total % churn	19.6%	9.9%	8.9%	9.6%	-49.3%	-9.8%	7.8%
Buy-to-let % of total market							
Outstanding debt	18.5%	18.7%	18.5%	18.5%	0.7%	-1.1%	0.4%
House purchase lending	9.0%	6.3%	6.7%	7.0%	-30.3%	5.9%	4.5%
Remortgage	35.4%	25.0%	23.1%	24.4%	-29.4%	-7.7%	5.6%
Total lending	18.2%	13.3%	13.2%	13.8%	-27.0%	-1.0%	4.9%

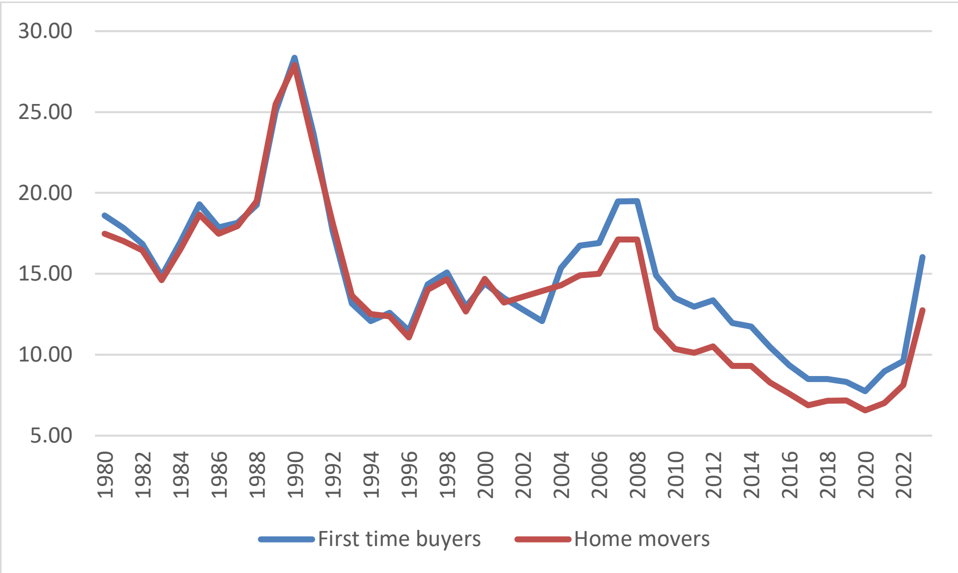
Source: Bank of England, UK Finance and IMLA

3. Mortgage affordability: an update

3.1 Homeowner affordability normalises

In last year's New Normal report[2] we examined the impact on affordability of the rapid shift from low to higher mortgage rates in 2022. Unsurprising, affordability remained a key issue in 2023, so we are revisiting the topic to see how the market has responded. Although we do not have full year data for 2023 yet, we have taken the average for the first 9 months of 2023 and included it in Chart 13.

Chart 13 – Mortgage interest as a % of borrower income



Source: UK Finance

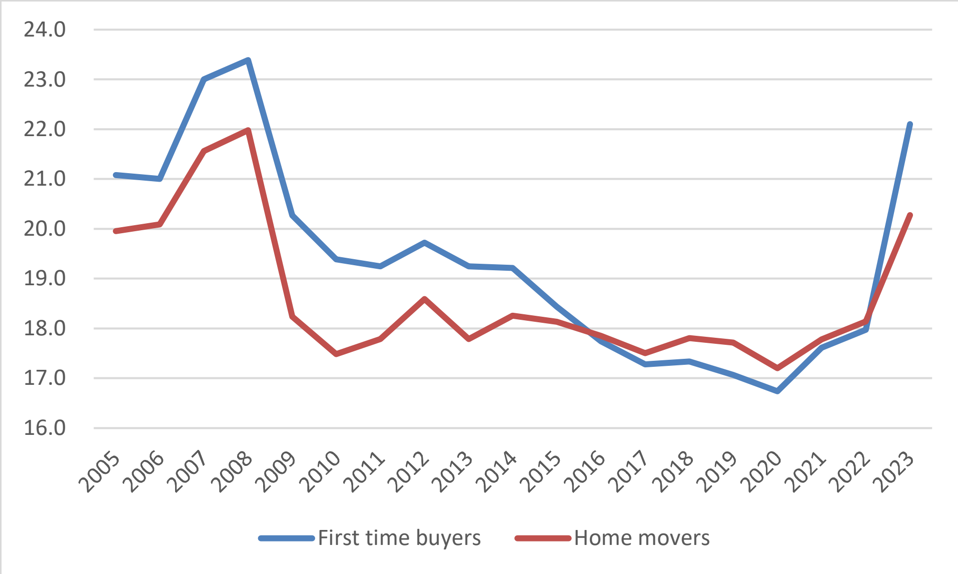
Put in its longer-term context, as Chart 13 does, affordability, as measured by the percentage of income spent on mortgage interest on new advances, remains comfortably below the peaks of 1990 and 2008. But Chart 13 does reveal one interesting difference between first-time buyers and home movers (those already in the property market). While home-mover mortgage interest payments consumed 12.7% of income on average in the year to September 2023, this figure was still below its long-run average of 13.8%. In contrast, for first-time buyers the 2023 figure of 16.0% was well above the long run average of 14.8%. This difference reflects the increased difficulties first-time buyers have faced as house price inflation has outstripped income growth.

Since 2005, UK Finance has also provided data on capital and interest payments as a percent of borrower income on new loans. Chart 14 shows the evolution of these payments for first-time buyers and home movers and includes data up to September 2023. For both groups, the payment burden is roughly back to where it was before the financial crisis, suggesting again that it is manageable for the average borrower. The

2 The New 'Normal' – prospects for 2023 and 2024 https://www.imla.org.uk/resources/publications/imla-the-new-%60normal-prospects-for-2023-and-2024.pdf

period after the financial crisis was the exception, with record affordability despite house prices being high relative to incomes.

Chart 14 – Capital and interest payments as a % of income



Source: UK Finance

The above data relate to those who actually bought and therefore may not be representative of the wider population. However, we can compare the incomes of those who bought to national averages. Perhaps surprisingly, since 2005 the average income both of first-time buyers and home movers has fallen relative to average earnings across the population. In 2005, the average first-time buyer's income was £38,300, 93% above UK average earnings. The average income for home movers was £57,200 that year, 188% above average earnings. By 2022, first-time buyers' average income had risen to £57,500 but this was 'only' 80% above national average earnings. Similarly, the premium of home movers' income to average national earnings was down, to 174%.

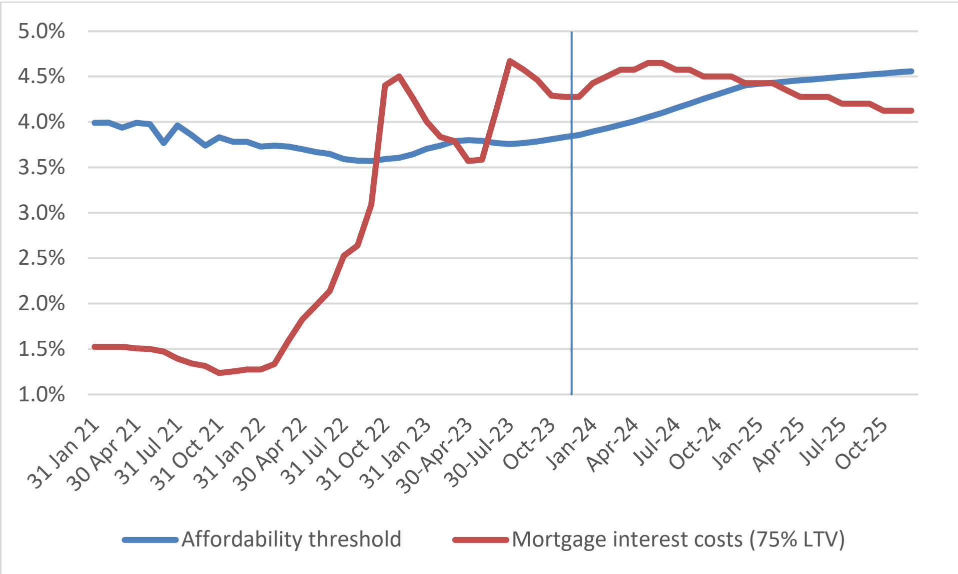
These premia reflect the fact that buyer income figures include many dual income households but the key point is that, despite house price inflation outstripping earnings growth over this period, the income bracket of buyers has not shifted up relative to the wider population. What has changed is the size of deposit put down by the average first-time buyer, which has more than doubled since 2005. Thus, it seems that the ability to save cash or access parental funds has become a more important determinant for entering homeownership than income.

3.2 Affordability in the buy-to-let market

Lenders and brokers report that the affordability requirements that are now in place have proven more challenging for buy-to-let landlords than owner-occupiers since rates spiked last Autumn. A sizeable minority of borrowers have not been able to remortgage to a different lender although their existing lender will usually have competitive product transfer options available.

Based on data from Homelet and the ONS, we estimate that gross rental yields were 4.7% in September 2023. This agrees exactly with the mean gross yield from IMLA's survey of private landlords carried out at that time[3]. As lenders are required to ensure that gross rental income is at least 125% of mortgage interest payments, we can calculate an affordability threshold for the average rented property expressed as a percentage of the value of the property and this is represented by the blue line in chart 15. For example, in September 2023 the average gross rental yield would correspond to an affordability threshold of 3.8% (4.7%/125%).

Chart 15 – Affordability threshold and mortgage interest costs (75% LTV)



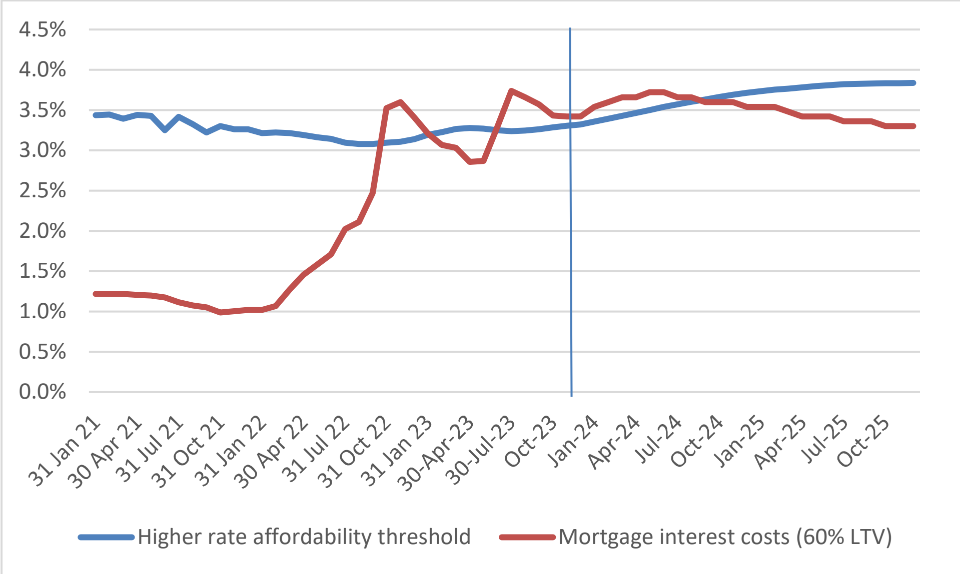
Source: Bank of England, ONS, Homelet

The affordability threshold can then be compared to the cost of the average 2 year fixed rate mortgage at 75% LTV, also expressed as a percentage of the whole property value. For example, in September 2023 this mortgage rate was 5.95%. Expressing that cost as a percentage of the entire property value is 4.5%. Thus Chart 15 shows the periods in the past and into the forecast period when an average buy-to-let borrower with a 75% LTV mortgage would most likely fail to meet minimum affordability requirements without other income being taken into account.

A similar exercise can be conducted for higher rate taxpayers holding their properties in their own name rather than through a corporate structure. Rather than dividing gross yields by 1.25, here lenders are expected to use a higher ICR of 145% so the yield is divided by 1.45. The result is that it is harder for the borrower to meet the affordability threshold at any given LTV. As Chart 16 shows, even at an LTV of 60%, higher-rate landlords of properties with average yields will have found it difficult to meet affordability requirements even without factoring in any stressing of the interest rate.

[3] IMLA landlord survey: understanding today's private rented sector providers (December 2023)

Chart 16 – Higher rate affordability threshold and 60% LTV mortgage costs



Source: Bank of England, ONS, Homelet

Some of these landlords will have sufficient other income such that they are deemed able to meet their buy-to-let mortgage payments in part from these other sources, but not all landlords will be in this position. For some, the inability to meet affordability requirements reflects an inability to generate sufficient income, exacerbated by the tax burden imposed by not being able to offset mortgage interest at their marginal rate. Many of these landlords will feel they have little choice but to exit the private rented sector altogether, exacerbating a shortage of accommodation that is pushing rent up for tenants.

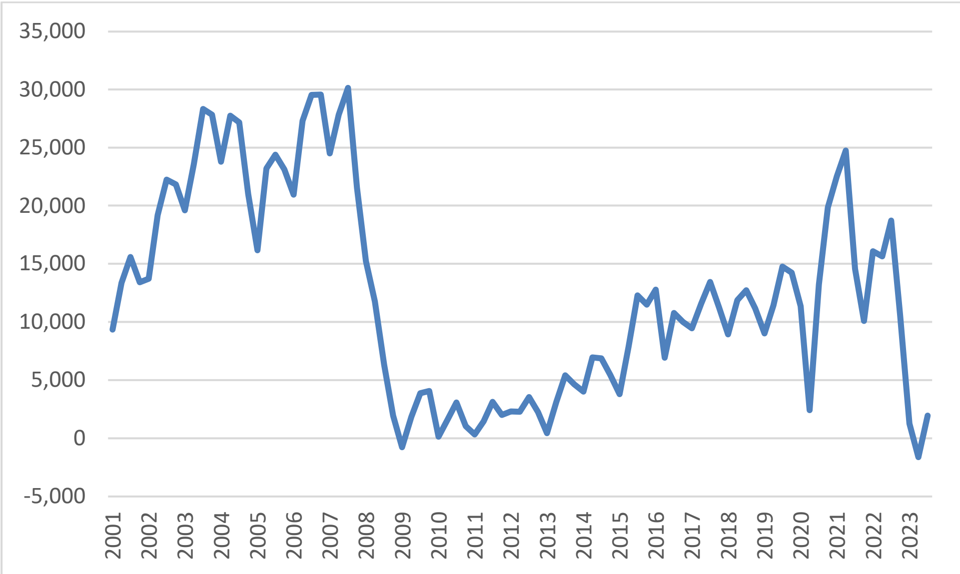
However, as Charts 15 and 16 show, we expect buy-to-let landlords' financial position to improve over the forecast horizon as rents rise and mortgage rates ease back. By the end of the forecast period, we expect gross rental yields to average 5.6% and affordability pressures to have eased for most landlords.

4. The rise and rise of cash

4.1 Net lending takes a dive

One of the most striking features of 2023's mortgage market has been the collapse of net mortgage lending (see chart 17). In the first ten months of the year, net lending totalled £1.3 billion against £53.7 billion for the same period in 2022. 2023 looks set to fall short of the previous record low reached in the aftermath of the financial crisis, when net lending dropped to £5.8 billion. While it was clear why net lending fell back so sharply during the financial crisis, as lenders tried to shrink their balance sheets, it is harder to explain the sharp turnaround this year, especially in light of the relatively robust performance of the housing market discussed above.

Chart 17 – Net mortgage lending (quarterly £mn)



Source: Bank of England

Part of the explanation lies in the decline in the number of outstanding mortgages. As Chart 18 shows, the number of owner-occupiers with a mortgage has been falling since the financial crisis with a cumulative fall of 1.9 million between the first quarter of 2008 and Q3 2023. This represents nearly 1 in 5 of the mortgages outstanding at the start of 2008. But in 2023, the outstanding number of buy-to-let mortgages also fell. In aggregate, the number of mortgages fell by 165,000 over the first three quarters of 2023, more than the whole of any previous year's fall.

The biggest driver of the trend decline in owner-occupiers with a mortgage is the age profile of these borrowers. The baby boomer generation, who have high rates of homeownership, are reaching the age when mortgages are typically paid off and they have not been replaced by a similar number of younger households. The fall in buy-to-let mortgages is a new phenomenon, however. Anecdotally, it seems that a combination of increased regulation, the threat of even more draconian regulation and adverse tax changes have combined with expectations of a possible house price correction to tip the balance for many landlords, particularly smaller operators, in favour of leaving the market. But the demographic profile of landlords is also playing a role, with many coming up to an age when they start to consider divesting their holdings. For example, 38% of the landlords in the IMLA survey were aged 60 or over.

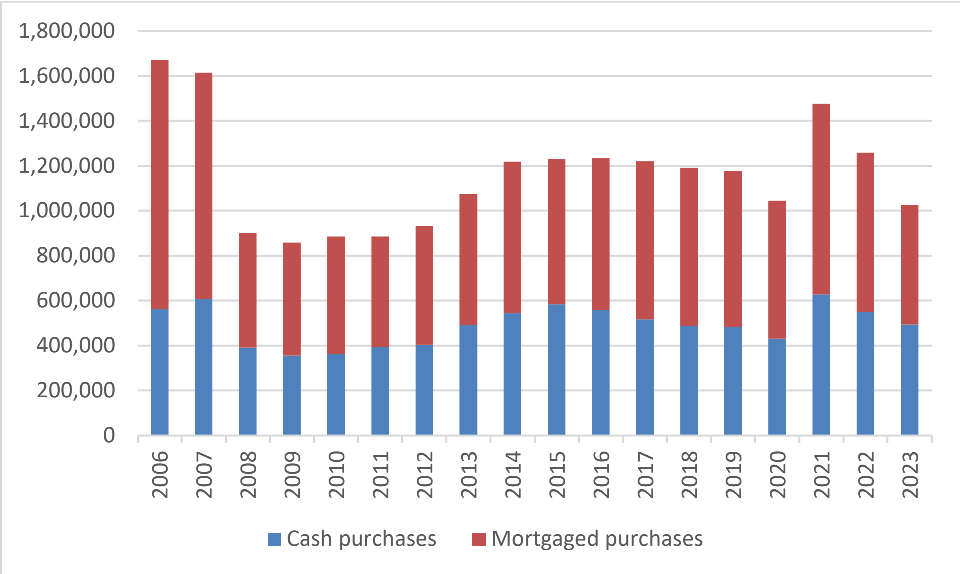
Chart 18 – Change in number of mortgaged properties

Source: UK Finance

4.2 Funding for transactions shifts to cash

It is not just the stock of mortgages that is in decline. The role of mortgage finance in property transactions has also diminished. In 2006, two-thirds of property purchasers used mortgage finance. The ratio was relatively stable after the financial crisis at between 55-60% but in 2023, we estimate that mortgaged transactions reached a new low, funding just over 50% of purchases (see Chart 19).

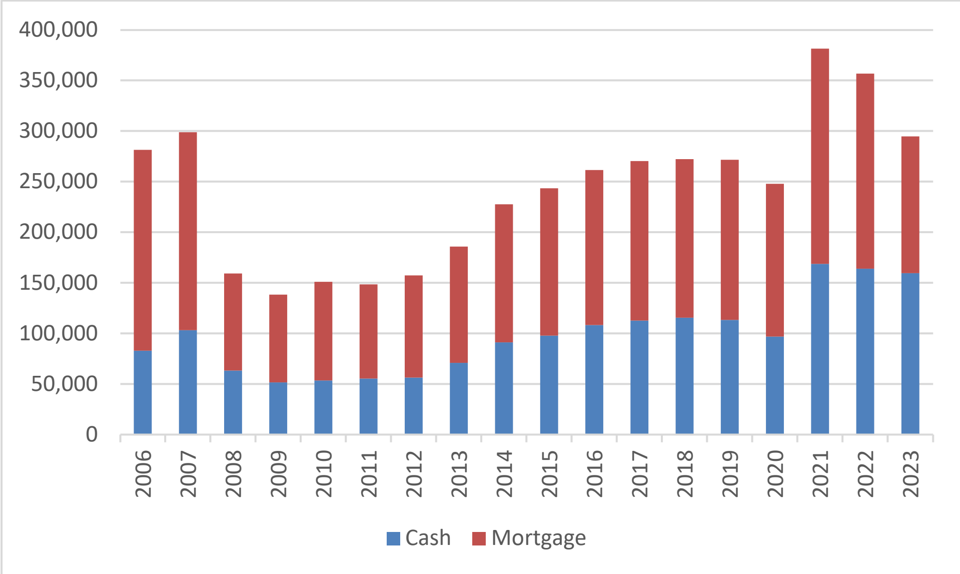
Chart 19 – Cash and mortgaged housing transactions



Source: UK Finance, HMRC

This phenomenon should not be too surprising. If the proportion of households with a mortgage is falling, it follows that more transactions are also likely to have cash buyers, as a higher proportion of people moving house will not have or need a mortgage, particularly in the case of older downsizers.

Chart 20 – Value of housing transactions (£mn)



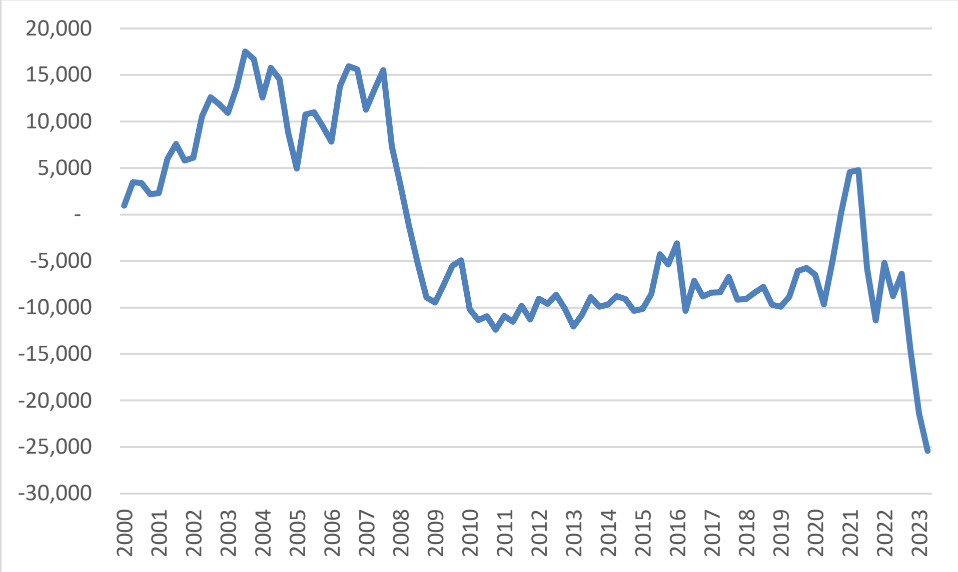
Source: HMRC, ONS, Bank of England, UK Finance

It is not just the number of transactions using mortgage finance that is falling. Chart 20 breaks down the total value of housing transactions, calculated using data from HMRC and the Land Registry, into those part financed from debt and the element financed from cash. In 2006, mortgage lenders provided 71% of the estimated £281 billion spent on residential property transactions. This share declined sharply during the financial crisis to 60% in 2008, stabilising around that level until 2020. Since then, as Chart 20 reveals, the amount of cash used in property purchases has reached new heights.

2021 was a record year in which over £380 billion was spent on residential property purchases but only 56% of the funds for these transactions came from lenders. Since that buoyant year, powered by a stamp duty holiday and pent-up demand after the Covid lockdown, the value of transactions has fallen but the relative importance of cash has continued to rise. For the first time in 2023, we estimate that more than half (54%) of the funding in the UK housing market came from cash.

Another data series that exposes the extent to which cash is eclipsing mortgage debt in the housing market is housing equity withdrawal, which measures the extent to which households are extracting cash from their homes by increasing the mortgage debt secured on it. For example, if physical investment in the housing stock through the building of new homes and improvements to the existing stock is £20 billion in a particular year and mortgage debt increases by £30 billion, households in aggregate must have withdrawn £10 billion of housing equity. This money is then available to them to spend, invest or pass on.

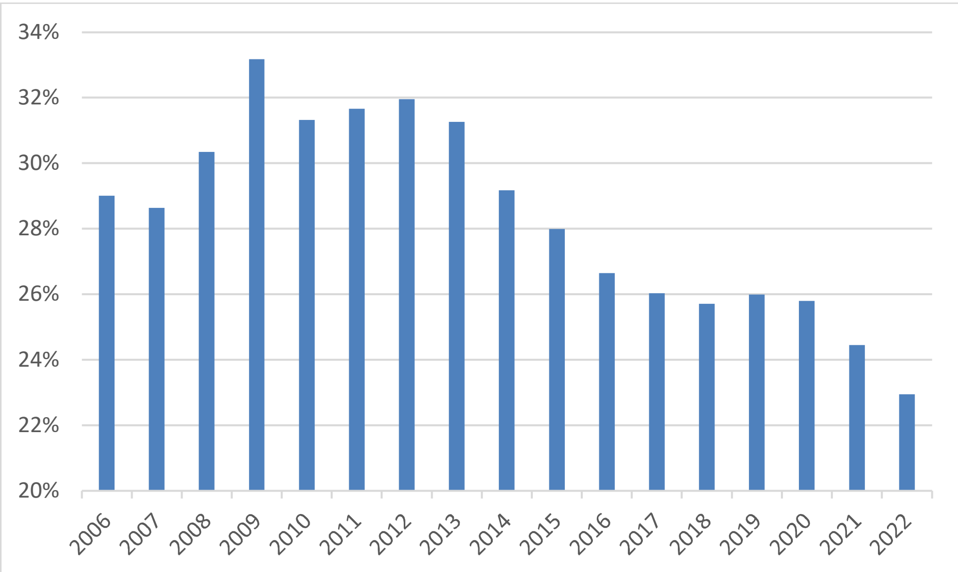
Chart 21 – Housing equity withdrawal (£bn)



Source: Bank of England

As can be seen in Chart 21, prior to the financial crisis it was normal for equity withdrawal to be positive most of the time as people took advantage of rising housing wealth to boost spending. As the Chart illustrates, the shift that took place during the financial crisis has proven to be structural rather than cyclical. IMLA has commented in the past on the extraordinary scale with which households have been injecting equity into their homes since 2008. But in the first half of 2023, housing equity injection reached new heights at £46.8 billion, exceeding any preceding full year. This is equivalent to £4,300 for every mortgage borrower and brings the total injected since 2008 to a staggering £512 billion.

Chart 22 – Average LTV of UK private housing stock



Source: Bank of England, DLUHC, Land Registry

A consequence of housing equity injection coupled with rising house prices has been a steady decline in the average LTV across the whole UK private housing market from an estimated 33% in 2009 to 23% in 2022 (see Chart 22). This has left households in a financially robust position. It also provides mortgage lenders with an opportunity, particularly in the later life lending market, to help homeowners release some of this accumulated equity to facilitate its transfer to the next generation.

5. Conclusion

2023 was a year when, after the disruption brought about by Covid and the Russian invasion of Ukraine, a degree of normality began to return to the world economy. This has opened a path back to lower interest rates, which in turn should improve mortgage affordability and set the scene for a mortgage market recovery. However, given the scale of shock from these seismic events, we should not expect the journey back to low and stable inflation and interest rates to be either rapid or trouble-free.

Having initially under-estimated the upward pressure on inflation, the Bank of England has since over-estimated the speed with which it will fall back. The smooth glide path the Bank has set out by which inflation will return to target over the next two years is more likely to be a bumpy road if recent history is any guide. Thus, it is judicious to be cautious about how quickly the UK can move past its current period of higher interest rates and what the new normal will look like.

Structural changes in the labour market, with a steadily increasing ratio of retired to working persons, suggests that unemployment will remain low by historical standards, potentially putting upward pressure on wages. An aging population globally could also point to a lower savings rate as a higher proportion of the population move into retirement, which might mean that the negative real interest rates we have experienced since the financial crisis might unwind. The result could be that the new normal for interest rates, after the recent cyclical surge has played out, is higher nominal and real interest rates than those of the past 15 years. Assuming that inflation averages 2% in the longer term, this might mean Bank Rate at 3% or more, a significant shift from what we knew for more than a decade but a substantial reduction compared to current rates.

For the housing and mortgage markets higher interest rates have accelerated the shift to cash, insulating the housing market but reducing lending volumes. Particularly in the buy-to-let market, borrowing taken out at much lower interest rates has tested affordability limits. But the same structural forces that are shaping the labour and savings market are also at work in the housing and mortgage markets. Homeowners as a group are ageing more quickly than the broader population, driven by the challenges first-time buyers face entering the market, reducing the role of mortgage finance relative to cash.

The trend towards cash has further to play out as the baby boomer generation moves into retirement. However, this does provide mortgage lenders with an opportunity to assist a housing equity-rich generation of retirees provide the financial assistance their children and grandchildren need to get a foot on the housing ladder as well as supporting their own standard of living, particularly for those with the less generous defined contribution pensions that are increasingly the norm.

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About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses wholly or predominantly via the broker channel. Its membership of 53 banks, building societies and specialist lenders include 18 of the 20 largest UK mortgage lenders (measured by gross lending) and account for approximately 93% of gross mortgage lending.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market.

Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), Building Societies Association, UK Finance and the Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high-profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme and Deposit Unlock.