The new ‘normal’ – one year on

Is the march back to a sustainable market on track?

April 2015

Executive summary

- Going into 2014 the mortgage market was experiencing its first sustained recovery since the financial crisis. If the authorities set out to slow the housing and mortgage markets via the actions of both the Financial Conduct Authority (the new rules arising from the Mortgage Market Review – the MMR) and the Financial Policy Committee (stress test guidance and limits on lenders' high loan to income lending) they cannot have been disappointed. The MMR, which was introduced in April, does seem to have had both a short term impact (particularly on remortgage activity) and a more permanent one (albeit disentangling the impact of FCA from FPC actions is not easy), as the affordability requirements make it harder for some borrowers to access new mortgage finance.

- By the end of 2014 much of the steam had come out of the mortgage market. While gross lending was 36% up on a year earlier in January, by December it was 2% down with a larger fall in remortgaging activity, and the market softened further in January 2015, falling 8% on a year earlier.

- IMLA forecasts provide a cautious view of the market in 2015. The slowdown going into 2015 has been driven by negative influences including worsened housing affordability, tighter affordability restrictions following the MMR and FPC stress testing recommendation as well as political uncertainty ahead of the General Election in May. However, strong economic fundamentals including low inflation, rising real incomes and continued low interest rates, entrenched by the fall in oil prices since last summer, should underpin the market over the course of the year.

- We forecast that gross mortgage lending in 2015 will reach £210bn, 3% above 2014's total, with a further increase to £220bn set for 2016. But we expect net mortgage lending to fall slightly to £22bn this year before recovering to £24bn in 2016.

- The proportion of the total value of housing transactions that involves mortgage finance – what in a sense could be thought of as the mortgage market's share in housing transactions – hit a new estimated all-time low in 2014 of 41.7%. In other words, hypothetically an 'average' house purchaser funded over 58% of the purchase with cash, with less than 42% of the funds being borrowed, including those that paid entirely in cash. Parts of the housing market – particularly central London – have become decoupled from the influences of mortgage availability and control. We expect this trend to continue with the mortgage share falling to 41.2% in 2015 and 39.3% in 2016.

- The shape of the mortgage market over the past few years has been altered a great deal by the changing fortunes of different lender types. For example, the aggregate mortgage books of specialist lenders fell from £426bn at the end of 2008 to £112bn in December 2014 as their numbers shrank, with a serious

adverse effect on the non-standard borrowers who specialist lenders had generally focussed on. But today the remaining specialist lenders and building societies are enjoying a rising gross lending market share at the expense of the banks, partly reflecting the enlarged non-standard prime market.

- The volume of mortgages sold through intermediaries suffered in the wake of the financial crisis, falling from 1.3m in 2007 to a low of 400,000 in 2012, taking the share of all sales down from 61% to 47%. But since then the intermediary channel has recovered sharply to a market share of 60% and sales of 600,000 in 2014. The MMR has given intermediaries a particular boost as the end of non advised sales has led lenders to source more business from brokers. Between Q1 2014, immediately before the introduction of the MMR, and Q4 2014 the number of borrowers using intermediaries rose by 20% against a 6% fall in those using direct distribution.

- Evidence suggests that there has been a structural decline in the rate of house sales. In the 1980s annual turnover averaged over 12% of the private housing stock, so houses changed hands once every 8 years on average. This has fallen to 4.5% so far in the 2010s, meaning that the average home now only changes hands every 23 years. Low housing turnover is driven by people buying their first home later; by a larger private rented sector (PRS), where turnover is lower; and by the baby boomer 'hoarding effect' where middle aged homeowners are staying put, tying up a large part of the housing stock. These factors are likely to keep turnover down for years to come, keeping mortgage lending subdued by past standards.

1. Introduction

One year ago the Intermediary Mortgage Lenders Association (IMLA) published its report '*What is the new 'normal'? Mortgage lending in 2014-15 and the march back to a sustainable market*'. One year on this report provides an update on the mortgage market's performance, examining how the market has evolved relative to our predictions and looking at the factors driving the changes we have seen. The paper then considers how the market might develop over the next few years, before examining three specific topics: how different categories of lender have fared; how mortgage distribution is evolving; and structural changes to housing turnover.

2014 was an exceptionally busy year for mortgage lenders. In April the new mortgage market rules which flowed from the Mortgage Market Review (MMR) finally came into force. But there was also, in June, the first use of the new macro-prudential tools given to the Financial Policy Committee (FPC) of the Bank of England, with the FPC recommending two measures: that lenders should assess affordability using an interest rate stress test based on Bank Rate being 3% higher and that mortgage lenders should not extend more than 15% of new mortgages at loan to income ratios at or above 4.5 borrower income.

These specific mortgage market regulations came on top of the on-going implementation of banking regulation through the Capital Requirements Directive (CRD) and the UK retail bank ring-fencing proposals. Most recently, the Bank of International Settlement (BIS) have issued a consultation on the Standardised Approach to capital, which floats the idea that the 35% risk weight for residential mortgages could be replaced with risk weights ranging from 25% to 100% based on loan-to-value (LTV) and debt-service coverage ratios. January 2014 also saw the Funding for Lending Scheme (FLS) withdrawn for mortgage lending.

If the authorities had hoped to slow the robust recovery in house prices and mortgage volumes that was underway going into 2014 they cannot have been disappointed. There was a marked difference in tone between the first and second halves of the year, with most of the house price growth in the first half and mortgage volume growth evaporating by the end of the year.

The gradual return to what might be deemed the new commercial normality in the lending industry continued in 2014. Mortgage rates came closer into line with Bank Rate as competition for new business intensified around price rather than product innovation. This was particularly evident in the second half of the year when a full scale price war broke out as demand from borrowers slipped back. However, not all aspects of the market could be described as normal. The differential between rates paid by lower and higher LTV borrowers continued to widen, reaching new highs by the end of the year. For example, the marginal costs of borrowing between 90% and 95% LTV reached over 30% by November and December.

Looking ahead to 2015, the slowing housing market towards the end of 2014 drove a more cautious and even pessimistic tone among forecasters, with at least one

forecasting house price falls nationally. While acknowledging that the housing market has entered a more subdued phase, we think the market is reasonably well underpinned by lack of supply so outright price falls are fairly unlikely this year.

A combination of exceptionally low mortgage rates, the change to the Stamp Duty regime in England and Wales announced in the Autumn Statement and the boost to real incomes from lower oil prices should all underpin housing market activity and mortgage demand over the course of 2015, offsetting the constraining influence of the MMR and the political uncertainty that the country faces until at least the May General Election.

But for now there will be no return to the elevated growth rates seen at the end of 2013 and in the earlier part of last year. It seems that the regulator's wish to see a permanently sober and 'sustainable' mortgage market might just be coming true.

2. The path of the recovery in 2014

Housing market

The housing market was strong heading into 2014 and we forecast house price growth of 6.6% for the year as a whole with 1.15m transactions in England and Wales, against 966,000 in 2013 (HMRC data). The outturn for 2014 saw house price growth of around 9-10% but slightly fewer than expected transactions at 1.1m. Using ONS house price data, the estimated total value of UK property transactions was £324bn, an increase of 25% on 2013.

Mortgage market

The combination of higher house prices and increased transactions drove a solid recovery in the mortgage market. Total gross mortgage lending rose from £179bn to £204bn. This was lower than our forecast of £215bn and less than implied by the estimated growth in the value of property transactions. As a result, the share of mortgage loans in the funds used to finance property transactions in aggregate fell to a new all time low of 41.7% from 42.7% in 2013, which itself was a record low. Had mortgage lending maintained its 2013 'market share' of the value of transactions, housing purchase lending would have been £3.2bn higher.

Buy-to-let lending had another strong year in 2014, with gross advances increasing 32% to £27.4bn. This gave buy-to-let a record share of total lending at 13.4%. Another niche lending product – equity release mortgages – had a record year in 2014 with lending of £1.4bn, 29% up on the previous year albeit from a low base. The gradual decline of the defined benefit pension and lower annuity rates have left many retirees with disappointing incomes, which it seems may finally be lifting the equity release market.

Growth in the mortgage stock

Net lending performed better than even we had anticipated. Having been £11bn in 2013 (now revised to £14bn), 2014 witnessed a 62% increase to £23bn (we were forecasting £20bn). This was the highest total since 2008, and proved helpful in a year when lenders collectively had a greater appetite to lend, as it represented a reasonable increase in the size of the overall cake. However, with net lending of £14.3bn the buy-to-let market accounted for nearly two thirds of the total growth in the mortgage stock.

Although 62% sounds like a dramatic increase in net lending, this is an inherently volatile figure (being the difference between two large numbers – gross lending and gross redemptions). Moreover, net lending peaked at £110bn in 2006 so 2014's figure of £23bn remains subdued in this longer run context and represents a modest 1.8% increase in outstanding mortgage loans. The UK mortgage debt to income ratio continued to fall, albeit modestly.

2014 – a game of two halves

The aggregate statistics for 2014, however, mask the real story, which was a pronounced slowdown over the course of the year. This is evident from Table 1 which shows each month's gross mortgage lending relative to the same month the previous year. This comparison removes any seasonality and shows the extent to which a red hot recovery at the start of 2014 stalled over the course of the year.

Table 1 – Increase in gross mortgage lending over 2014 compared to a year earlier

	House purchase	Remortgage	Other	Total
Jan	46.1%	36.8%	-21.3%	35.7%
Feb	48.6%	34.3%	-28.2%	35.7%
Mar	37.6%	32.4%	-13.8%	30.6%
Apr	46.7%	22.9%	-3.1%	34.3%
May	22.7%	-4.5%	8.6%	13.1%
Jun	26.8%	8.9%	-6.9%	18.8%
Jul	26.4%	0.1%	-10.9%	15.8%
Aug	12.6%	2.0%	-18.3%	7.7%
Sep	18.7%	0.1%	-30.5%	9.0%
Oct	11.1%	-8.2%	-16.7%	3.4%
Nov	0.8%	-15.1%	-28.2%	-6.0%
Dec	1.3%	-8.9%	-2.5%	-1.9%
Jan-15	-7.1%	-8.6%	-18.7%	-8.4%

Source: Bank of England. Note: The basis of the breakdown between house purchase, remortgage and other has been revised so while the total figure remains comparable to last year the components do not.

Interestingly the impact of the MMR, which came into force on 26 April, looks to have been immediate, with a sharp slowdown evident in May, particularly for remortgage activity. These statistics support anecdotal evidence about the initial impact of the MMR, which suggested that some lenders had to slow the volume of business being processed in order to ensure that their systems met the new rules, with priority being given to house purchase transactions over remortgages.

But the subsequent recovery failed to materialise. This was particularly true of remortgage volumes which by October were down 8% on the same month a year earlier. As the MMR was designed to tighten affordability requirements, most lenders agree that it has excluded some customers who could previously have accessed a loan – albeit a small minority – and therefore has placed an ongoing constraint on growth in the market stretching beyond the implementation phase.

In IMLA's July 2014 market research, 85% of lenders reported that the MMR had reduced access to mortgage finance amongst low income borrowers and 77% reported that borrowers with dependents had faced the same outcome. Brokers reported similar results.

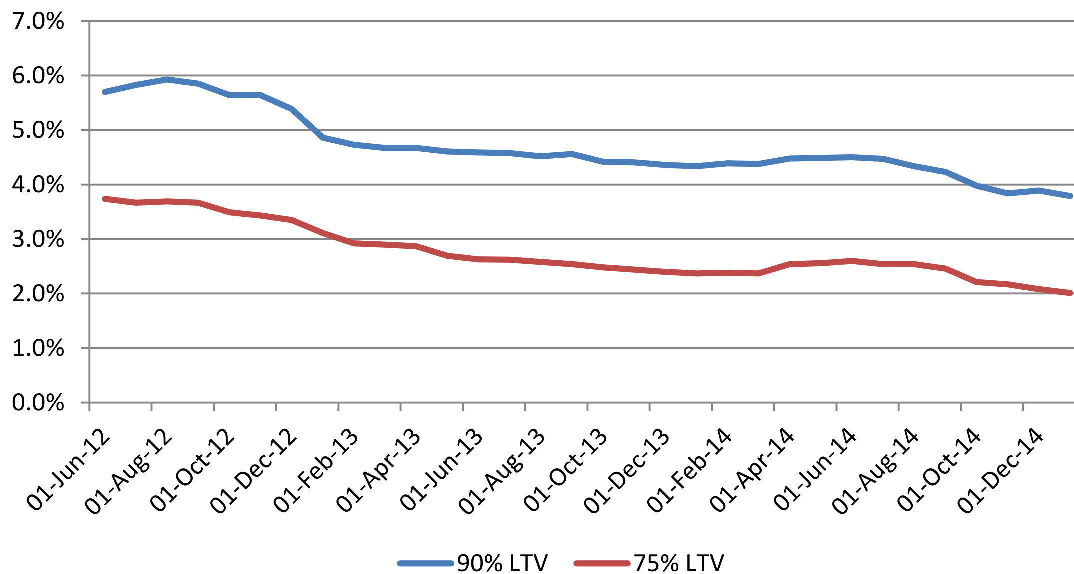
However, it would be wrong to conclude that the slowdown was entirely the result of the MMR. Even buy-to-let, which was not covered by the new rules and has been the strongest part of the market in recent years, experienced a slowdown towards the end of 2014. Nonetheless, just as the announcement of Help-to-Buy in the 2013

Budget seemed to kick off the housing recovery, so the MMR and introduction of macro-prudential rules by the FPC marked the point when house price growth slowed sharply, housing transactions plateaued and the mortgage market recovery started to stall.

Pricing trends in 2014

One consequence of the unexpected softening of demand in the second half of 2014 was that lenders suddenly found it harder to reach their lending targets for the year, provoking an intensification of price competition so marked that it could be described as a price war. Chart 1 shows the average price of 75% and 90% LTV 2 year fixed rate mortgages. Both the 75% and 90% LTV categories saw record low rates on the latest data for the end of January 2015 – 2.01% and 3.79% respectively. As recently as the end of 2012 the 75% category recorded average pricing of 3.35%. Arrangement fees have also been on a downward path.

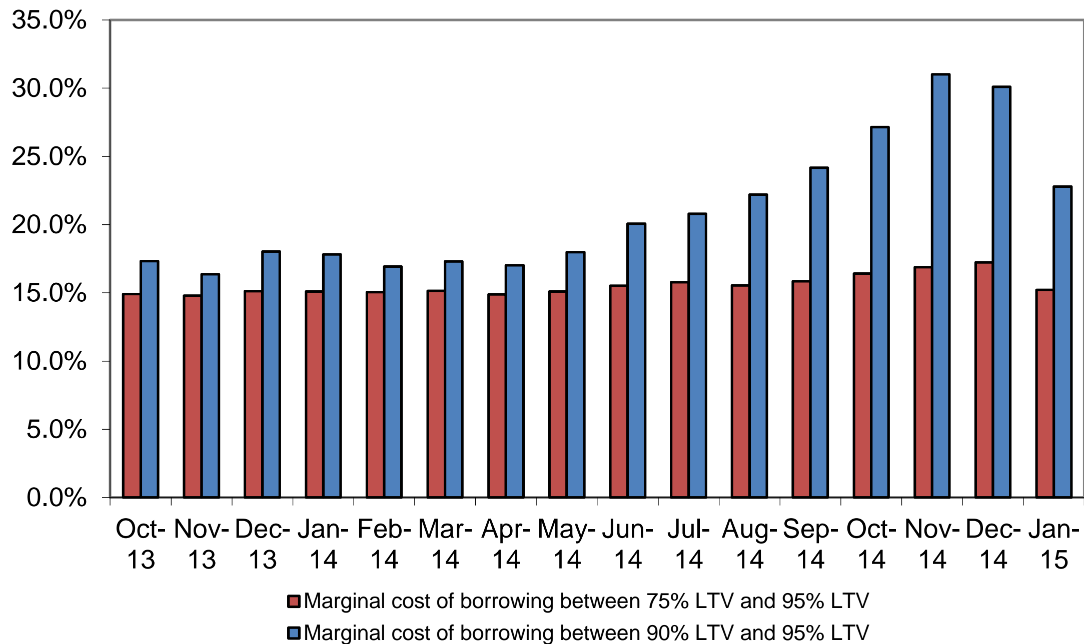
Chart 1 – Average 2 year fixed rate mortgage rates



Source: Bank of England

Lenders' healthy appetite for new mortgage business seemed undented by the withdrawal of FLS support for the mortgage market in January 2014. The lowering of mortgage rates despite the changes to the FLS indicates that the financial sector has continued its gradual return to normality. But this does not appear to extend to the high LTV segment.

Chart 2 – Marginal cost of top slice of high LTV lending (based on average 2 year fixed rate mortgage rate)



Source: Bank of England

The data shown in Chart 2 are calculated by comparing average rates on 75%, 90% and 95% LTV 2 year fixed rate mortgage deals, disaggregating the cheaper low LTV portion to give an implied cost for the top slice from 75% to 95% and from 90% to 95%. The results are surprising as they show that the marginal cost of this top slice of debt has been high (15% or more) and over the course of 2014 it was generally rising.

By December 2014 the marginal cost of borrowing between 75% and 95% was a hefty 17% and the cost of borrowing between 90% and 95% was an astonishing 30%, higher than the rate on many credit cards, showing how reluctant lenders remain to take on the risk of lending above 90% LTV, although a sharp drop was recorded in these implied top slice rates in January 2015 (see Chart 2).

Buy-to-let

The on-going shift in tenure towards private rented accommodation continued in 2013-14 with the English Housing Survey recording that 19% of households were renting privately against 11% in 2003. Unsurprisingly, against this background, 2014 witnessed another solid performance from the buy-to-let mortgage market with gross advances up 32% and net lending up 55%. The stock of buy-to-let mortgage debt grew 8% against less than 2% for the mortgage market as a whole.

This was the fifth straight year of recovery although buy-to-let lending remains well below its 2007 peak. The slowdown in activity over the course of the year that was evident in the mainstream market was less apparent in buy-to-let but even here

gross lending growth slowed from over 40% in the first quarter to around 30% by the end of the year.

Remortgage activity was particularly buoyant in buy-to-let, representing more than 50% of lending in the segment and more than 25% of all remortgaging. This was probably driven mostly by a combination of rate chasers as new product offerings became more price competitive and landlords remortgaging to release equity to expand in the face of buoyant tenant demand.

3. The outlook for 2015 and 2016

The wider economic environment

Last year's report pointed out that the current cyclical recovery cannot be considered normal because of the scale of policy interventions to support the economy globally. Governments have run large fiscal deficits and central banks have taken unprecedented measures to maintain demand.

One year on and despite the fact that economies such as the UK and US have put in credible growth performances, globally we are far from the point where we can say that monetary policy is on the path back to normality. Japan embarked on another round of quantitative easing (QE) and in February the European Central Bank (ECB) finally stated its intention to follow suit despite German misgivings. The need for such intervention underlines the continued fragility of the global economy, which is bound to temper the economic climate in the UK.

The additional dose of unconventional monetary policy, coupled with lower inflation expectations, has had a marked effect on long term interest rates around the globe, including in the UK. While a year ago the talk was of preparing for increases in Bank Rate, this year long term UK government bond yields have touched record lows and Governor Carney has even mentioned the possibility of further rate cuts if inflation fails to revive. We have therefore stuck with our forecast that Bank Rate will remain at 0.5% this year and projected this forward in to 2016 (see Table 2 showing our key assumptions).

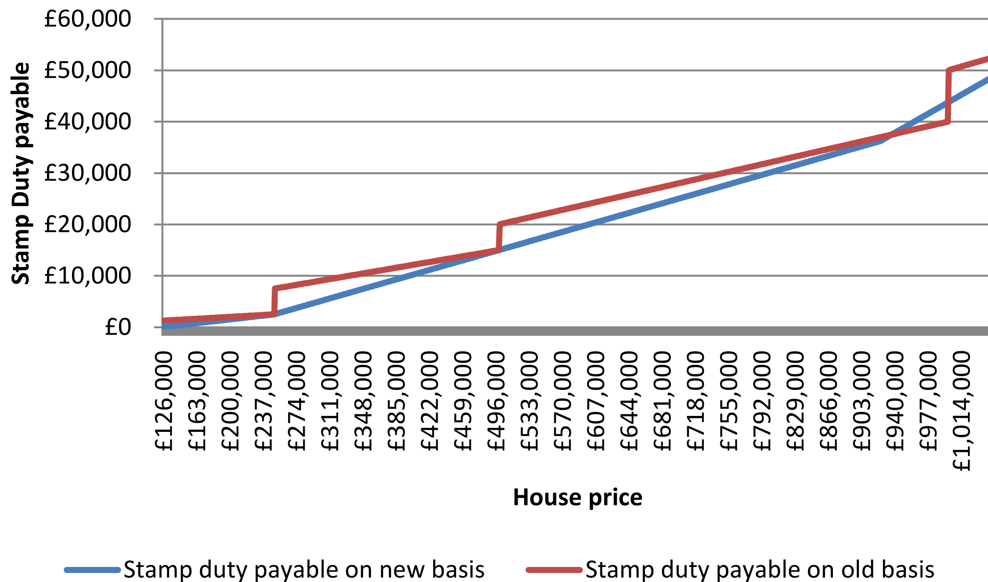
Housing and mortgage markets in 2015 and 2016

The MMR and new macro-prudential rules have constrained some consumers' ability to borrow while house price increases have outstripped earnings growth, worsening affordability. These factors will act as a break on the number of property transactions and on house prices in 2015 and 2016. However, two positive developments are likely to help to underpin housing market activity:

- Firstly, by reducing the rate of inflation, the drop in the price of oil boosts real incomes and will delay the point at which the Bank of England will feel it appropriate to raise interest rates. Although some inflation hawks have, perversely, highlighted the inflationary consequences of real wages rising off the back of falling oil prices, the risk of inflation remaining stuck well below 2% is a real one. The Bank of England misjudged the amount of slack in the labour market when it used 7% unemployment as the threshold in its policy of forward guidance. Despite the unemployment rate now being down to 5.7% and falling there are still few signs of wages being the source of upward inflationary pressure. Having been caught out before, the Bank of England will presumably want to take a cautious approach to raising rates in the absence of much stronger evidence of inflationary wage rises.

- Second, the unexpected change to the Stamp Duty regime announced in the autumn statement, which will reduce the tax burden on most transactions, should encourage more housing activity. Encouragingly, first time buyers will be amongst the biggest winners in relative terms if they are looking to buy somewhat above the £125,000 threshold (see chart attached).

Chart 3 – Stamp Duty payable under old and new basis of calculation



Source: HMRC

Against these positive factors, political concerns are likely to hold the market back in the first half, and if the General Election in May produces an inconclusive result, without a stable coalition being formed, the political uncertainty could drag on with economic consequences.

Even with an outright majority for one of the main two political parties, specific policies could cause the market to underperform. Labour's mansion tax will directly affect a very small percentage of properties outside London but it could have a material impact on the market in the capital. The Conservatives' promise to hold a referendum on EU withdrawal could also hit the market, especially in London, given the uncertainty about the economic impact of withdrawal.

Table 2 – key forecast assumptions

	Actual values		Forecast values		Percentage changes		
	2013	2014	2015f	2016f	2014/13	2015/14f	2016/15f
House prices (ONS average for year)	242,167	264,697	275,000	285,000	9.3%	3.9%	3.6%
Housing transactions (UK, thousands)	1,070	1,223	1,200	1,250	14.3%	-1.8%	4.2%
Value of housing transactions (£bn)	259,058	323,613	330,000	356,250	24.9%	2.0%	8.0%
% of transaction value that is mortgaged	42.7%	41.7%	41.2%	39.3%	-2.3%	-1.1%	-4.6%
Bank Rate	0.5%	0.5%	0.5%	0.5%	0.0%	0.0%	0.0%

Source: The Wriglesworth Consultancy, ONS and HMRC

Table 2 shows our forecasts for Bank of England Bank Rate and three key housing market variables. Despite our forecast that Bank Rate will remain at 0.5% over 2015 and 2016 we forecast a relatively subdued housing market in 2015 with house prices up about 4% over the year as a whole and transactions 2% down on 2014. The forecast reflects both the positive and negative factors discussed above and recognises the trajectory of the market going into 2015. Year-on-year house price growth of 4% implies a rise of only 1% over 2015 against the December 2014 level. Housing transactions are best described as flat over 2015, running at 100,000 a month, in line with the Q4 2014 monthly average, the 2% year-on-year fall reflecting the declining profile already experienced at the end of 2014.

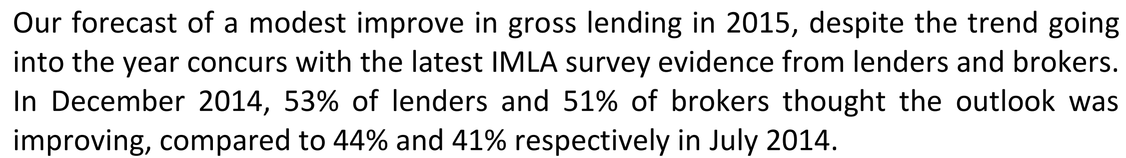
In 2016 we forecast a modest pickup in house prices and transactions. This is based on the assumption that by 2016 people will have adjusted to the new political landscape whilst the underlying economic environment will remain supportive with the positive effects of the oil price fall likely to peak then.

Table 3 – Mortgage market forecast (£m)

	Gross mortgage lending (£m)				Percentage changes		
	2013	2014	2015f	2016f	2014/13	2015/14f	2016/15f
House purchase	110,535	134,851	136,000	140,000	22.0%	0.9%	2.9%
Remortgage	53,786	57,073	61,000	65,000	6.1%	6.9%	6.6%
Other	14,562	12,474	13,000	15,000	-14.3%	4.2%	15.4%
Total	178,883	204,398	210,000	220,000	14.3%	2.7%	4.8%
Net lending	14,083	22,757	22,000	24,000	61.6%	-3.3%	9.1%

Source: The Wriglesworth Consultancy, Bank of England

Table 3 shows our forecast for the main mortgage variables. We expect gross lending to rise 3% from £204bn to £210bn, with the strongest growth in the remortgage market where we see lending growing by 7% against only 1% growth in lending for house purchase. The 'other' lending category includes further advances and all lending made by the category of lender termed 'other' (which includes insurance companies and public bodies), which can be quite volatile from year to year, but we forecast little change in 2015. Against this fairly subdued background, net mortgage lending is unlikely to show much momentum and could easily fall back given the weak January figures – we forecast a 3% fall to £22bn in this volatile number.


Our forecast of a modest improve in gross lending in 2015, despite the trend going into the year concurs with the latest IMLA survey evidence from lenders and brokers. In December 2014, 53% of lenders and 51% of brokers thought the outlook was improving, compared to 44% and 41% respectively in July 2014.

We expect a faster rise in gross lending in 2016 to £220bn and a rebound in net lending to £24bn. Against the backdrop of a positive economic environment, we feel that mortgage lending volumes, which remain modest by recent standards, do have scope to grow. However, this rebound is still not sufficient to prevent mortgage lending as a share of the value of property transactions slipping further over the forecast horizon, to 41.2% in 2015 and 39.3% in 2016 (see Table 2).

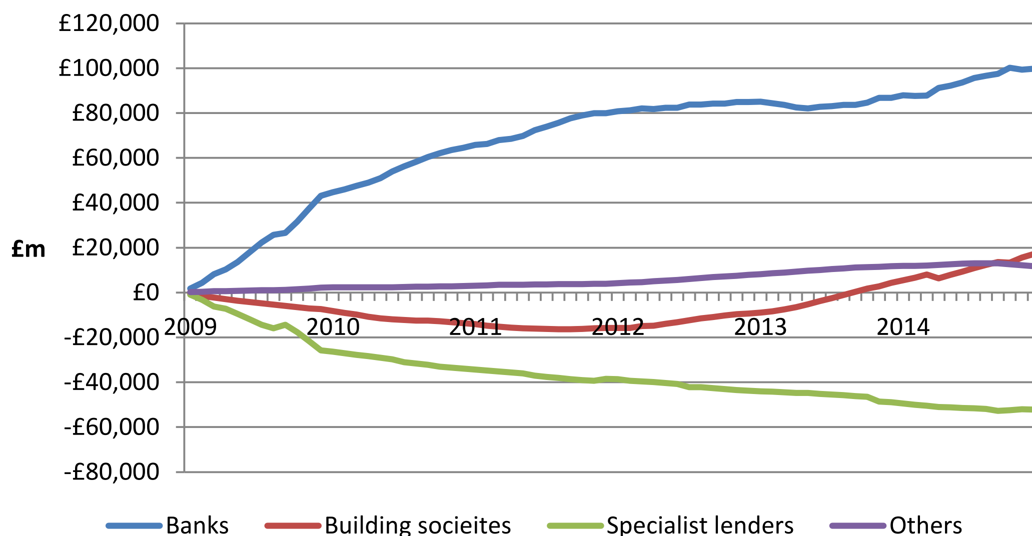
Although there is much uncertainty about volumes, the pension changes from April 2015 should free more cash to enter the buy-to-let market and a good proportion of these new landlords could be cash purchasers. This is another factor likely to push down the overall mortgage share in house purchases.

4. Evolution of market shares

Since the financial crisis the supply of credit has taken on a much more prominent role. Previously, commentators tended to focus on factors driving demand for mortgage borrowing, taking it for granted that lenders would be able to meet this demand. This section looks at how the main types of financial institution supplying mortgages have fared over the past few years and how this has impacted the availability of mortgage credit in general and the supply of credit to niche borrowers.

Chart 4 shows the cumulative change in the size of mortgage portfolio since 2009 held by the four types of institution that supply this credit: banks; building societies; specialist lenders; and others. These institutions have performed very differently since the financial crisis, and this has altered the mortgager landscape. Chart 4 shows that specialist lenders as a group have been the main loser and banks the largest winner.

Chart 4 – Increase/decrease in mortgage loan portfolios (£m)



Source: Bank of England and Building Societies Association

However, there is much more to this story than Chart 4 suggests and every lender type has faced its own problems:

- **Banks.** Going into the financial crisis banks held about 55% of UK mortgages by value. This reached 70% by mid 2010 as competitor building societies and specialist lenders fell away. But since 2010, banks' mortgage stock share has been on a gentle slide to around two thirds today. So, after an initially robust performance banks collectively are now punching below their weight.

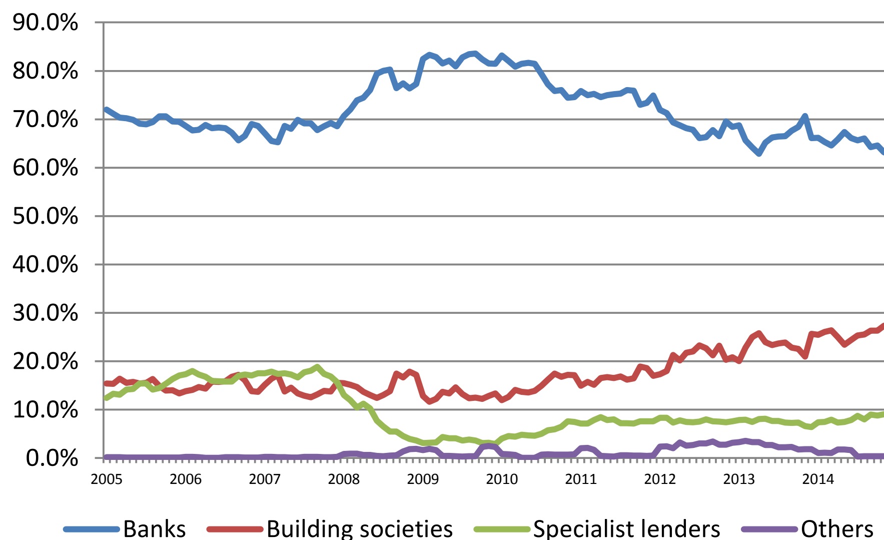
- **Building societies'** share of the mortgage stock fell slightly through the financial crisis to around 16%, but since 2011 it has shown a marked and somewhat unexpected recovery to nearly 20%. The fear was that building societies' inability to raise equity capital would put them at a disadvantage to

banks in an environment where regulators were demanding higher capital ratios. But their lending growth suggests that they have been able to adapt successfully to a world of higher capital requirements despite relying mainly on their own capital resources.

- **Specialist lenders** suffered most in the financial crisis. Being wholesale funded they found their whole business model was at risk and a considerable number of specialist lenders withdrew from the market and ceased trading. Their market share in stock terms fell dramatically from a peak of over a third at the end of 2008 down to 9% by 2014, with the mortgage balances they held falling from £426bn to £112bn by the end of 2014. However, the specialist lending sector may have finally reached a turning point, with positive net lending of £700m recorded in December 2014.

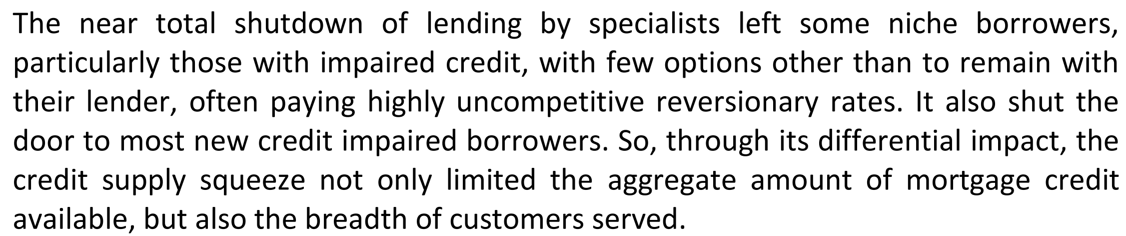
Chart 5 compares the performance of these different lender categories by showing the evolution of gross lending market shares. It clearly shows the resurgence of building societies and specialist lenders at the expense of the banks since 2010. In particular, it shows that the recovery for specialist lenders started much earlier than the stock share suggests. Gross lending by specialist lenders rose 48% in 2010 and another 44% in 2011, although this was from an exceptionally low base. In 2014 specialist lenders again put in a good performance with gross lending rising 26%.

Chart 5 – Share of gross mortgage lending



Source: Bank of England and Building Societies Association
Note: Building society total includes Co-operative Bank between January 2010 and November 2013

The revival of specialist lenders is particularly remarkable given how many firms closed down in the wake of the financial crisis. The previous precipitous decline of this lender segment not only reduced the overall supply capacity in the industry but also had a disproportionate impact on non-standard borrowers as these lenders mostly focused on niches which were underserved by the large banks and building societies, including credit impaired and self-employed borrowers and at that time the buy-to-let market.


The near total shutdown of lending by specialists left some niche borrowers, particularly those with impaired credit, with few options other than to remain with their lender, often paying highly uncompetitive reversionary rates. It also shut the door to most new credit impaired borrowers. So, through its differential impact, the credit supply squeeze not only limited the aggregate amount of mortgage credit available, but also the breadth of customers served.

However, specialist lenders and others have found that the ongoing demand for niche lending provides them with an opportunity in today’s marketplace. Indeed, specialist lenders may prove to be winners from mortgage regulation, as some larger lenders with automated loan underwriting systems are less focused on the self-employed and other non-standard customers in the post-MMR world because these borrowers fit less well into an automated affordability assessment.

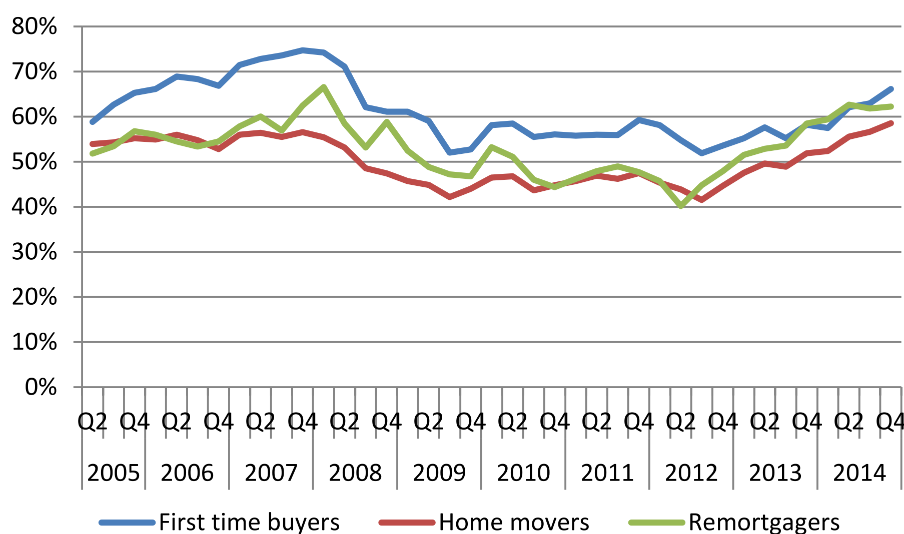
This seems to be confirmed by the December 2014 IMLA market research, which found that 56% of brokers reported an increase in the volume of cases placed with specialist lenders relative to summer 2014, ahead of 49% with regional/local building societies, 48% with national building societies, 38% with high street banks and 36% with challenger banks.

5. Distribution channels

The issue of how lenders choose to distribute their mortgage products to consumers has always been one of the key elements in their overall proposition and one in which IMLA, of course, has a particular interest. Prior to the financial crisis there was a broad trend away from branch distribution and towards the use of intermediaries.

As can be seen from Chart 6, by the end of 2007 more than 70% of first time buyers and more than 60% of those remortgaging were using a broker or other intermediary to source their loan. Across the whole regulated market in 2007, 1.3m borrowers (61%) used an intermediary.

Chart 6 – Percentage of borrowers using an intermediary



Source: Regulated Mortgage Survey

There was then a sustained fall in intermediaries' share of distribution following the financial crisis. Sales reached a low of 400,000 in 2012, taking the intermediary share of all regulated sales down to 47%. Part of the explanation for this lied in lenders' desire to take more control over the whole mortgage value chain. When lenders' appetite for writing new business declined, it made sense to allow the intermediary channel to bear the brunt of the squeeze. Lenders had the fixed cost of their own distribution, which incentivised them to keep using this channel.

But since 2012 the intermediary channel has recovered sharply, with its market share rebounding to 60% with sales of 600,000 in 2014. In the remortgage market the recovery of market share has been even stronger with intermediaries arranging 62% of remortgages in Q4 2014 against only 40% in Q2 2012.

This seems to have reflected the gradual normalisation of the UK mortgage market and lenders' growing appetite to increase origination volumes. Lenders looking to increase their mortgage business quickly have often favoured mortgage brokers,

seeing them as a tap that can be turned on quickly and turned off just as fast when lending targets are met.

Another factor favouring intermediary distribution is the growth of buy-to-let and the increase in the number of non-standard borrowers seeking credit. The buy-to-let market has always had a greater reliance on intermediaries and today 80-90% of buy-to-let borrowers use a broker. Non-standard borrowers, including the self employed, those borrowing into retirement and adverse credit cases, are also more likely to use an intermediary and brokers generally have a good understanding of which lenders are likely to be accommodating in each particular circumstance.

In 2014 the introduction of the MMR was a major factor favouring intermediary distribution in the regulated market. Between Q1 2014, immediately before the introduction of the MMR, and Q4 2014 the number of borrowers using an intermediary rose by 20% against a 6% fall in those using direct distribution. The December 2014 IMLA market research also showed a net +8% of brokers reporting a higher volume of applications.

The MMR removed non advised mortgage sales and many lenders were reluctant to bear the cost of retraining their mortgage sales forces in advised sales. Some smaller building societies moved to intermediary distribution only. And it has not just been branch based distribution that has been affected - lenders' newer telephony and online sales channels have also been impacted as lenders try to understand what advised sales means for these channels.

In the post-MMR world, the mortgage sales process takes significantly longer, reducing the volume of business that any individual broker or lender sales adviser can undertake. This has raised concerns about capacity constraints. Borrowers often have to wait several weeks for a mortgage interview even in today's subdued market. If demand does pick up sharply it could expose the lack of capacity at both lenders and brokers.

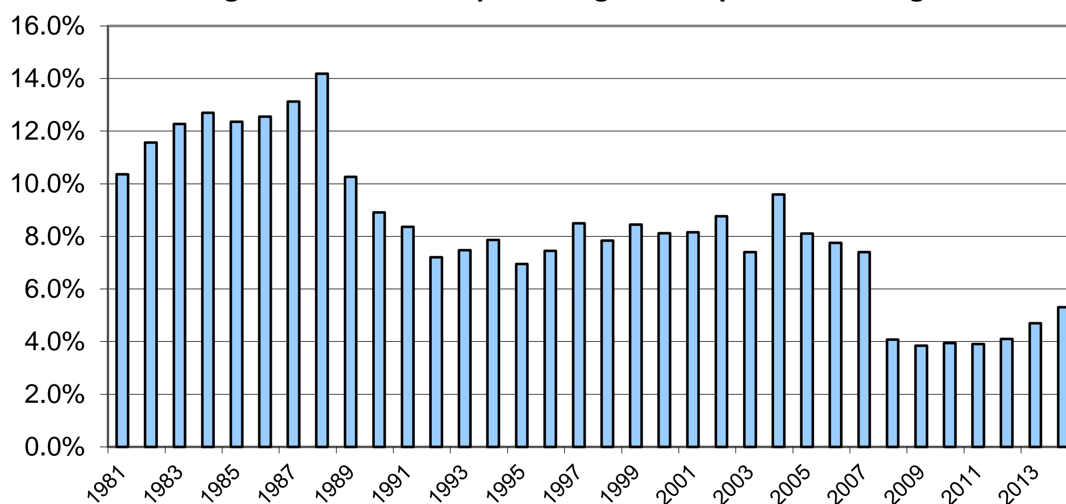
6. The outlook for housing transactions

Historically, one of the most important drivers of the mortgage market is the level of housing transactions. The cyclicality of house prices has been reinforced by fluctuations in the number of transactions, which also tends to move in line with the economic cycle. This combination has historically driven a strong cyclical pattern in lending for house purchase but also for net mortgage lending, as housing transactions often involve a net extraction of equity (those buying tend to have larger mortgages than those selling).

The downward trend in transactions

However, there is strong evidence that the UK is not just faced with a cyclical downturn but rather a structure changed towards permanently lower levels of housing transactions. Chart 7 shows the number of house sales as a percentage of the total private housing stock (owner-occupied and private rented housing). The downward trend is clear from Chart 7 alongside the cyclical pattern.

Chart 7 – Housing transactions as a percentage of the private housing stock



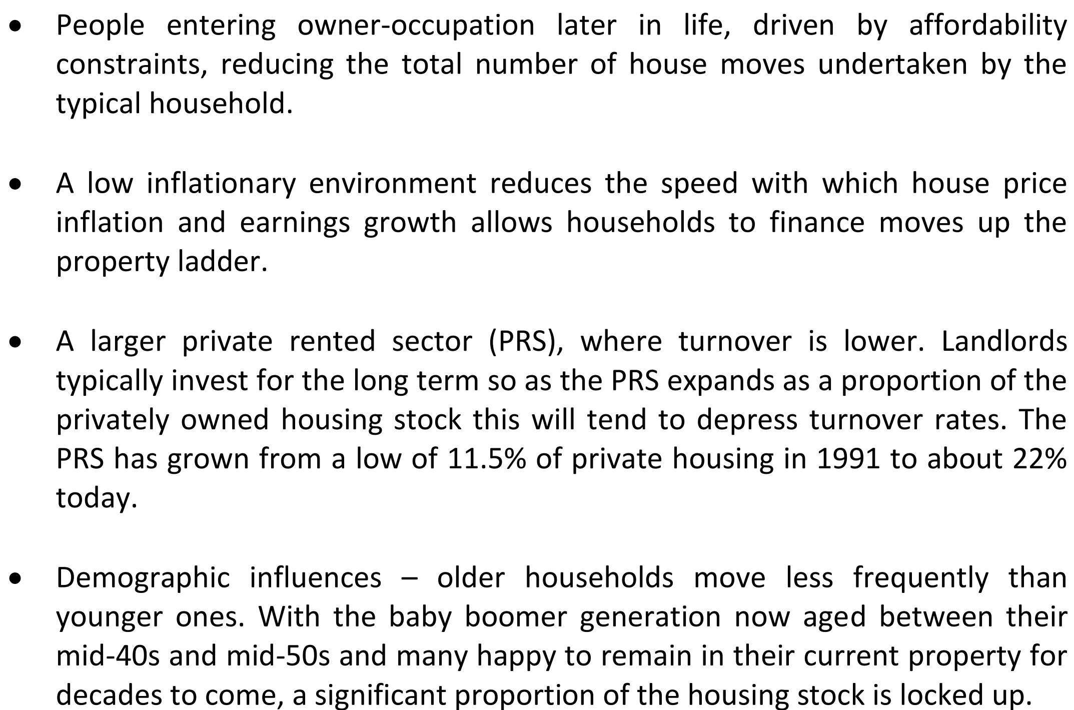
Source: DCLG and HMRC. Partly estimated.

In the 1980s annual turnover averaged over 12% of the housing stock, meaning a private dwelling on average changed hands once every 8 years. This had fallen to 7% by the 2000s (a sale every 14 years) and roughly 4.5% in the 2010s, meaning that the average home now only changes hands every 23 years.

Factors driving the downward trend

A number of factors are driving this trend:

- Higher transaction costs, particularly Stamp Duty. Until 1997, Stamp Duty had never exceeded 1% regardless of the value of the sale. Rates on higher value properties were subsequently moved up. Now the top marginal rate is 12%.



- People entering owner-occupation later in life, driven by affordability constraints, reducing the total number of house moves undertaken by the typical household.

- A low inflationary environment reduces the speed with which house price inflation and earnings growth allows households to finance moves up the property ladder.

- A larger private rented sector (PRS), where turnover is lower. Landlords typically invest for the long term so as the PRS expands as a proportion of the privately owned housing stock this will tend to depress turnover rates. The PRS has grown from a low of 11.5% of private housing in 1991 to about 22% today.

- Demographic influences – older households move less frequently than younger ones. With the baby boomer generation now aged between their mid-40s and mid-50s and many happy to remain in their current property for decades to come, a significant proportion of the housing stock is locked up.

Bullet points 1-4 above are factors that are unlikely to be reversed for the foreseeable future and point to permanently lower transaction levels. However, perhaps the largest influence has been the baby boomer 'hoarding effect' mentioned above, and this should be reversed as the baby boomer generation, with its high rates of homeownership, reaches old age. At this stage, a significant proportion of the housing stock will be unlocked. Until this point (which is probably at least some two decades away) housing supply will continue to be constrained.

What does this mean for the mortgage market?

Lower housing turnover certainly points to low house purchase lending by past standards. But it also points to lower net lending, given that property purchasers typically have higher mortgage debt than property sellers. It supports the view the previous peaks in mortgage lending may not be reached for decades to come.

Lower housing market liquidity also increases risks for homeowners and lenders. It makes it harder for the owner to alleviate finance stress by selling up and it makes obtaining an accurate valuation more difficult because there are fewer comparable sales for valuers to use. This could be a particular concern with higher value properties, where valuation is always more difficult because these properties are more heterogeneous.

The recent change to the Stamp Duty regime should aid market liquidity in the mainstream market by cutting Stamp Duty for most buyers and removing the price distortions of the old slab system. But for higher value properties the top marginal rate of Stamp Duty has risen from 7% to 12%, and properties over £2m now face a

substantially larger bill as well as the risk of a mansion tax if Labour wins the General Election.

One part of the mortgage market might benefit from lower transactions, however. If people move less frequently, they will have a reason to use the remortgage market more often to ensure they are getting the best possible deal. With people moving less frequently there is also likely to be more equity extraction through remortgaging, as people access the capital tied up in their homes between infrequent moves.

7. The new normal reviewed

In the report *'What is the new 'normal'? Mortgage lending in 2014-15 and the march back to a sustainable market'* that we published a year ago we concluded that:

"even the embryonic recovery we have seen owes a great deal to government intervention in the form of a series of policy measures aimed specifically at the market – the most recent of which are the FLS and Help-to-Buy – and to extraordinary monetary policy (record low Bank Rate and £375bn worth of QE)."

It is worth bearing in mind that the cushion of support of government policy interventions will one day be taken away. The FLS has already been removed for mortgage lending but other interventions such as Help-to-Buy have had a greater positive impact, so their removal will carry more risk. And the removal of the most significant stimulus – the emergency monetary policy measures of 0.5% Bank Rate and £375bn of QE – although delayed by low inflation, still ultimately poses the largest challenge of all.

In last year's report we also pointed out that "after the support measures have expired or been unwound, the regulatory changes will still be in place". 2014 was a milestone year with the introduction of the MMR and first use of macro-prudential tools specifically aimed at cooling the mortgage market. Although these new measures cannot be held entirely responsible for the slowdown seen over the year, we may be getting the first taste of how the new regulatory regime can engineer a more subdued market.

If the removal of policy props such as ultra low interest rates creates a weakened market in the future it is more difficult to see how regulation can act as an effective positive counterweight. So it would seem that, while the aim of dampening the credit cycle is laudable, regulation could have an asymmetric effect in future, curtailing the upswings while providing little support in the downswings, to the frustration of many borrowers.

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About IMLA

IMLA is the specialist trade body representing the interests of mortgage lenders who market their products through brokers, rather than solely direct or through a branch network. Its directors and members are drawn from the senior ranks of mainstream banks, building societies, 'challenger' banks and specialist lenders.

IMLA provides a unique opportunity for senior industry professionals to meet on a regular basis to discuss key current initiatives and contribute actively through IMLA and other industry forums.

IMLA was formed in 1988 as the Association of Mortgage Lenders and was instrumental in the creation of the Council of Mortgage Lenders (CML). It changed its name to IMLA in 1995. Subsequently IMLA helped bring the Association of Mortgage Intermediaries (AMI) into being and was instrumental in bringing the mortgage advisers qualification CeMAP to fruition. For more information, please visit www.imla.org.uk

About the author

Rob Thomas is Director of Research at The Wriglesworth Consultancy. 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.