The new 'normal' – prospects for 2022 and 2023

Rob Thomas, Principal Researcher,
Intermediary Mortgage Lenders Association
(IMLA)

January 2022

Executive summary

- **Gross mortgage lending in 2021 is estimated to have reached £304 billion, the best performance since 2007.** Net lending also had its best year since 2007, reaching an estimated £68 billion, a 51% rise on 2020. The mortgage market was powered by the post-lockdown recovery, supercharged by the stamp duty holiday.

- **We estimate that the total value of housing transactions reached a record of nearly £370 billion in 2021.** With house prices up nearly 10% on 2020 and transactions up by 36%, the aggregate value of housing transactions rose 49%, much more sharply than mortgage lending for house purchase. As a result, the proportion of purchasing power financed by mortgage borrowing fell from an estimated 60% to 56%. This reflects the extent to which existing homeowners, both mortgaged and unmortgaged, drove the market.

- **The need to raise interest rates to curtail the post-Covid rise in inflation will dampen the housing and mortgage markets in 2022 and 2023.** We see Bank Rate reaching 1.0% by the end of 2022 and 1.5% by the end of 2023, with a clear risk of greater increases. As a result, we think house prices will be largely flat and gross mortgage lending will fall to £275 billion, with a further fall to £265 billion in 2023. But limited supply will prevent a significant fall in aggregate house prices.

- **Bond markets are continuing to signal that interest rates will remain in ultra-low territory for the foreseeable future.** One of the most consequential questions about the UK economy is whether we are entering a period of permanently higher inflation. The bond market seems to have rejected this scenario with the yield on 50 year UK government bonds at 1.0%, even as short term interest rate expectations have increased.

- **Gross buy-to-let lending to fall back to £38 billion in 2022 and £37 billion in 2023.** Buy-to-let landlords took advantage of the stamp duty holiday (although they were still subject to the 3% surcharge). But a less positive outlook for house prices in 2022 and 2023 will dampen buy-to-let house purchase demand.

- **Intermediaries set to remain the dominant distribution channel, serving nearly 80% of the market.** Although we expect the share of distribution accounted for by intermediaries to fall back slightly in 2022 and 2023 it will remain near record levels just below 80% of mortgage advances by value.

- **IMLA welcomes the Bank of England Financial Policy Committee (FPC) decision to consult on redrawing its stressed affordability requirements.** We have consistently argued that the three percentage stress is unrealistically high and that it imposes a barrier to financially prudent people entering homeownership with associated costs to those remaining in the private rented sector.

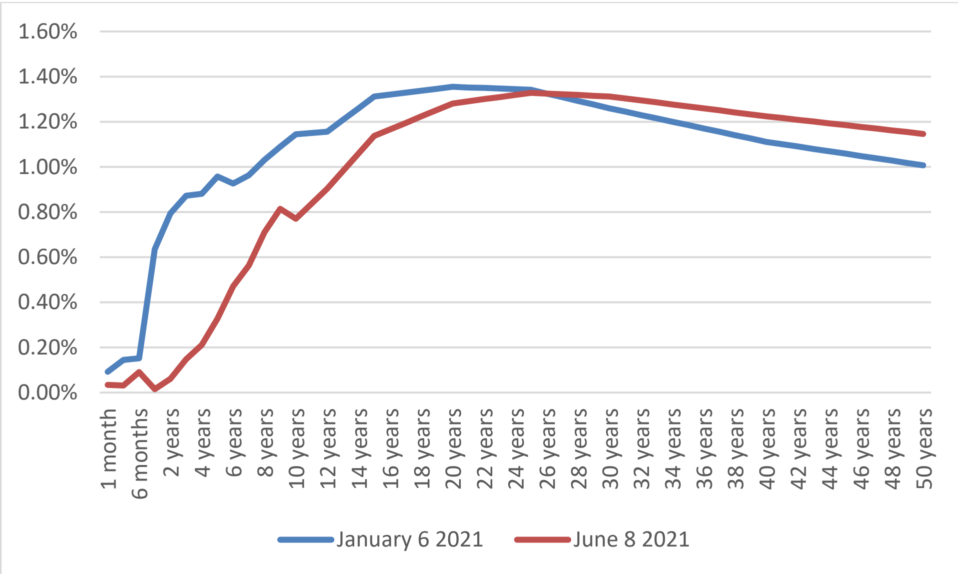
1. The market in 2021

1.1 A post-Covid 'new normal'

2021 was a year of recovery from the sharpest global recession on record. But it was also a year when many businesses and workers realized that getting back to work would not mean getting back to life as it was pre-pandemic. Significant changes have taken place that are unlikely to be reversed in the near future, if ever. Many employers have accepted that staff who can work from home at least part of the week cannot easily be required to return to old ways of working. This in turn has led to changes in office use and commuter volumes and revised expectation about how far people can live from their office.

Global supply chains remain heavily disrupted as uncoordinated national lockdowns have upset the carefully choreographed logistics of global trade of the pre-pandemic world. This in turn has created significant bottlenecks in some markets. And varying responses to the risk of new outbreaks of the virus has made the return to smooth trading patterns that much harder, casting further uncertainty over the economic outlook.

Chart 1 – Sterling yield curve



Source: World government bonds.com

The restarting of industry at a time when disruption to logistics and remaining Covid-related restrictions were preventing supplies from moving as freely as normal produced a surge in inflation in producer input prices globally. With labour markets also tight in many countries fears have been sparked that a wage price spiral might start taking hold. Central banks and bond markets have so far viewed rising inflation as a temporary phenomenon. Central banks have been slow to tighten monetary policy and, as Chart 1 illustrates, the yield curve indicates that while investors have revised up their expectations for interest rates over the next few years they have revised down their expectations about rates in the longer term.

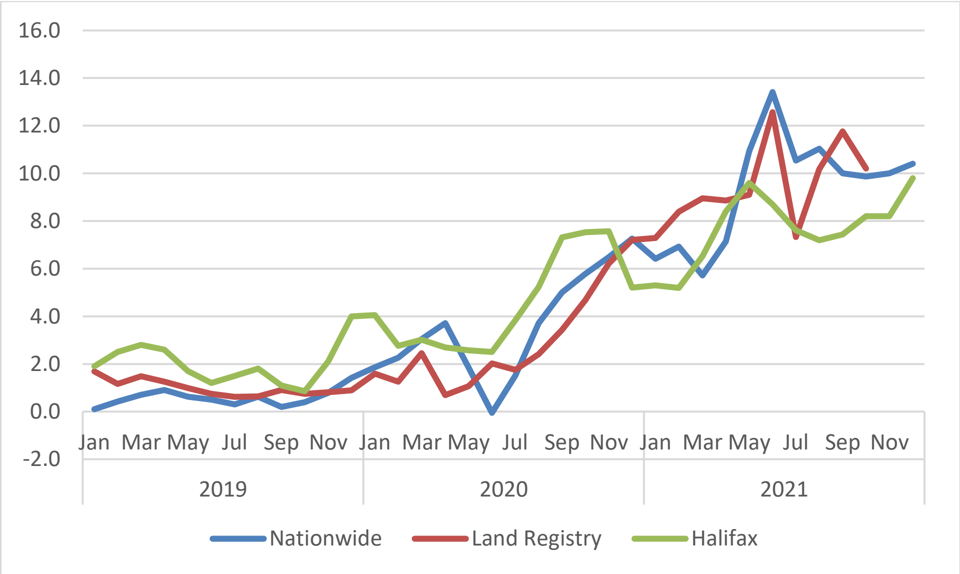
It is increasingly clear that disruption to supply chains will affect the economy throughout our forecast period of 2022-23 and we expect inflation to remain higher for longer than current official forecasts, remaining well above the 2% target by the end of 2023. This will put pressure on the Bank of England to raise interest rates more aggressively but the rise will be tempered by the understanding that the economy will need longer to emerge from Covid related disruption than previously thought.

1.2 A supercharged housing recovery

After the economy entered the Covid lockdown in March 2020, forecasters were quick to downgrade their projections for the housing market. Despite indications that supply remained constrained relative to demand, by the summer and autumn of 2020 a number of prominent bodies were forecasting one of the sharpest declines in house prices on record.

For example, in June 2020 estate agents Savills predicted house price falls of 7.5% over the year while the OBR forecast of July 2020 had house prices falling 0.7% that year and by 3.8% in 2021. By November it was clear that house prices were holding up well, not least because of the stamp duty holiday announced in July, and yet the OBR forecast an 8.3% decline in house prices over the course of 2021. Two months later in contrast, IMLA forecast a 6.3% rise in house prices in 2021 and 1.6% rise in 2022.

Chart 2 – UK house prices (12 month % increase)

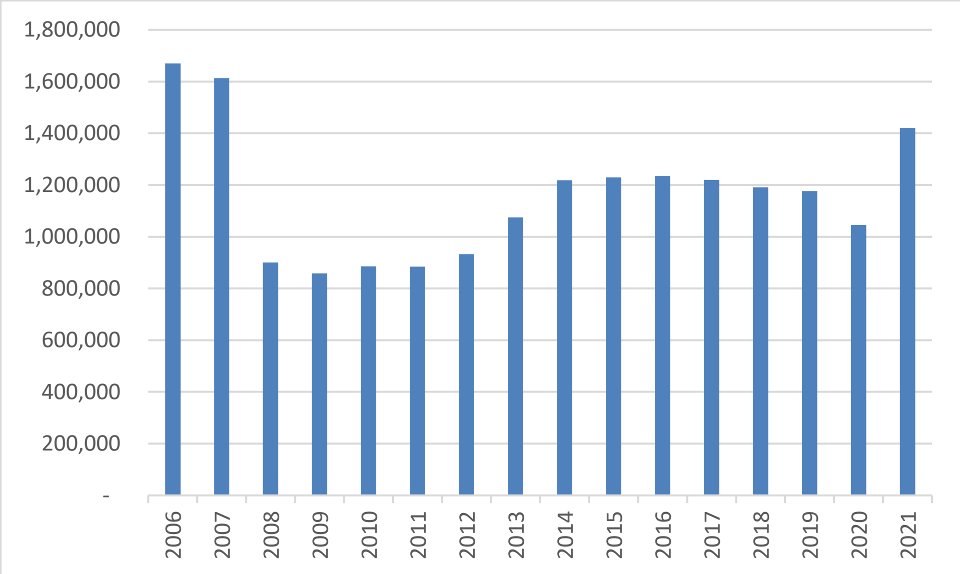


Source: Nationwide Building Society, Lloyds Banking Group and HM Land Registry

Undoubtedly the single most important factor in the surging housing market from mid-2020 (see Chart 2) was the stamp duty holiday on properties with a value up to £500,000, announced in July 2020 to run until March 2021 (the UK government announcement applied to England and Northern Ireland but Scotland and Wales introduced similar breaks). As the rates above £500,000 were not adjusted up and the duty is calculated on a graduated basis, purchases above £500,000 also benefitted. For example, sales at £1 million in England would previously have carried duty of £43,750, but this fell to £28,750, a saving of £15,000.

Even those buying additional properties (second homes and buy-to-lets) benefited from the holiday, although they were still subject to the 3% surcharge. This boosted the buy-to-let house purchase market, which saw an estimated 70% rise in volumes to £17 billion after a period when volumes had been depressed.

Chart 3 – UK property transactions



Source: HMRC. 2021 partly estimated.

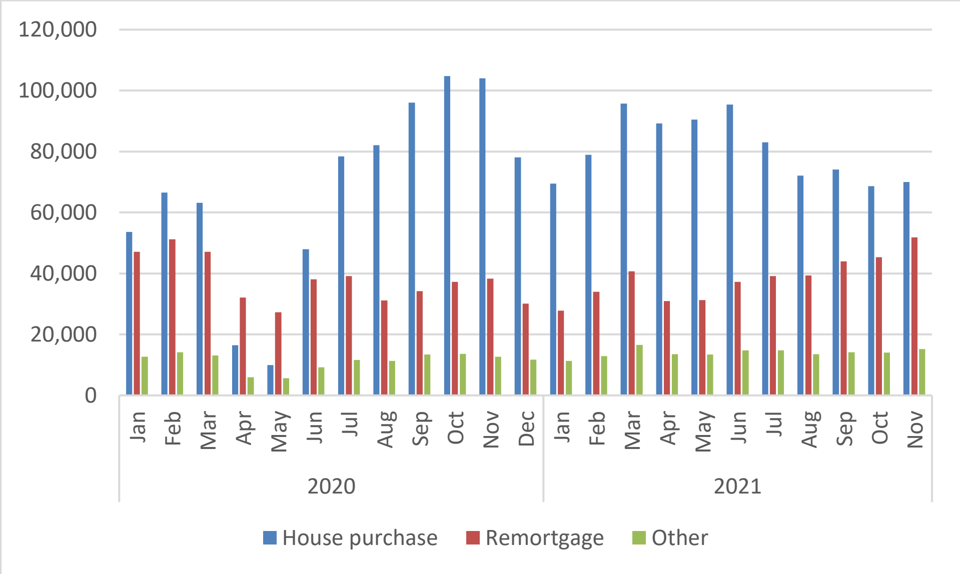
Overall, UK property transactions reached an estimated 1.42 million in 2021, the highest level since 2007 (see Chart 3). However, taking 2020 and 2021 together, transactions averaged 1.2 million, in line with the annual average since 2014, illustrating that much of the activity could be accounted for by delayed moves from the period when the market was closed by Covid restrictions. Also, factors other than the stamp duty holiday were at play. Generous government support and looser monetary policy helped households to accumulate an additional £375 billion of retail deposits between February 2020 and October 2021, an average of £22,000 for a family of four. Undoubtedly, some of these additional cash savings will have supported property purchases.

1.3 Mortgage markets

The past two years have been something of a rollercoaster ride for the mortgage market. The combination of unprecedented volatility in mortgage volumes, Covid restrictions and the need to administer the payment deferral scheme has placed a significant stress on lenders at an operational level. Lenders have responded remarkably well to these pressures, particularly given the operational pressures created by a time limited stamp duty holiday.

Perhaps the best guide to the strength of the mortgage market is the approvals data as approvals lead transactions by about 3-4 months on average. Chart 4 shows that the scale of volatility in house purchase approval numbers far exceeded that for remortgages, as would be expected given the Covid restrictions on transactions in early 2020 and the subsequent stamp duty holiday.

Chart 4 – Number of mortgage approvals per month



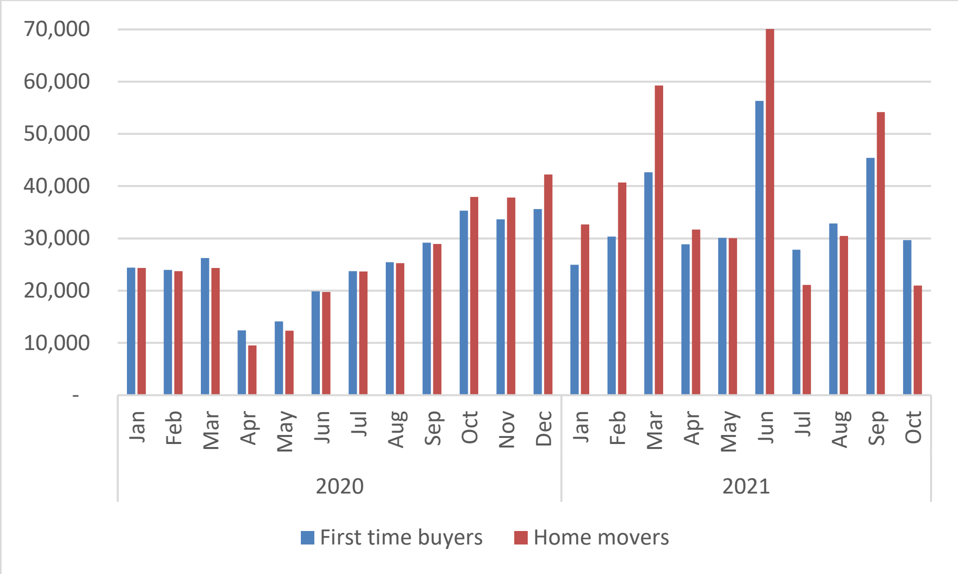
Source: Bank of England

What was surprising was the strength of house purchase approvals from March to July 2021, given that the initial deadline for the stamp duty holiday was the end of March 2021. Given the lags involved in purchasing, buyers who wished to take advantage of the holiday needed to be sorting out finance in late 2020 and indeed approvals for purchase peaked in October and November. But a second wave of approvals came through from March after Chancellor Sunak announced in the Budget that the holiday would be extended in full until the end of June with a reduced exemption until the end of September.

Between March and June 2021, house purchase approvals averaged 93,000 a month, little less than the August to November 2020 average of 97,000. It is not clear why so many buyers who had decided not to respond to the initial stamp duty holiday took advantage of the extension. Maybe capacity constraints in the house buying and conveyancing progress in late 2020 were factors or perhaps people were more confident about their prospects by Spring 2021 or concerned that in a rising market they might miss out if they delayed purchasing any longer. Greater clarity around the requirements for attending offices may also have been a factor for those looking to move further from their place of work.

Even in November 2021 however, approvals for house purchase were, at 70,000, above the monthly average for 2019, suggesting that the market has maintained some momentum in the post-stamp duty period. Remortgage approvals have also been on an upward track since April, hitting their highest level of the post-pandemic period in November, as can be seen in Chart 4.

Chart 5 – Number of mortgage advances by type of purchaser



Source: UK Finance

One feature of the market that is clear is that the stamp duty holiday has stimulated moving homeowner activity far more than first time buyers (see Chart 5). This is unsurprising given that first time buyers already benefited from stamp duty relief on properties up to £300,000, which covers the overwhelming majority of first time buyer transactions. In 2020, there were roughly the same number of mortgaged first time buyers and mortgaged moving homeowners (304,000 and 310,000 respectively) but during the first ten months of 2021 there were 349,000 mortgaged first time buyers and 393,000 mortgaged moving homeowners.

2. The mortgage market outlook for 2022 and 2023

2.1 Background environment in 2022 and 2023

Table 1 outlines our projections for key assumptions behind our mortgage market forecast. It shows that we expect the recovery in output to continue in 2022 but the 5.3% rise in GDP on 2021 as a whole masks a slowdown in growth over the course of 2022. Uncertainty remains heightened because of the risk of further Covid related lockdowns and because the dislocation that earlier lockdowns created has left serious supply bottlenecks which will impede growth. But despite the recent surge in Covid cases our forecast assumes that we avoid further full-scale national lockdowns, which should temper the negative economic effects.

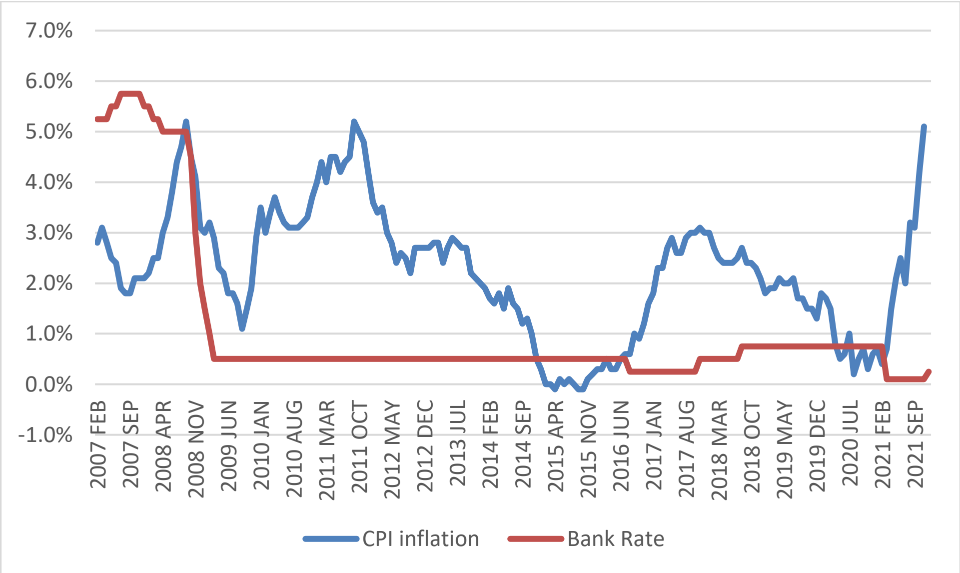
Table 1 – key forecast assumptions

	Past values		Forecast values				
	2020	2021e	2022f	2023f	2021/20f	2022/21f	2023/22f
Real GDP (£bn)	1,959	2,090	2,200	2,250	6.7%	5.3%	2.3%
Unemployment rate (Q4)	4.8%	4.3%	3.8%	3.8%	-10.4%	-11.6%	0.0%
CPI inflation rate (Q4)	0.5%	4.9%	4.7%	3.8%	880.0%	-4.1%	-19.1%
House prices (average for year)	237,300	259,500	272,000	271,000	9.4%	4.8%	-0.4%
Housing transactions (UK, thousands)	1,045	1,420	1,150	1,100	35.9%	-19.0%	-4.3%
Bank Rate (end of year)	0.10%	0.25%	1.00%	1.50%	150.0%	300.0%	50.0%

Source: IMLA, ONS and HMRC

With CPI inflation at 5.1% in November 2021 and expected to rise further in early 2022, the Bank of England felt the need to raise Bank Rate in December to 0.25%. As Chart 6 shows, Bank Rate is heavily negative in real terms (-5.0% in November) and measured using RPI was at a record negative of 7.0%. As a result, we expect Bank Rate to be raised three times in 2022 to 1.0% and raised to 1.5% by the end of 2023.

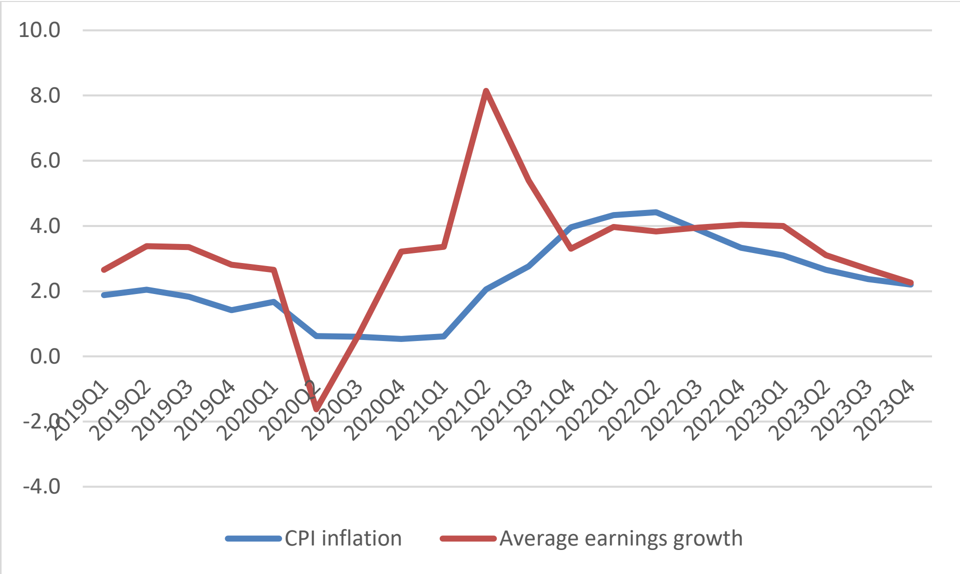
Chart 6 – Consumer price inflation and Bank of England Bank Rate



Source: ONS, Bank of England

Even a rise to 1.0% will leave Bank Rate highly negative in real terms based on our forecast for CPI inflation of 4.7% in Q4 2022, suggesting that monetary policy will remain accommodative even as rates rise. There are reasons why central banks will be reluctant to raise rates too quickly or by too much. One is the on-going threat of new strains of Covid that could lead to social distancing measures that impact economic activity. Another is the difficulty estimating how much of the recent rise in inflation is the product of supply chain disruption that will gradually reverse and how much is due to excess demand in goods and labour markets that might prove more long lived. Finally, falling long term bond yields suggest that investors continue to worry more about weak demand than permanently elevated inflation, and central banks pay close attention to signals from the bond market.

Chart 7 - OBR projections for % earnings growth and inflation (November 2021)



Source: OBR

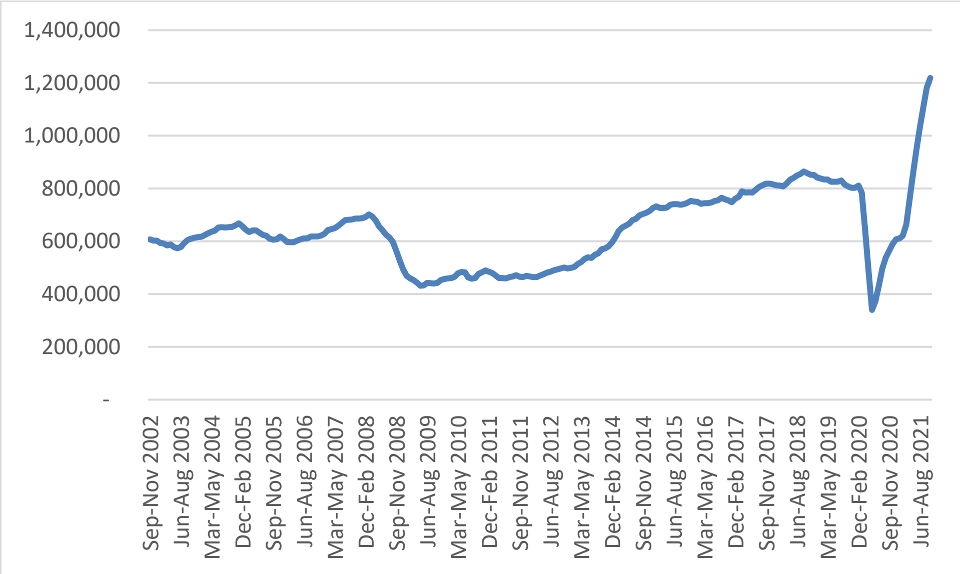
Chart 7 shows the latest Office for Budget Responsibility (OBR) forecasts for CPI inflation and earnings growth published in November 2021. It is surprisingly sanguine about the prospects for inflation and earnings growth given current economic pressures, expecting both CPI inflation and earnings growth to fall back towards 2% by the end of 2023. Given the on-going disruption to supply chains and the tightness of the labour market we think the risks to this forecast are firmly on the upper side, creating the risk that policymakers will feel the need to tighten policy more than current official projections suggest.

2.2 Outlook for the UK housing market

Although the performance of the housing market will be adversely impacted by higher interest rates, the effect is likely to be tempered by several factors. Firstly, the decline in longer term interest rates mentioned above, even as the market expects short term rates to rise, should ensure that longer term (5 year plus) fixed rate mortgage rates do not rise too much. Secondly, the market continues to exhibit a shortage of supply which will underpin prices as witnessed by the latest RICS residential survey which shows near record low housing stock per surveyor branch.

Additionally, household balance sheets have been bolstered by increased retail deposits and higher house and equity prices since 2020. Broad money supply as measured by Sterling M3 is increasing more slowly than in 2020, but still recorded a gain of 8.2% in the year to October 2021, well ahead of pre-pandemic rates of growth. And the unprecedented accumulation of retail deposits of £252 billion in 2020 has been followed by a further £120 billion in 2021 up to October, again well ahead of pre-pandemic rates of saving.

Chart 8 – Number of job vacancies (UK)



Source: ONS

The labour market is also proving resilient, which should bolster household confidence. The unemployment rate was down to 4.2% on the latest data while job vacancies hit a record high in the latest three month period (September to November) of just over 1.2 million (see Chart 8) and in the August to October period pay growth was 4.9% compared to a year earlier, meaning that workers' wages were still rising nearly as fast as prices measured using the CPI.

While annual wage growth has been distorted by the weakness seen in mid 2020, affecting the year-on-year comparison, vacancy data point to something more profound. Covid has led many workers to reassess their priorities and a significant number of older workers have left the workforce.

According to the Resolution Foundation, the number of people who are economically inactive – that is, not working or looking for work – has increased by 586,000 since the start of the crisis. It also found that workforce participation has fallen by 1.2 percentage points among 55-64-year-olds since mid-2019 – a bigger fall than in any other recession over the past 40 years. And whereas in previous recessions it was reduced demand for labour that encouraged people to leave the labour force, today it is mainly workers choosing to withdraw, creating a shortage of labour in many occupations.

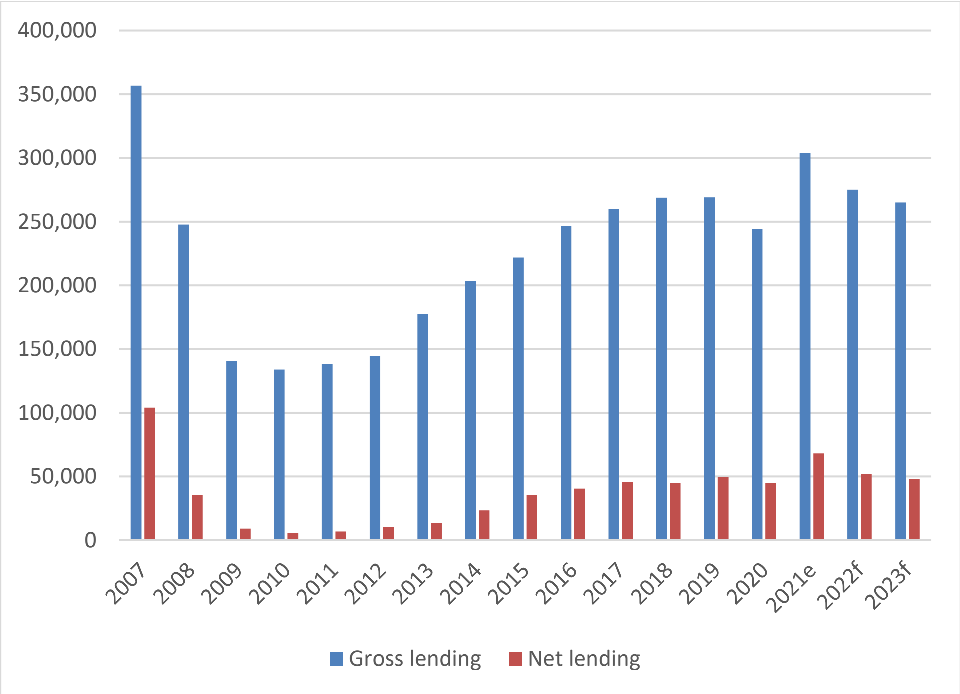
Taking these various factors together, average house prices are likely to be cushioned even now that the artificial stimulation of the stamp duty holiday has passed. However, the market became so frothy in some areas that localised price falls are likely as already stretched affordability was pushed even further.

2.3 Outturn relative to previous year's forecast

In last year's report, IMLA forecast gross mortgage lending of £283 billion for 2021 including £172 billion for house purchase and net lending of £50 billion. By way of comparison, UK Finance forecast gross lending of £215 billion (£101 billion for house purchase) and net lending of £17 billion while the November 2020 OBR report forecast net mortgage lending of £33 billion. The estimated outturns were gross lending of £304 billion of which house purchase was £207 billion and net lending of £68 billion.

2.4 Mortgage market forecast

Chart 9 - Forecasts for gross and net lending (£m)



Source: Bank of England and IMLA

We expect total gross mortgage lending to fall by 10% to £275 billion in 2022, with a further fall to £265 billion in 2023 (see Chart 9). We expect net lending to fall more sharply by 24% to £52 billion in 2022, with a further fall to £48 billion in 2023. As Table 2 shows, the fall is driven by lending for house purchase, which we expect to be £175 billion in 2022, 15% below 2021's figure, which was boosted by the stamp duty holiday. We anticipate a further fall in house purchase lending in 2023 to £165 billion as the effects of higher interest rates dampens the market.

In contrast, we expect the remortgage market to be stronger in 2022, reaching £89 billion. Lenders prioritised house purchase lending during the stamp duty holiday and lower house purchase volumes going forward will encourage some lenders to focus more heavily on winning business in the remortgage market.

Table 2 – Mortgage market forecast

	Gross mortgage lending (£m)						
	2020	2021e	2022f	2023f	2021/20f	2022/21f	2023/22f
House purchase	149,662	207,000	175,000	165,000	38.3%	-15.5%	-5.7%
Remortgage	84,137	84,500	89,000	88,000	0.4%	5.3%	-1.1%
Other	10,349	12,500	11,000	12,000	20.8%	-12.0%	9.1%
Total	244,148	304,000	275,000	265,000	24.5%	-9.5%	-3.6%
of which:							
Buy-to-let lending	38,100	44,500	38,000	37,000	16.8%	-14.6%	-2.6%
of which for house purchase	10,000	17,000	10,000	10,000	70.0%	-41.2%	0.0%
Buy-to-let share of total	15.6%	14.6%	13.8%	14.0%	-6.2%	-5.6%	1.0%
Lending via intermediaries*	154,693	204,000	179,000	171,000	31.9%	-12.3%	-4.5%
Share of total*	78.7%	80.3%	79.6%	79.5%	2.0%	-0.9%	0.0%
Net lending	45,013	68,000	52,000	48,000	51.1%	-23.5%	-7.7%
Product transfers	168,000	185,000	195,000	200,000	10.1%	5.4%	2.6%
2.5%+ arrears (thousands)	83,260	77,000	79,000	84,000	-7.5%	2.6%	6.3%
Possessions (thousands)	2,660	2,500	7,200	8,200	-6.0%	188.0%	13.9%

* Regulated loans only

Source: IMLA, Bank of England, UK Finance

We expect mortgage intermediaries' share of lending to fall slightly in 2022 and 2023 to around 79.5% after the exceptional proportion reached in 2021, when many brokers were able to continue to serve customers even during lockdown periods through remote channels.

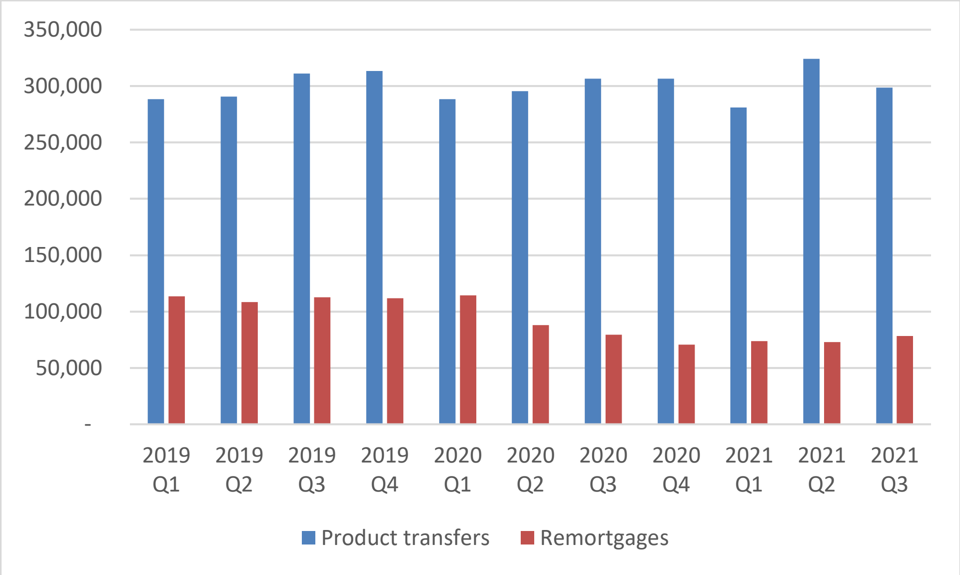
For the first time we have included a forecast for arrears and possessions (see Table 2). We expect arrears of 2.5% of mortgage balances or more to rise modestly this year as interest rate rises take effect with a slightly faster rate of increase in 2023 as rates rise further. But these numbers still represent less than 0.8% of mortgage accounts, a very low rate by historical standards.

We expect the number of properties taken into possession to return to more normal levels this year after the Covid-related moratorium, reaching 7,200 with a further rise in 2023 to 8,200 reflecting the somewhat less benign interest rate environment. But again, in a longer term context these are exceptionally low rates.

2.5 Product transfers and remortgages

Aggregate product transfer data has only been available since 2018. This data series shows that the majority of borrowers choose a new product with their existing lender rather than remortgaging to an alternative lender once their current product period had ended. For every remortgage there are four product transfers. This ratio rose with the Covid pandemic in 2020 and has remained higher as a result of a decline in the number of remortgages, as Chart 10 shows.

Chart 10 – Number of product transfers and remortgages



Source: UK Finance

For the first time this year we have forecast product transfers by value (see Table 2). We expect product transfers to reach £195 billion in 2022, growing less than remortgage volumes. However, in the longer term we think the shift to product transfers will continue given the ease with which borrowers can switch products online with many lenders, and given that many lenders now pay procuration fees to brokers who advise on a product transfer.

2.6 Buy-to-let mortgage market forecast

Buy-to-let lending in 2021 was an estimated £44.5 billion, 17% up on the previous year, but the real story lay in the house purchase market with lending reaching £17 billion, the best performance since 2007 and the third highest annual figure on record. The stamp duty holiday exempted any purchase up to £500,000 from Stamp Duty Land Tax (SDLT) and, although the second home surcharge remained in place, a buy-to-let investor purchasing a £500,000 property could cut their stamp duty bill from £30,000 to £15,000.

Naturally many buy-to-let investors looking to expand their property holdings took the opportunity to purchase during the stamp duty holiday, so we expect house purchase buy-to-let lending to fall sharply in 2022. We expect £10 billion of house purchase lending in 2022 and the same total in 2023.

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

	2020	2021e	2022f	2023f	2021/20f	2022/21f	2023/22f
Whole market							
Outstanding debt (£bn)	1,499	1,567	1,619	1,667	4.5%	3.3%	3.0%
House purchase lending (£m)	149,662	207,000	175,000	165,000	38.3%	-15.5%	-5.7%
House purchase % churn	10.1%	13.5%	11.0%	10.0%	33.2%	-18.6%	-8.6%
Remortgage	84,137	84,500	89,000	88,000	0.4%	5.3%	-1.1%
Remortgage % churn	5.7%	5.5%	5.6%	5.4%	-3.3%	1.4%	-4.1%
Total % churn	16.5%	19.8%	17.3%	16.1%	19.9%	-12.9%	-6.6%
Buy-to-let market							
Outstanding debt (£bn)	273	281	289	296	3.0%	2.8%	2.4%
House purchase lending (£m)	10,000	17,000	10,000	10,000	70.0%	-41.2%	0.0%
House purchase % churn	3.7%	6.1%	3.5%	3.4%	63.8%	-42.9%	-2.6%
Remortgage	27,070	26,200	26,800	25,800	-3.2%	2.3%	-3.7%
Remortgage % churn	10.1%	9.5%	9.4%	8.8%	-6.7%	-0.6%	-6.2%
Total % churn	14.3%	16.1%	13.3%	12.6%	12.5%	-17.0%	-5.1%
Buy-to-let % of total market							
Outstanding debt	18.2%	17.9%	17.8%	17.8%	-1.4%	-0.5%	-0.5%
House purchase lending	6.7%	8.2%	5.7%	6.1%	22.9%	-30.4%	6.1%
Remortgage	32.2%	31.0%	30.1%	29.3%	-3.6%	-2.9%	-2.6%
Total lending	15.6%	14.6%	13.8%	14.0%	-6.2%	-5.6%	1.0%

Source: Bank of England, UK Finance and IMLA

In contrast to the purchase market, buy-to-let remortgages were depressed in 2021, falling an estimated 5%. This reflected lenders' need to focus on the busy purchase market at a time when administrative resources were under pressure due to Covid restrictions as well as the on-going shift towards product transfers. However, we expect buy-to-let remortgages to show a 2% recovery in 2022 to £26.8 billion before falling back in 2023 as product transfers grow in popularity.

3. Mortgages versus housing equity versus savings: what drives housing demand?

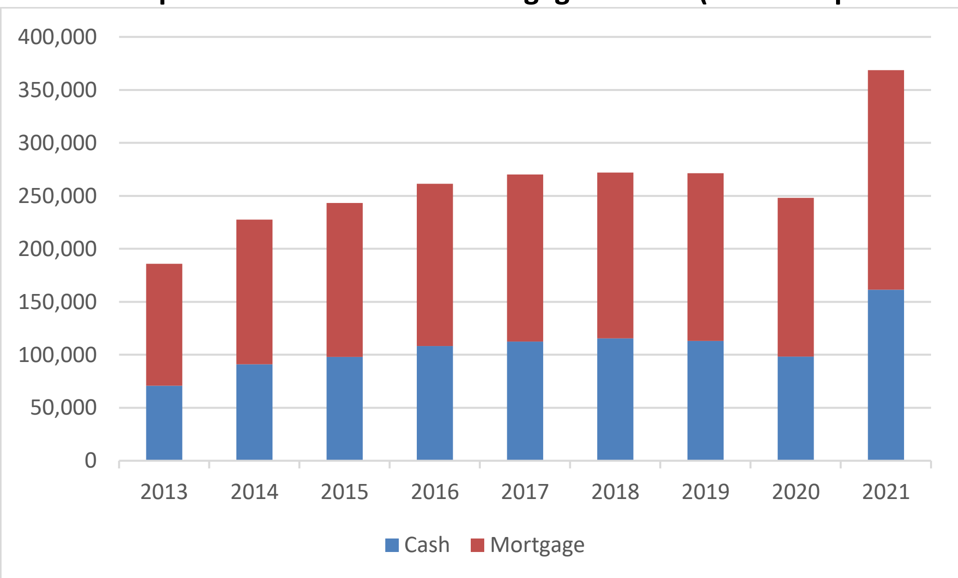
3.1 The split between cash and mortgage finance

The financial resources needed to finance a property transaction must come from one of three sources: mortgage borrowing, housing equity or other savings. There is very detailed data on mortgage borrowing from the Bank of England, Financial Conduct Authority (FCA) and UK Finance. There is some data on the total value of property transactions that allows us to see the relative importance of mortgage finance but there is no public data on the split between housing equity and other savings. Mortgage lenders and conveyancers should have some data on this split but it has never been collated into a public data series.

However, we can make certain inferences. We know that true first time buyers have no housing equity of their own so their only sources of finance are mortgage borrowings or savings from other sources, including money they have saved and money from the bank of mum and dad. We also know the breakdown between mortgage borrowing and cash from UK Finance data on first time buyer transactions.

Equally, we know the breakdown between mortgage finance and other sources for home movers from UK Finance data although, as mentioned above, we do not know what proportion of other sources is housing equity they have carried forward from their previous property and how much is other savings they have chosen to use. We also know the number of unmortgaged transactions and can estimate the value of these transactions.

Chart 11 – Split between cash and mortgage finance (all house purchases - £m)



Source: Bank of England, ONS, HMRC

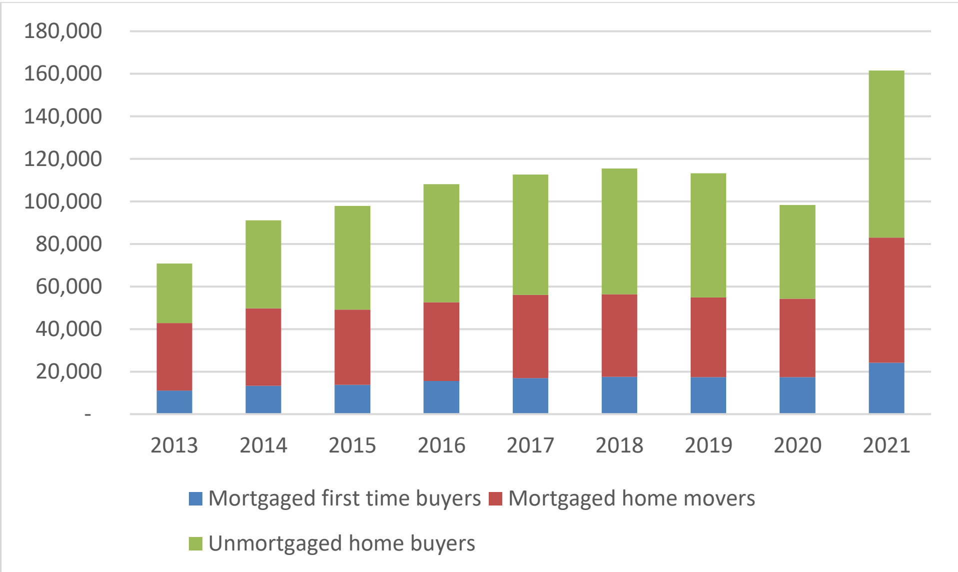
Comparing the total value of property transactions with mortgage lending for house purchase shows us that something unusual occurred in 2021 (see Chart 11). While in 2020, mortgages provided 60% of the funds used in UK housing transactions, in 2021, based on the data we have so far, we estimate that this proportion fell to 56%. Mortgage lending for house purchase rose by a healthy 38% to an estimated £207 billion but the total value of housing transactions rose much faster: 49% to nearly £370 billion.

3.2 Mortgaged first time buyers, mortgaged home movers and unmortgaged buyers

The shift towards cash in 2021 mirrors the shift towards home movers seen in UK Finance data. We estimate that the number of mortgaged first time buyers increased 30% in 2021 against a 41% jump in the number of mortgaged home movers. The number of unmortgaged transactions also rose by an estimated 37%. The shift partly resulted from the differential impact of the stamp duty holiday because first time buyers were already exempt from stamp duty on transactions up to £300,000, so most prospective first time buyers had no additional incentive to purchase, unlike moving homeowners whether they needed mortgage finance or not.

Another factor was the ‘race for space’ that developed as people re-evaluated their housing needs in the wake of Covid lockdowns and firms began to implement new policies on office working. Many large employers formally introduced a hybrid office and working from home policy that allowed staff to consider living much further from their place of work.

Chart 12 – Cash used for UK property purchases (£m)



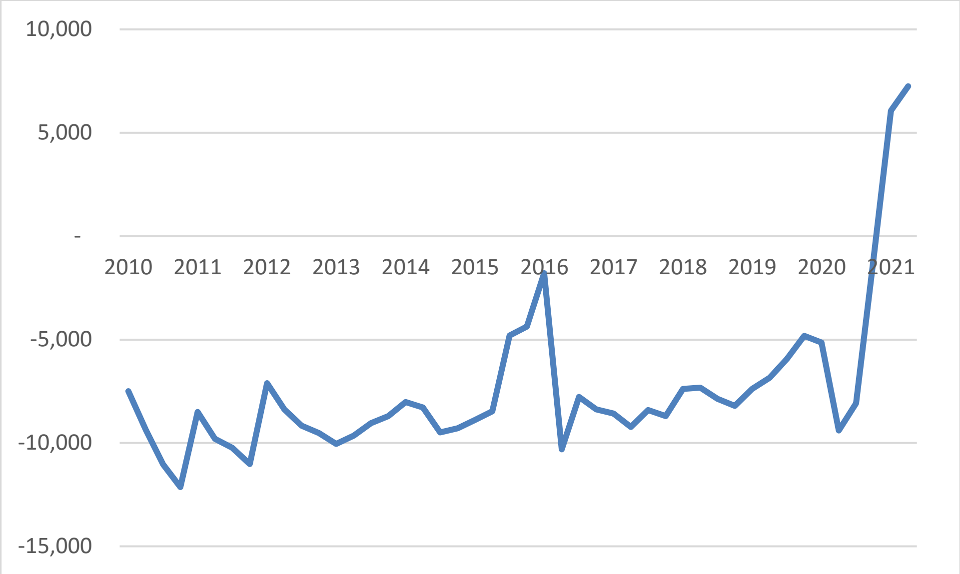
Source: Bank of England, ONS, HMRC, UK Finance

Chart 12 shows the sources of cash finance used in UK property transactions by type of buyer. Of the estimated £161 billion of cash injected into housing transactions in 2021, 49% came from unmortgaged buyers, 36% from mortgaged home movers and

15% from first time buyers. However, first time buyers still injected £24 billion of cash savings into the property market, 39% more than in 2020. Cash injected by mortgaged home movers rose 59% while for unmortgaged buyers it leapt by 78%.

3.3 Housing equity withdrawal

Chart 13 – Housing equity withdrawal (£m quarterly)



Source: Bank of England

These figures illustrate the extent to which the stamp duty holiday encouraged more established homeowners with plenty of equity to move house. But paradoxically, as Chart 13 illustrates the sharp rise in transactions also triggered a bout of housing equity withdrawal. After years in which housing equity withdrawal was consistently negative, in the first half of 2021 households withdrew £13.3 billion of housing equity.

Housing equity withdrawal compares the change in aggregate mortgage debt with the level of real investment in the housing stock. Where the increase in mortgage debt is equal to physical housing investment households in aggregate are neither withdrawing nor injecting equity. If the increase in the stock of mortgage debt exceeds the level of physical investment households in aggregate must have withdrawn equity.

When households move to more expensive properties many will need to increase their mortgage debt. Although they are not withdrawing equity themselves, the seller can withdraw cash from the transaction and will create housing equity withdrawal where the mortgage they are paying off is smaller than the purchaser's balance. For example, if there was no physical investment in the housing stock and the only transaction was the sale of one property with a £200,000 mortgage to a family taking on a £500,000 mortgage, housing equity withdrawal would be recorded as £300,000.

We expect a more normal pattern to re-emerge in 2022 with cash playing a less prominent role, but with record levels of housing equity and higher levels of cash saving, there can be no doubt that cash will remain a crucial driver of housing demand, while housing equity withdrawal is likely to turn negative again as housing transactions fall back.

4. Conclusion

2021 was a positive year for the mortgage market despite the difficult conditions created by the Covid pandemic and the social distancing measures that remained in place at times. The mortgage sector had been tested in 2020 by a shock unlike any it had previously experienced but lenders were able to maintain high levels of service and implement a mortgage deferral programme that, at its peak in June 2020, was used by 17% of all borrowers.

2021 was a year of recovery, aided by unprecedented government support for the economy both on the fiscal and monetary front. But 2021 was also a year of uncertainty stoking a degree of caution on the part of consumers, which has been carried into 2022. New strains of Covid still threaten further social distancing measures which could set back the economy, although we are not predicting any further national lockdowns, and the legacy of past Covid measures have created supply disruption and labour shortages.

The disruption to global supply chains caused by Covid cannot be rapidly corrected in an environment where countries continue to impose restrictions to keep Covid infections down, suggesting that supply shortages are likely to remain a feature of the economy throughout our forecast horizon to the end of 2023. This will make it difficult for central banks to gauge how much of the higher inflation we are experiencing is transitory and how much is the product of potentially more persistent forces such as upward pressure on wages or more general demand pressures.

The UK’s demographic profile, with the peak of the baby boom generations now close to 60 years of age, suggests that the labour shortages employers are currently suffering from could come to be seen as structural, pointing to more persistent upward pressure on wages. In addition, the UK has less potential to import labour from the EU since Brexit. As a result of this and continued supply shortages, the Bank of England and OBR forecasts that predict CPI inflation will be close to its target of 2% by the end of 2023 should be considered optimistic.

For the housing and mortgage markets the legacy of the Covid pandemic has been a further substantial jump in house prices relative to incomes, particularly in rural areas targeted by affluent urban buyers looking for more space. This has made the difficulties of those hoping to get onto the property ladder even more acute. Fortunately, the Bank of England FPC has, after reviewing its mortgage recommendations, decided to consult on removing the stress requirement in the affordability calculation.

IMLA has been calling for a review of the affordability stress test for some time on the grounds that artificially constraining the amount people can borrow, as witnessed by borrowers’ debt servicing burden falling to a record low of 16.9% in 2020, has resulted in fewer opportunities for financially prudent first time buyers, which in turn has resulted in more young households remaining in the private rented sector, which can adversely affect their long term financial security. We explored the potential scale of consumer detriment for those who cannot buy in our paper *The intergenerational divide in the housing and mortgage markets* published in October 2019.

The removal of the 3% stress in the affordability calculation, should it occur, would result in more borrowers being able to meet the challenge of buying in today's more expensive market. But as the FPC itself recognised in its announcement "the LTI flow limit is likely to play a stronger role than the affordability test in guarding against an increase in aggregate household indebtedness". As the IMLA paper *The mortgage affordability paradox*, published in November 2021, pointed out, constraining the proportion of lending at 4.5 LTI and above can result in some purchasers who could comfortably afford the monthly mortgage payment being unable to access homeownership.

For example, the IMLA report pointed out that "An average earner in London buying an average priced first time buyer property with a 50% deposit in 2020 would have spent a modest 10.5% of their income on mortgage interest yet would still have required a loan of 5.5 times income." As such loans are rationed by the FPC's LTI flow limit there must be a concern that the laudable objective of allowing financially prudent buyers to borrow what is required in high prices areas will still be thwarted.

Media contacts

For further information please contact:

- Rob Thomas, Director of Research, on 020 7427 1406
- Sophie Placido, Dan Edwards or Tom Stewart-Walvin at Rostrum, on 020 3404 7700

imla@rostrum.agency

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 46 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), 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.