Recent trends in the UK first-time buyer mortgage market

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Summary

First-time buyers (FTBs) represent an important component of the mortgage lending market in the UK, accounting for almost 40% of house purchase loans over the past decade. But since FTBs are normally defined by lenders as those who do not have to sell a property in order to purchase, this includes some who owned a property before, estimated to be around 20% of FTBs.

Lending to FTBs contracted sharply in late 2007 and 2008. This decline can be attributed to both credit demand and supply. Credit availability has tightened considerably, as lenders have lowered the loan-to-value (LTV) ceilings on their lending, and increased the interest rate spreads on high LTV products in particular. Moreover, demand is likely to have been adversely affected by lower job security and a weakening of housing market confidence.

2009 saw some recovery in FTB lending, consistent with reports of stronger demand, partly reflecting pent-up demand from FTBs coming back to the market, perhaps encouraged by lower house prices. More recently there have also been reports of lenders loosening LTV criteria, consistent with a slight improvement in credit availability, but the median LTV ratio on FTB lending has remained low. Lending volumes actually fell back in early 2010 as demand weakened, and although this was reported largely to reflect one-off factors, it makes the underlying strength of the market difficult to assess.

For those FTBs able to access the mortgage market, servicing payments has generally become easier overall, as they have benefited from lower levels of the official Bank Rate of interest and lower house prices. But estimates from the Council of Mortgage Lenders (CML) suggest that in 2009 around 85% of FTBs aged under 30 have had to receive assistance, often from parents, to finance the large deposits required – compared to around 50% in 2007 and 8% in 1995-97.

Despite the recent stabilisation, market conditions remain challenging, and both the supply and demand for loans appear to be weaker than before the crisis. In discussions with the Bank in June 2010, the major UK lenders expected lending to FTBs to remain subdued over the remainder of 2010.

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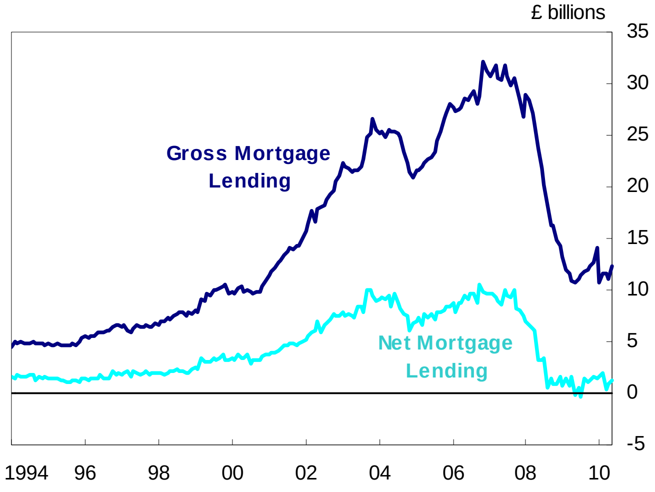
Background

1. The mortgage market has undergone a significant contraction since the beginning of the financial crisis. House prices fell by around 20% from their peak to their recent trough, and mortgage lending fell sharply in 2008 and early 2009 (**Chart 1**). Although market conditions appear to have stabilised somewhat, and with some increase in house prices from their lows, mortgage lending remains subdued. With remortgaging activity very weak, the mortgage market is currently dominated by lending for house purchase, both to first-time buyers (FTBs) and home movers.

2. FTBs account for around 40% of loans for house purchase (**Chart 2)**. However, the definition of FTB generally used by lenders is all who do not have to sell a property in order to purchase, and will therefore include those who have let out their home and are now buying a second property (e.g., accidental landlords, or those needing to move to another part of the country) or who have previously sold their home and rented for an extended period. Estimates from the Council of Mortgage Lenders (CML) suggest that around 20% of FTBs may fall into this category,[2] but there is little evidence that the proportion of "returners" has changed recently.[3]

Chart 1

Gross and net mortgage lending

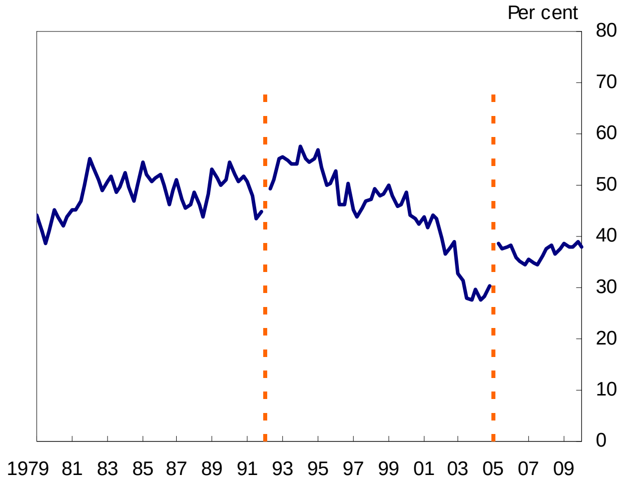


Source: Bank of England.

Monthly data to May 2010. Seasonally adjusted.

Chart 2

Number of new loans to first-time buyers as a proportion of total for house purchase



Source: CML

Quarterly data to 2010 Q1. Dotted lines indicate breaks in series. See the Annex for details of the series breaks. Non seasonally adjusted.

3. This paper describes the recent trends in FTB lending and attempts to identify the factors driving these developments. It finds that notwithstanding a recent stabilisation, credit

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2 Smith et al (2005): Understanding first-time buyers, Chapter 3 provides further information on "returners", and characteristics of FTBs in general.

3 See "Disaggregating first-time buyer lending" section of this paper for further information on "returners".

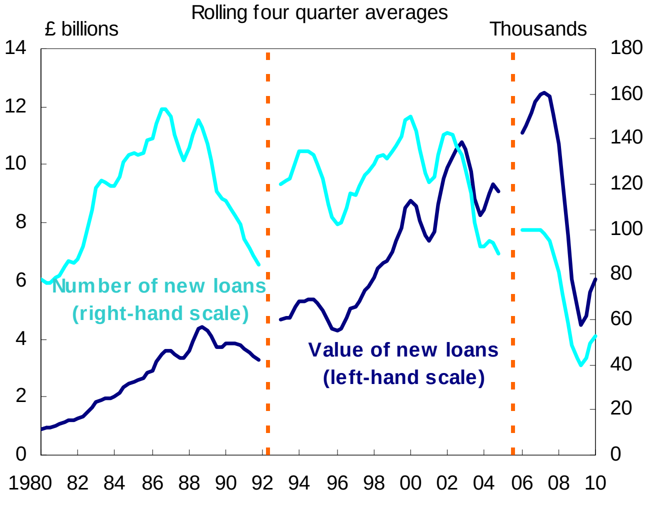
conditions for FTBs remain tight, mainly due to high deposit requirements for mortgages. And although demand and lending have increased over the last year, many FTBs are dependent on assistance, often from parents, to raise the large deposits required. In discussions with the Bank in June 2010, the major UK lenders expected lending to FTBs to remain subdued over the remainder of 2010.

Lending to first-time buyers

4. Looking over the longer term, the value of new loans to FTBs showed fairly steady growth between 1980 and 2006 (**Chart 3**). Much of this was driven by rising house prices and loan values, as over that period the number of new loans was little changed in comparison. But since the start of the financial crisis in late 2007 both the value and number of new loans to FTBs contracted rapidly, with the number of loans reaching 30,000 in 2009 Q1 (**Chart 4**) – the lowest quarterly value reported since records began in 1974.

Chart 3

Lending to first-time buyers: long-run smoothed data (rolling four quarter averages)

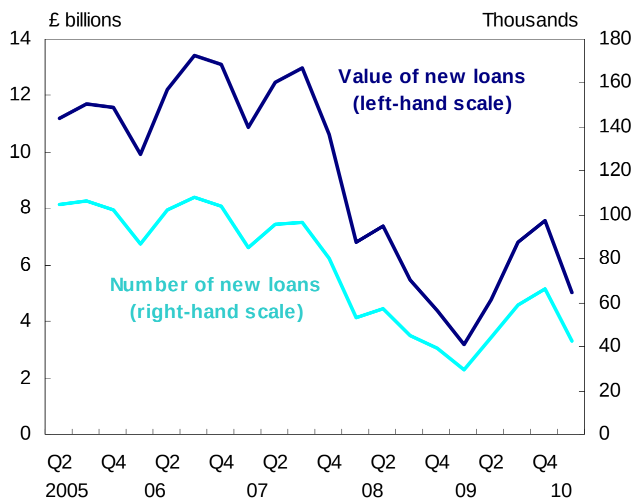


Source: CML.

Rolling four quarter averages of the value and number of new loans to FTBs, to 2010 Q1. For example, the 2010 Q1 figure is the average of 2009 Q2 – 2010 Q1 values. Dotted lines indicate breaks in series. See the Annex for details of the series breaks. Non seasonally adjusted.

Chart 4

Lending to first-time buyers: short-run data, not smoothed



Source: CML.

Non seasonally adjusted.

5. More recently, there has been some increase in both the number and value of new loans to FTBs in 2009, and although lending fell back in 2010 Q1, it remains stronger than a year ago. The fall in 2010 Q1 was largely reported to reflect one-off demand-side factors, such as the end of stamp duty tax relief at the end of 2009 and adverse weather around the turn of the year. These effects make assessing the current underlying strength of the market difficult, though looking through these recent movements, new loan numbers remain far below the levels immediately before the crisis and those of the early 1990s recession. In order to understand how significant the recent recovery in lending has been and whether a

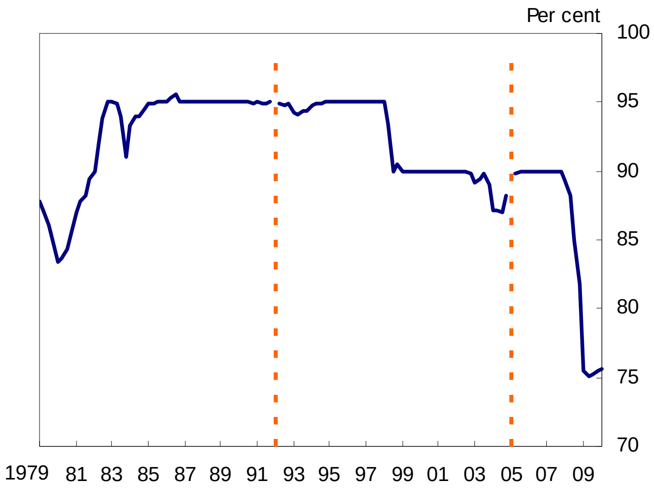
further increase is likely, we need to look into the factors driving the aggregate trend, in terms of supply and demand for credit.

Lending Criteria

6. Discussions with the major UK lenders in June indicated that loan-to-value (LTV) ratios are currently the most significant constraint on borrowing for FTBs. Since the early 1980s FTBs have tended to borrow at high LTVs, of at least 90%, as they tend to be younger and have smaller savings and, unlike home movers and remortgagors, cannot use the equity in a property they own to finance the deposit. But **Chart 5** shows that after a prolonged period of relative stability, the median LTV ratio on FTB loans fell sharply following the start of the financial crisis, and stood at some 75% in 2009. The proportion of FTB mortgages advanced at LTV ratios of 90% or above fell from around 45% in 2007 to less than 5% in 2009 (**Chart 6**). Although the tightening of LTV criteria should help contain lenders' exposure to risk and would be consistent with a more prudent approach to lending, one effect has been to make it more difficult for FTBs to get on the housing ladder.

Chart 5

Median LTV ratio on new loans to first-time buyers

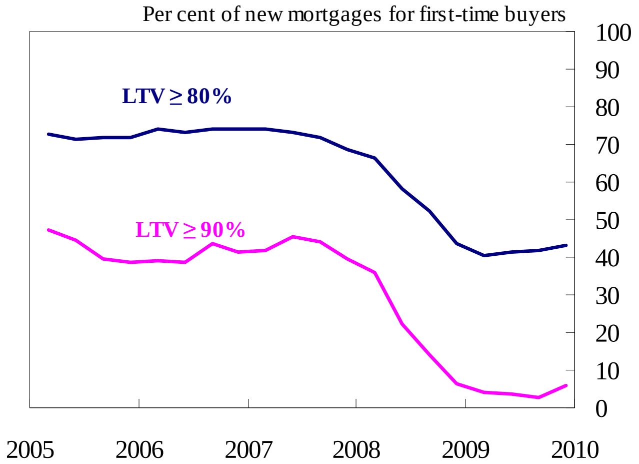


Source: CML.

Quarterly data to 2010 Q1. Dotted lines indicate breaks in series. See the Annex for details of the series breaks. Non seasonally adjusted.

Chart 6

First-time buyer high LTV lending

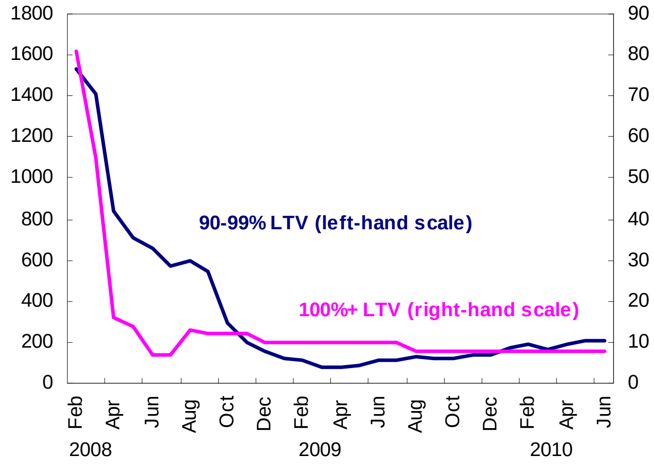


Source: FSA Product Sales Database (PSD).

Quarterly data from 2005 Q2 to 2010 Q1. The data submitted by each lender to the PSD are the same as that for post-2005 Q2 CML data in **Chart 5**, but the PSD has slightly larger coverage than CML data. Non seasonally adjusted.

Chart 7

Number of advertised high LTV products

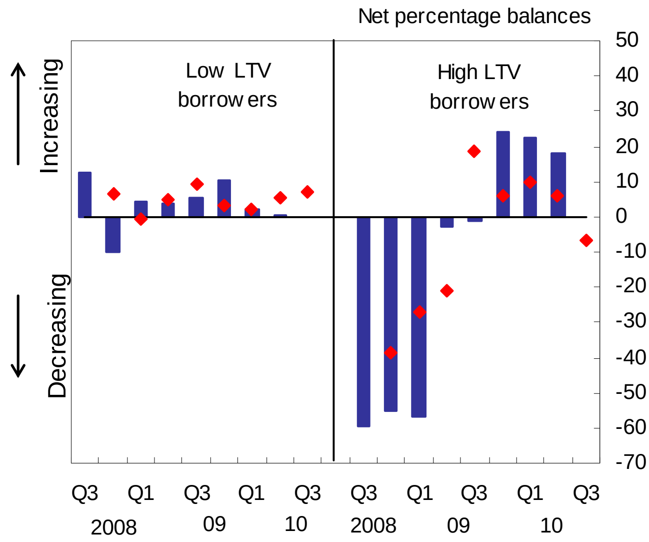


Source: Moneyfacts Group plc.

Monthly data to June 2010.

Chart 8

Secured credit availability by LTV ratio



Source: Bank of England's *Credit Conditions Survey*.

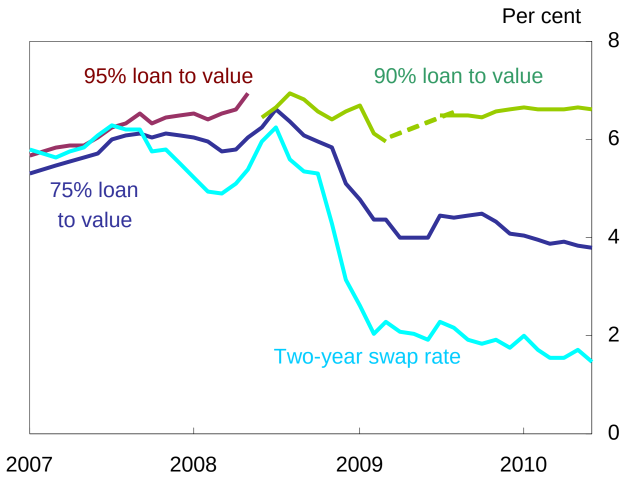
The blue bars show the responses over the previous three months. The red diamonds show the expectations over the next three months, moved forward a quarter. A positive balance indicates that more credit is available.

7. The fall in the median LTV on FTB loans has coincided with a sharp reduction in the number of high LTV products available on the market (**Chart 7**), which suggests that it was caused by banks tightening lending criteria rather than a shift in borrower preferences. In addition to this, evidence from the Bank's *Credit Conditions Survey* (**Chart 8**) shows that over the year to 2009 Q3 lenders significantly reduced credit availability for high LTV borrowers, while credit availability for low LTV borrowers was little changed. It is likely that house price falls, funding and capital constraints, and a re-assessment of the risk on high LTV mortgages have all contributed to reduced availability of these products. But more recently there have been signs of stabilisation in the high LTV mortgage market. In recent discussions with the Bank some major UK lenders reported a tentative increase in their willingness to lend at high LTV ratios, partly reflecting improved house price outlook, lower than expected arrears and unemployment, and some easing in wholesale funding conditions. This is in line with the *Credit Conditions Survey* finding of increased credit availability at higher LTV ratios in 2009 Q4 – 2010 Q2 (**Chart 8**).

8. Perhaps reflecting the easing in high LTV credit availability, the proportion of FTB loans advanced at LTV ratios of 90% or more ticked up in 2010 Q1 (**Chart 6**). But the share of loans advanced at higher LTV ratios remains very low, and estimates based on CML data suggest that, despite the fall in house prices, the median FTB deposit increased from £13,000 in 2007 to £32,000 in 2010 Q1. The high deposit requirements have made it harder for FTBs to access mortgages, perhaps particularly given the effects of recession in restraining wage growth and reducing job security. Those effects may also have encouraged households to hold higher levels of precautionary savings, rather than commit their savings to house deposits.

Chart 9

Quoted rates on two-year fixed rate mortgages

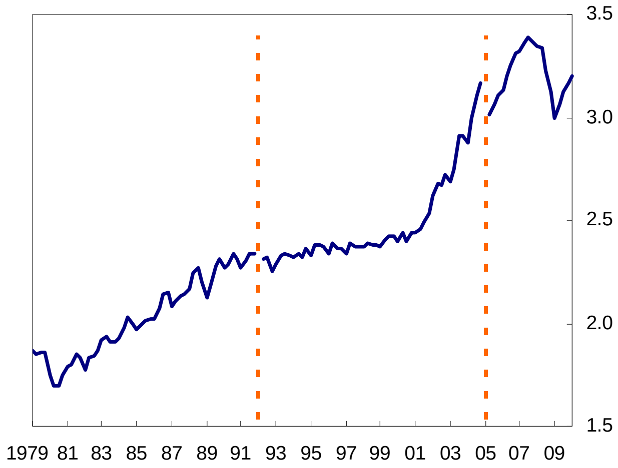


Source: Bank of England.

End month rates. Monthly data to May 2010. 95% LTV series finishes in April 2008, and 90% LTV starts in May 2008, and is not published for March–May 2009, as fewer than three products were offered in these periods.

Chart 10

Median loan-to-income ratio for first-time buyers



Source: CML.

Quarterly data to 2010 Q1. Dotted lines indicate breaks in series. See the Annex for details of the series breaks. Non seasonally adjusted.

9. Those FTBs able to access high LTV products are paying high interest rates relative to those borrowing at lower LTV ratios. **Chart 9** shows that while the quoted rate on two-year fixed 75% LTV mortgages fell following reductions in swap rates in late 2008, the rate on 90% LTV mortgages in recent months has remained little changed, and above rates seen on 95% LTV mortgages in early 2007, despite large falls in swap rates since that time. Although the high spreads between the 90% and 75% LTV mortgages partly reflect heightened credit risk and so capital costs, they are also likely to reflect a low level of competition in the high LTV mortgage market, following a withdrawal of some lenders after the start of the financial crisis. In discussions with the Bank in early 2010, some major UK lenders suggested that competition was focused on low LTV lending.

10. Where lenders have lent to FTBs, the loan-to-income (LTI) ratios have been only slightly lower than at their peak in 2007 (**Chart 10**). LTI ratios remain at much higher levels than in the 1980s and 1990s, following a period of rapid growth between 2001 and 2007. In recent discussions with the Bank, some of the major UK lenders reported that although they have not made significant changes to LTI criteria over recent months, they tend to rely more on other affordability checks, such as testing the ability to maintain repayments at "stress level" interest rates of around 6-8%. Some lenders also said that credit scoring and affordability criteria for high LTV products on which FTBs tend to rely are more restrictive than those on lower LTV products, reflecting the greater credit risks in higher LTV lending.

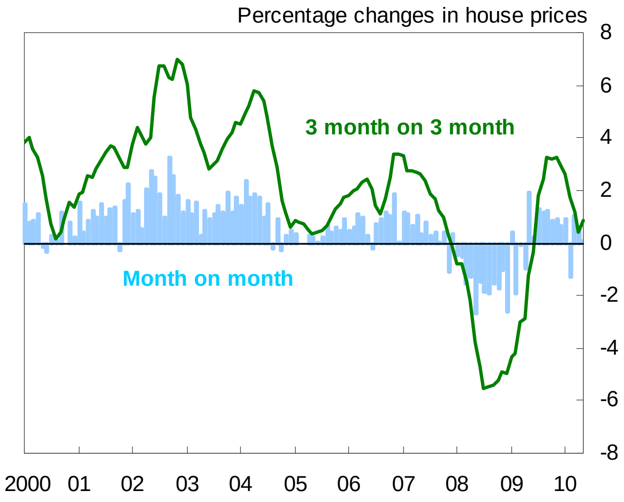
11. So overall, market indicators point to reduced mortgage availability compared both to the pre-crisis period and the longer term, in the form of tighter LTV criteria and elevated spreads on high LTV products. However, LTVs appear to have stabilised and LTI ratios have only fallen slightly since the 2007 peak, with some lenders indicating recently an increased willingness to lend at high LTVs.

Demand

12. The fall in FTB lending since early 2007 appears to have reflected reduced loan demand as well as tighter loan availability, though it may be that the tightening in credit availability has contributed to the weakening of demand. The weakening of economic activity following the start of the crisis, and the associated uncertainty around household incomes, will have made FTBs more reluctant to borrow: in particular, for those looking to borrow at higher LTV ratios, who will face higher mortgage spreads (**Chart 9**). The March 2010 *Building Societies' Association Property Tracker* survey shows that the lack of job security was considered one of the top three barriers to property purchase by around 60% of borrowers between December 2008 and March 2010, compared to only 12% in June 2008. Finally, for those households who are able to raise the deposits and can afford repayments, demand has been constrained by the low levels of housing stock for sale – though this appears to have eased somewhat in recent months. And overall housing market confidence is likely to have fallen in light of the falls in house prices in 2007-09 (**Chart 11**) and increased uncertainty about the housing market prospects.

Chart 11

House price inflation



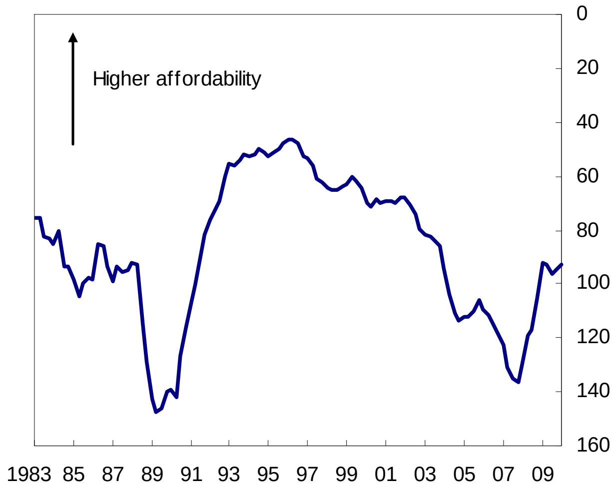
Sources: Nationwide, Halifax and Bank calculations.

House price inflation is calculated using the average of the Halifax and Nationwide indices. The published Halifax index has been adjusted in 2002 by the Bank of England to account for a change in the method of calculation. Monthly data to May 2010. Seasonally adjusted.

Chart 12

Nationwide's first-time buyer affordability index

(base = 1985 average)



Source: Nationwide.

Quarterly data to 2010 Q1. The index measures the proportion of initial mortgage payments to take-home pay. Inverted scale. Higher numerical values of the index indicate lower affordability. Non seasonally adjusted.

13. Following the initial slowdown, demand from FTBs is likely to have increased in 2009, alongside a more general increase in demand for house purchase indicated in the Royal Institution of Chartered Surveyors (RICS) *Housing Market Survey* and the Bank's *Credit Conditions Survey*. The September 2009 RICS survey also pointed to increased

demand from FTBs, specifically over the three months to August 2009.[4] A number of major UK lenders said that the rise in demand in 2009 partly reflected pent-up demand from FTBs coming back to the market, perhaps encouraged by lower house prices. Lenders also noted that the stamp duty tax relief on purchases of property valued up to £175,000, effective between September 2008 and December 2009, brought forward some planned purchases.

14. In the most recent months, however, demand from FTBs looks to have fallen back, which helps explain the slowdown in lending in 2010 Q1 (**Chart 4**). The major UK lenders attributed most of this fall to temporary one-off factors, such as the end of the stamp duty relief and adverse weather around the start of the year, though it appears that the weakness in demand has been somewhat more persistent than initially anticipated. It is possible that the pent-up demand evident in 2009 has been sated, and the recent rise in house prices (**Chart 11**) has put some properties out of reach of aspiring FTBs. So despite the apparent recent recovery, there is some uncertainty about the underlying strength of the market. But for those borrowers able to access a mortgage, there is evidence to suggest that repayment affordability has improved.

Affordability

15. Repayment affordability generally depends on the size of the loan, the interest rate and borrower income. The fall in house prices following the start of the financial crisis (**Chart 11**) and tighter LTV criteria have led to a reduction in the size of a typical FTB mortgage. And although mortgage spreads have increased, the sharp reductions in Bank Rate and swap rates mean that those FTBs able to finance larger deposits, for example of some 25% of the property value, have generally faced lower interest rates in 2009 compared to 2007-08 (**Chart 9**).

16. Nationwide Building Society publish an index of FTB affordability, which uses data on mean earnings of a full-time worker on adult rates from the ONS earnings surveys, and on repayments for a typical 90% LTV mortgage to an FTB, to estimate the ratio of initial mortgage payments to take-home pay. This index suggests that affordability increased in 2007-08 to around its long-term average, and remained at this level in 2009-10 (**Chart 12**). Some caution is required in interpreting these figures, however: for example, affordability at the moment is supported by the low level of Bank Rate and swap rates, which are offsetting the effect of high spreads on mortgage rates. However, in the shorter term, with FTB demand and affordability having increased, the biggest obstacle to getting a mortgage is likely to be the high deposit requirement.

Disaggregating First-time Buyer Lending

17. It is perhaps surprising that FTBs have continued to be able to raise the deposits required to access mortgage products. One explanation for this could be an increase in “returners” among FTBs, which may include second-home buyers and those borrowers who have sold a property previously and so can afford the larger deposits. CML estimates suggest that “returners” tend to be over 30 years old, older than “genuine” FTBs. So the median FTB age should provide an indication of whether the proportion of returners in the

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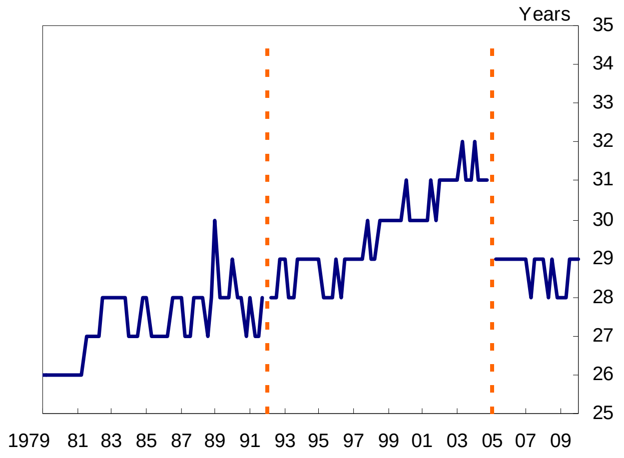
[4] The specific question on demand from FTBs was a one-off question asked in the September RICS survey, available at http://www.rics.org/site/download_feed.aspx?fileID=4591&fileExtension=PDF.

market has increased. CML data show, however, that the median FTB age has remained little changed since 2005 (**Chart 13**).

Chart 13

Median first-time buyer age

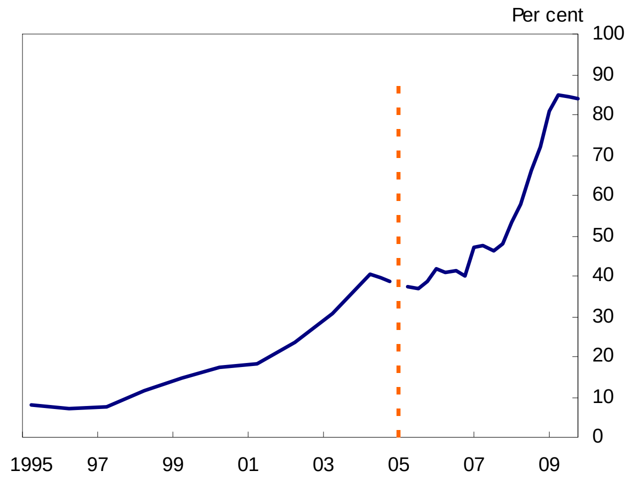


Source: CML.

Quarterly data to 2010 Q1. Dotted lines indicate breaks in series. See the Annex for details on the series breaks. Non seasonally adjusted.

Chart 14

Proportion of "assisted" first-time buyers aged under 30



Source: CML.

Annual data up to 2004 and quarterly data from 2005 Q2 onwards. Dotted line indicates the break in series in 2005 Q2 due to two different surveys used. The data before and after 2005 Q2 are not strictly comparable.

18. Even though the median age data suggest little change in the proportion of "returners" among FTBs overall, looking further into FTB statistics sheds some light on how FTBs are able to access mortgages in the current market. CML have produced estimates of the proportion of FTBs aged under 30 receiving deposit assistance (**Chart 14**), by estimating the number of FTBs whose deposits are higher than their savings to date.[5] These data suggest that the proportion of assisted FTBs has increased from around 50% in 2007 to 85% in 2009. The longer-term change has been even greater, as the proportion of assisted FTBs in 1995-97 was around 8%. With a rising proportion of younger FTBs receiving assistance, it is likely that the proportion of "returners" among unassisted FTBs has increased since the beginning of the crisis.

19. Some major UK lenders have confirmed that increased FTB activity has been supported by higher levels of parental deposits. And there are products on the market that are aimed specifically at assisted FTBs. The UK Government also provides support to FTBs, for example via the "HomeBuy"[6] shared ownership schemes, where the Government takes an equity stake in the property, reducing the deposit which needs to be raised by the borrower.

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[5] Deposits data are collected directly from lenders. Savings to date are estimated based on a lifecycle savings model, using national earnings, taxation and savings rate data. For more details on the estimation see Tatch and Pannell (2006) "Will the real first-time buyers please stand up", Annex A.

[6] For further information on the HomeBuy shared ownership schemes see http://www.homesandcommunities.co.uk/homebuy.

Market Outlook

20. The high degree of deposit assistance among younger FTBs indicates that conditions in this market remain challenging. Looking forward, a number of factors affecting the UK financial sector and the broader macroeconomy may restrain lending to FTBs, and mortgage lending more generally.

21. The recent editions of the Bank of England's *Trends in Lending* report have indicated that bank funding conditions remain tight,[7] with term funding costs elevated, placing a potential limit on the volume of lending banks can support. Although conditions in wholesale and securitisation markets have improved relative to earlier in the crisis, recent concerns about sovereign risks have caused further disruption in these markets. Retail funding has remained relatively expensive as competition for these deposits has been high. The Bank's June 2010 *Financial Stability Report*[8] has highlighted that UK banks need to refinance a significant amount of wholesale funding over the next few years, which may be costly and difficult to raise, especially if banks seek to improve their liquidity position by increasing reliance on retail and long-term wholesale funding.

22. FTB demand may also remain subdued, reflecting the broader weakness in the macroeconomy and weak earnings prospects. The Bank's May 2010 *Inflation Report* suggested that the level of economic activity is very unlikely to return to its pre-crisis trend for a considerable period, and that high unemployment is likely to continue to exert downward pressure on earnings growth in the near term.

23. Overall, the data and market intelligence indicate that conditions in the FTB market have stabilised, but activity remains subdued and the structure of the market, in terms of lenders' ability to supply loans and households' ability to borrow, is very different from that before the crisis. In discussions in June, the major UK lenders expected lending to FTBs to remain weak over the remainder of 2010, and the CML have forecast only a modest increase in gross mortgage lending in 2010 for the housing market as a whole.[9]

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7 For example, see the June 2010 edition of *Trends in Lending* Section 1, available at http://www.bankofengland.co.uk/publications/other/monetary/TrendsJune10.pdf.

8 Available at http://www.bankofengland.co.uk/publications/fsr/2010/fsrfull1006.pdf (see Chapter 4 in particular).

9 The CML forecast published in November 2009, available at http://www.cml.org.uk/cml/publications/marketcommentary/186.

Annex:
Data sources used in the paper

This paper draws on a variety of data sources, however the bulk of data on lending to FTBs is sourced from the CML (Charts 2-5, 10, 13, 14). CML data cover three different surveys, which collect data on individual mortgage transactions. Prior to 1992 Q2, data are for building societies only, grossed up from a 5% sample of mortgage completions. From 1992 Q2 onwards, CML data cover all mortgage lenders, however two different surveys are used before and after 2005 Q2. The Regulated Mortgage Survey used from 2005 Q2 onwards has a greater market coverage (over 90%) and more accurate data than the Survey of Mortgage Lenders used before 2005 Q2 (50% coverage). The FSA Product Sales data used in Chart 6 use the same definitions as the CML Regulated Mortgage Survey data, but are based on a larger sample of lenders.

The paper also draws on data collected by the Bank of England. The mortgage lending data in Chart 1 are based on a near-census survey collecting statistical data from UK-resident mortgage lenders. The quoted mortgage rates data in Chart 9 are also produced by the Bank of England, and are a weighted average of advertised mortgage rates for 30 UK-resident lenders (weights are derived from mortgage balances data). The advertised rates data are sourced from Moneyfacts Group Plc, who are also the source for the data on the number of advertised products by LTV (Chart 7). Chart 8 uses data from the Bank's *Credit Conditions Survey*, which has over 90% coverage for mortgage lending. This survey's net balances represent weighted sums of individual lenders' responses (weighted using balance sheet data).

The paper also makes use of data published by lenders, such as house price indices (Chart 11) derived from data on house purchase transactions financed by the lender, and an FTB affordability index (Chart 12), which measures the ratio of initial mortgage payments to take-home pay, using data from the CML and ONS earnings surveys.

Data analysis is supplemented by intelligence gathered by the Bank of England, based on regular discussions with the major UK lenders (Banco Santander, Barclays, HSBC, Lloyds Banking Group, Nationwide and Royal Bank of Scotland).[10]

[10] Membership of the group of major UK lenders is based on the provision of credit to UK-resident companies and individuals, regardless of the country of ownership.

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