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Housing Market Note

savills

Residential Research

FIXED RATES AND REMORTGAGING

False Dawn?

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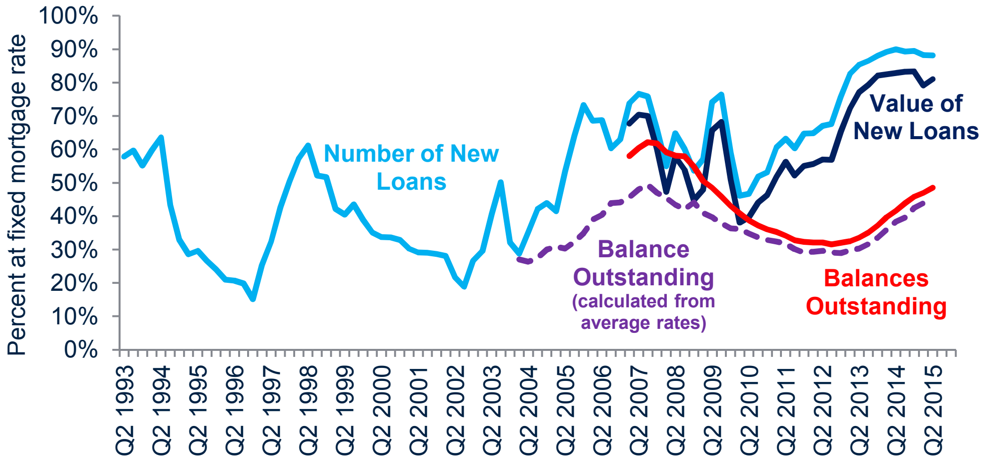
With the prospect of base rate increases seemingly drawing nearer, fixed rate mortgages should help many households avoid the immediate pain (assuming that any increases are passed through to mortgage rates). Most new mortgages in the UK (88% by number and 81% by value) have a fixed rate period and this has raised the proportion of outstanding mortgage debt on a fixed rate from 32% in 2012 to 49% in the second quarter of 2015. With hindsight, it is worth noting that mortgage rates have followed a downward trend during the same period and so the benefit of a fixed rate may have been piece of mind rather than financial. However, there are now tentative signs that mortgage rates have bottomed out.

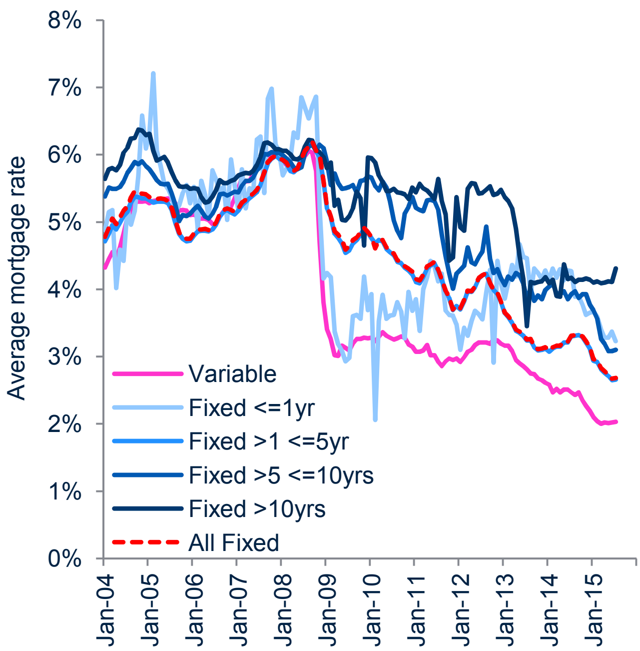
Fig 1 – Fixed Rate Lending



Source: CML, Bank of England, FCA

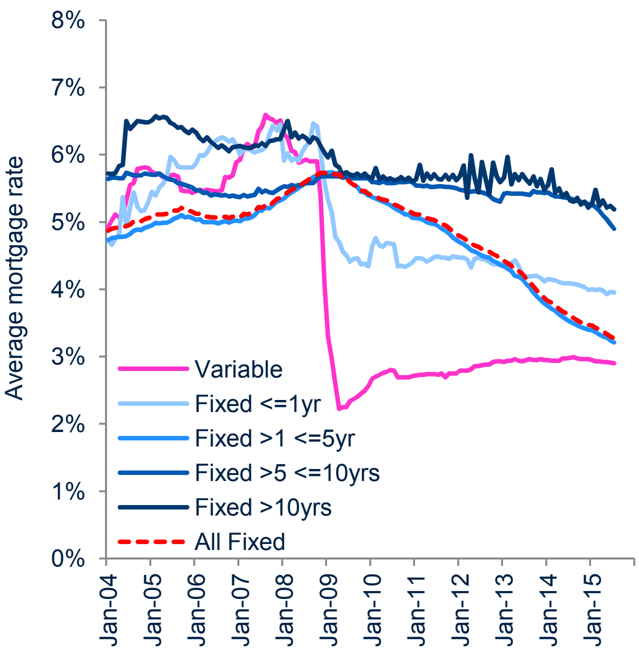
Data on the actual length of fixed rate periods is limited (let me know if I've missed it), so to estimate this I've used data on average mortgage rates for all fixed lending compared to the average rate for different fixed periods. For both new lending and outstanding lending (as per the charts below), the overlap suggests that most mortgages are fixed for a period of five years or less. At a guess, the average is probably closer to two years. That means many recent borrowers are likely to exit their fixed rate period into a market with rising interest rates and tougher lending criteria. That could cause problems for some borrowers and particularly if their mortgage was arranged prior to the introduction of the Mortgage Market Review rules.

Fig 2 – Average Rates On New Lending



Source: CML, Bank of England

Fig 3 – Average Rates On Outstanding Lending



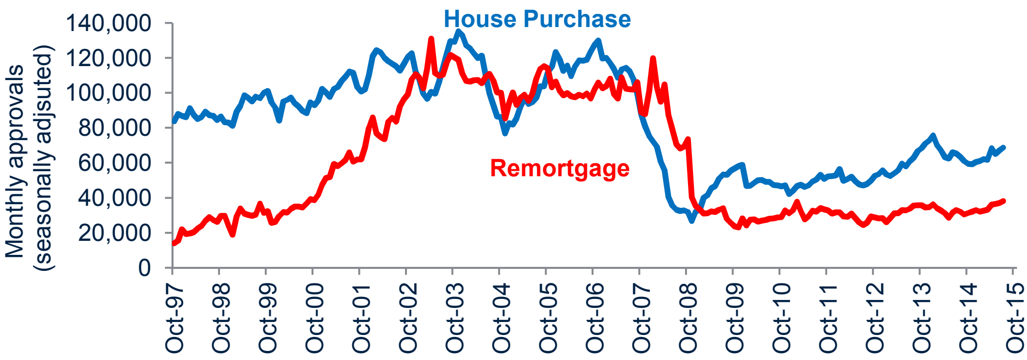
Source: CML, Bank of England

Remortgage approvals may be growing by 15% per year but their recovery is well below the trend of those for house purchase. It remains to be seen whether base rate increases will drive greater demand for remortgaging onto fixed rates. But if current remortgaging levels are due to limited appetite/ability of lenders, we could see some borrowers struggling in a higher rate environment.

For those with expiring fixed rate periods, that could lead to the sudden shock of moving onto a higher variable rate. Arguably that could be worse than borrowers slowly adjusting their living expenses in-line with a gradual increase in rates. As per my previous note's conclusion (http://sav.li/4qe); the return to a fully functioning mortgage market will be essential.

The role of remortgaging during the housing bubble probably deserves greater exploration. The ability to extract ever increasing amounts of equity from your home thanks to rising valuations, which then create a feedback loop for future transactions and remortgages, will most likely have contributed to rising house prices.

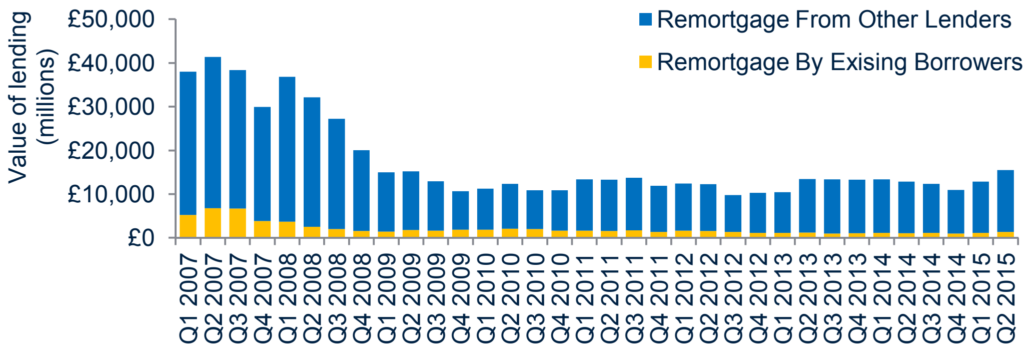
Fig 4 – Number of Mortgage Approvals By Purpose



Source: Bank of England

The majority of remortgages (by value) are by people moving from one lender to another. Only 9% of remortgaged lending was to existing borrowers during 2015 compared to 15% during 2007.

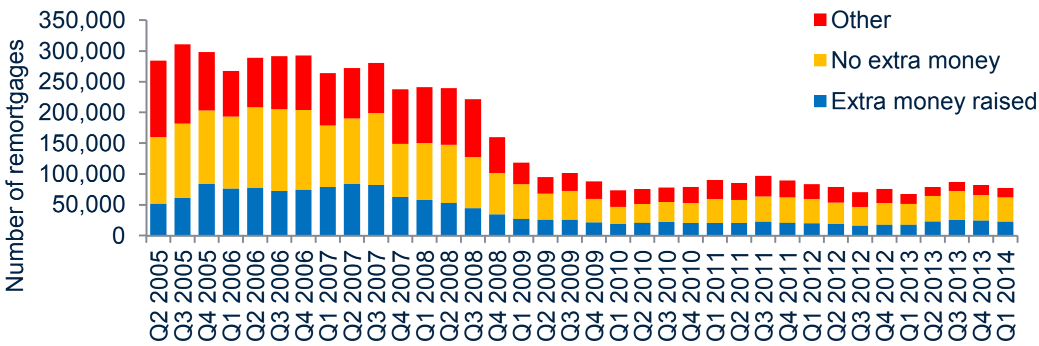
Fig 5 – Value Of Remortgages By Existing Borrower Or Not



Source: FCA MLAR

51% of remortgages in the first quarter of 2014 (latest available) raised no extra money while 29% raised extra money for either home improvements or debt repayment. That's fairly similar to the proportions during 2006 but with a much lower aggregate value.

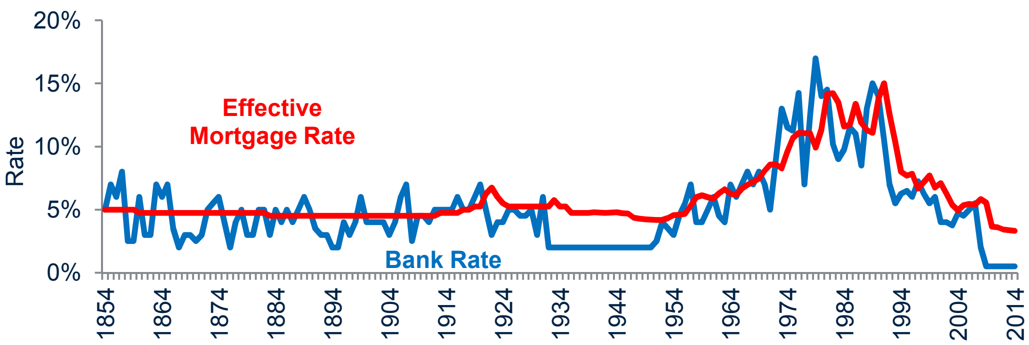
Fig 6 – Number Of Remortgages By Purpose



Source: FCA PSD

Although not directly relevant to the above analysis, I always like a long-run chart. This data on the effective mortgage rate is taken from the Bank of England's 'Three Centuries' data. The average effective mortgage rate over the entire period is 6.0% compared to 3.3% in 2014.

Fig 7 – Long Run Effective Mortgage Rate



Source: Bank of England, Halifax