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Improved liquidity tops lenders wish list for 2008

- The “events of the late summer” – as the Treasury has referred to them – are not the whole story of 2007, and certainly not of the decade that preceded it. Over the last 10 years, lenders have contributed to a strong growth in home-ownership, as well as to the development of both the private and social rented sectors.
- The UK mortgage market has been identified as the most complete in Europe, offering a range of products for different customers at different stages of their lives. As well as conventional home loans, lenders now offer lifetime, Islamic, shared equity, offset and flexible mortgages.
- Recently, however, the industry has been reverberating from the unprecedented shocks of the summer. The closure of wholesale funding markets and a run on a major bank are unique events in modern times, making predictions even more difficult than normal.
- At the top of our wish list for 2008 is concerted action to restore liquidity to wholesale funding markets. We welcome the measures taken by the Bank of England and other central banks earlier this month, but more action will be needed.
- The government should also provide better targeted support for home-owners in difficulty. State support for home-owners whose circumstances have changed remains woefully inadequate, compared to tenants. There are significant gaps in the existing safety net.
- The UK mortgage industry has a long and impressive record of dynamism, competitiveness, and innovation, together with the delivery of choice, value and benefits to consumers and the wider economy. And given the right operating environment, the mortgage industry can continue to provide all of this in the future.

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Unique events

As we come towards the end of the year, it is customary to reflect on what has happened over the last 12 months and to anticipate what we are looking for in 2008 on behalf of lenders. But with the industry still reverberating from the unprecedented shocks of the summer, predicting what might happen is even more difficult than usual. And as we look back at what the industry has achieved, it is also all too easy to focus on events unfolding since August. After all, a combination of the closure of wholesale funding markets and a run on a major bank are unique events in our recent history.

But in reflecting on the consequences of what the Treasury has rather coyly referred to as “the events of the late summer,” we must not forget that they are not the whole story of 2007, and certainly not of the decade of strong growth in home-ownership and success for the mortgage industry that preceded it. Since 1997, the proportion of the UK’s population owning their home has expanded from 67% to 70%. In delivering this growth in owner-occupation, the UK mortgage industry has also expanded rapidly and shown itself to be dynamic, innovative and highly competitive. In the last decade, gross lending has grown by 155% and the number of people buying their home with a mortgage has increased by one million. As we reach the end of the year, lenders are helping more than 11.8 million households become home-owners.

Over many years, the lending industry has enjoyed the support of successive governments in delivering the sustainable growth of home-ownership. Owner-occupation has the potential to expand further. Our consumer surveys consistently show that more than 80% of people want to be home-owners at some stage in their lives. And earlier this month, housing minister Yvette Cooper said: “Seventy per cent of households are now home-owners, and 90% say they want to be. As a government, we want to widen access to home-ownership and help more people build up assets.” When it was re-elected in 2005, the government announced a long-term goal of extending home-ownership to three-quarters of the population. If it really is committed to that, lenders will match their resolve in helping achieve the goal.

Support for home-owners

At this stage, the government needs to do more to show that it wants the growth of home-ownership to be sustainable. In particular, it needs to reverse the policy mistake made in 1995, when income support for mortgage interest was severely cut back by the Conservative government. In an age in which owner-occupation has increasingly become the norm, reform of the benefits system is long overdue to ensure that it provides adequate support for home-owners whose circumstances have worsened.



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Over the last decade, lenders have contributed significantly to the development of the rental sector, as well as to the growth of owner-occupation. Ten years ago, buy-to-let barely existed. Yet as we approach the end of the year, the number of mortgages taken out by landlords has reached almost one million.

The growth of buy-to-let has contributed to a revival of the private rented sector, following decades of decline. It has brought about an improvement in standards of rental accommodation, and provided not only a choice of tenure but a wider choice of properties for people opting to rent. And lenders have also been funding housing associations, helping them fulfil the goal of providing decent homes for social tenants. So we hope the review of the rental sector announced last week by Yvette Cooper will encourage lenders to contribute to its development.

But there is much more that has been delivered by a UK mortgage industry that for many years has been the envy of much of the rest of the world. One independent survey identified the UK lending market as the most complete in Europe, with a broad range of products available for different consumers at different stages of their lives. UK lenders have been at the leading edge of innovation to provide lifetime mortgages, Islamic mortgages, and loans that allow borrowers with past payment problems to re-build their credit status. Shared equity mortgages provide help to first-time buyers facing affordability problems. And there are loans that allow customers to use their savings to offset borrowing costs or that provide other flexible features such as regular over-payments.

Options for consumers

Lenders have also been innovative in developing a range of channels through which customers are able to choose to deal with them. Lenders maintain a substantial branch network, but can also be approached through an active intermediary sector, telephones and the internet. In order, then, that UK lenders can build on their past successes, continue to support the expansion of sustainable home-ownership and other tenures, and provide a wide range of product choices – and value – to customers, what sort of environment do firms need to operate in next year?

- At the top of our list is concerted action to restore liquidity to wholesale funding markets. We welcome the action taken earlier this month by central banks, including the Bank of England, to inject liquidity into funding market. But more will need to be done. A shortage of funding is continuing to restrict the ability of some lenders to offer mortgages that were previously available, leading to the withdrawal and re-pricing of products and tighter lending criteria.
- As our chairman Jon Pain outlined at the annual CML conference earlier this month, we need a quick and effective resolution of Northern Rock's position to help restore consumer and market confidence.



“The government needs to do more to show that it wants the growth of home-ownership to be sustainable”



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- There must be a process of consultation within the industry on the lessons that have to be learned from recent events, and what our responses should be. Clearly, this debate has already begun. But it will be impossible to conclude it until funding markets have been successfully re-opened and are functioning efficiently again.
- Better targeted support from the government is needed for home-owners in financial difficulty. State support for home-owners whose circumstances have changed remains woefully inadequate, compared to assistance for tenants. There are significant gaps in the existing safety net.
- Regulation of lending by the Financial Services Authority (FSA) must focus on areas of real potential detriment to consumers. With the maintenance of market confidence a key objective, it is crucial that what the regulator says is both proportionate and based on proper evidence. In a rapidly changing market, the FSA must ensure that its regulatory work is focusing where it should be – that is, on managing through current and future risks.
- There should be early action to regulate sale-and-leaseback schemes. At a time when the number of households falling into mortgage arrears is expected to rise, it is important to close this gap in consumer protection as soon as possible.
- Lenders, the Treasury and the FSA must give a robust response to inappropriate measures in the white paper on mortgage credit due to be published by the European Commission this week. Measures seeking to harmonise consumer protection in different European countries are not needed at this stage. They will not promote the integration of European markets or deliver net benefits to consumers, particularly in the UK, which already has high levels of consumer protection, efficient markets and a high degree of product diversity and choice. In particular, the Commission should not implement any measures before it has completed its own study of the role of intermediaries in European mortgage markets. There must a rigorous cost-benefit analysis of any specific measures before they are introduced.

Conclusion

Long before “the events of the late summer,” the UK mortgage industry had an impressive record of dynamism, competitiveness and innovation, and the delivery of choice, value and benefits to consumers and to the wider UK economy. It can continue to provide all of this in the future, given the right operating environment. Recent moves by central banks both to inject liquidity into funding marks and reduce rates are welcome first steps towards reinforcing confidence. But as we move into the new year, the Bank of England, the Treasury, the FSA, the CML and lenders will need to build on that with further action that is concerted, timely and appropriate.

**“We hope
the review
of the
rental sector
announced
by Yvette
Cooper will
encourage
lenders to
contribute
to its
development”**



Conservatives urged to reverse policy mistake

In a recent meeting with the Conservative leadership, we urged the party's most senior figures to pledge to improve state support for home-owners who encounter difficulty in repaying their mortgage.

At a meeting last week with party leader David Cameron and shadow chancellor George Osborne, we emphasised that firms would exercise forbearance with borrowers in difficulty wherever possible, as it was not in lenders' interests to take possession of a property unless there is no realistic alternative.

The overwhelming majority of people facing higher borrowing costs next year will absorb them and carry on paying their mortgage as normal. Those least likely to be able to cope will be those whose incomes have fallen or who have experienced an unexpected change in their circumstances.

We urged the Conservatives to improve the inadequate level of state support for home-owners, compared with tenants, and to redress the policy mistake made by the Conservative government in 1995, when it sharply cut back income support for mortgage interest.

The most urgent current priority, however, is action to re-open wholesale funding markets. We explained to the party leadership how the lack of funding is currently affecting the mortgage market. Measures to artificially dampen down interest rates must take account of the real cost of funds to lenders, we argued.

Fixed-rate borrowing declines in popularity

Fixed-rate borrowing became less popular in October, reflecting a greater likelihood of further rate cuts. Data from our regulated mortgage survey showed that 66% of borrowers took out a fixed-rate loan in October, compared with 72% in September. Fixed-rate loans have been consistently popular throughout 2007, running at levels at or above 70%.

Mortgage affordability continued to tighten in October, with interest payments consuming an average of 20.6% of the income of a first-time buyer, compared to 20.4% in September. For movers, the proportion rose from 17.5% to 17.6%. Both are now at their highest level for at least 15 years. But the Bank of England's decision to cut rates earlier this month – with the prospect of further reductions next year – will provide some relief for borrowers in the coming months.

Lending remained strong in October, totalling £33.5 billion, up 9% from the £30.6 billion lent both in the previous month and a year ago. But most loans in October were approved before the full impact of the credit crunch. Going forward, we expect lending to be more subdued, reflecting changed market conditions. This is already showing up in mortgage approval numbers.

- Scottish legal, property and financial services firm Aberdeen Considine and Company has joined the CML as an associate. There are now 163 members and 104 associates.
- The Land Registry is looking to introduce the electronic transfer of funds for home-buying in 2009. The proposal is part of the Registry's wider plans for the introduction of electronic conveyancing.
- Annual house price inflation ticked up to 11.3% in October, from 10.8% in September, according to the Department for Communities and Local Government. The mix-adjusted average house price in the UK in October was £220,195.





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Research sheds light on fixed-rate mortgages

Long-term fixed-rate mortgages need to be cheaper and more flexible to make them more attractive to consumers, our recently published research shows. Consumers do want them, but more is needed to widen their appeal.

Among those favouring fixed-rate mortgages, deals lasting for up to five years are the most popular, the research shows. But 43% of those attracted to a fixed-rate option would choose a medium (five to 10 years) or long-term (more than 10 years) loan, suggesting a significant minority appetite for them.

The research, commissioned from YouGov in early November, showed that 42% of people would have chosen a fixed-rate mortgage at that stage. Only 13% would have opted for a variable rate, while the rest did not know.

A quarter of those responding to the survey said that nothing would induce them to take out a mortgage with a fixed term of more than 10 years. But 37% of people were attracted by the peace of mind of knowing that they would be protected from higher costs if rates went up. Thirty-six per cent thought the idea that a long-term-fixed-rate mortgage would help them manage their household budget was attractive. And 27% cited "certainty" as an attraction of long-term fixed rates.

A smaller proportion (16%) cited reassurance about borrowing large amounts of money as a factor. But when asked whether people borrowing large amounts relative to their income should be required to take out a fixed-rate mortgage to protect themselves against higher monthly payments, a significant majority of those who expressed a view said that they should.

Asked what was discouraging about taking out a long-term fixed rate, a significant proportion (46%) said they were worried about losing out if interest rates went down. Other reasons cited by people worried about them were being locked into the same lender for a long time (35%), a lack of flexibility (27%) and the inability to make – or the cost of making – early repayments (26%). Given that most long-term fixed-rate deals are portable and can be transferred if a borrower wants to move house, it was reassuring that only 12% were worried about not being able to borrow more or move during the fixed-rate period.

People might be more willing to take out a long-term fixed-rate loan if they believed they could exit them more easily and at a lower cost. But consumers were ambivalent about how lenders should price for this, with many people expressing no view. Among those who did respond, most preferred a lower upfront rate with an early repayment charge, rather than the option to pay off the loan with no charge with the cost build into a higher rate.

Almost a half (44%) said they would be willing to pay up to one-tenth more on their monthly bill for the freedom to redeem at any time with no additional cost. But the actual cost that customers would accept remains questionable.

In the absence of incentives from the government to take out long-term fixed-rate mortgages, the number of consumers choosing them looks set to remain low at the moment. What might be more likely to happen is a move from short-term to medium-term fixed rates.

