Housing equity: a market update

- Housing equity held by mortgage borrowers exceeds their debt by £800 billion. In aggregate, the loan-to-value (LTV) on mortgaged properties is less than 60%, implying a substantial equity cushion even in today’s uncertain times.
- Of course there is substantial variation within this aggregate. But nearly half of outstanding mortgages have an equity cushion of at least 30%. A further quarter have a cushion of equity of between 10% and 30%.
- Previously we estimated that around 900,000 mortgaged home-owners were in negative equity at the end of 2008. But house price growth had helped to reduce this number to around 650,000 borrowers less than a year later.
- More recently, housing wealth has been adversely affected by a further softening of house prices. Mortgage borrowers have seen their wealth fall by more than £250 billion since 2007. Using methodology that is more reliable but not directly comparable to our earlier studies, we now estimate that around 827,000 households – fewer than 8% of those with a mortgage – had some negative equity in the first quarter of this year.
- The extent of negative equity today does not match the early 1990s, when substantial falls in house prices contributed to an estimated peak of 1.6 million households in negative equity.
- There is no direct causal link between negative equity and mortgage payment difficulties.
- Lower housing equity makes it harder for people to move house, and this will have contributed to subdued property turnover in recent years.
- Parts of the country that have seen the greatest weakness in house prices are more likely to have borrowers in negative equity. Northern Ireland and the northern parts of England fall into this category.

Introduction

The credit crunch has had a profound impact on many aspects of the housing and mortgage markets.

Falling house prices across the UK in the wake of the credit crunch have had an adverse effect on housing equity. It may therefore be surprising to learn that the household sector in aggregate still holds a phenomenal amount of housing wealth.

Notwithstanding substantial housing equity withdrawal (HEW), house price increases propelled the housing wealth of UK households inexorably upwards during the ten years...
or so prior to 2007, causing it to peak at a little over £4 trillion. Most of the increase in housing wealth relates to owner-occupation, but the renaissance of privately-owned rental properties, associated with the emergence of buy-to-let lending, also contributed to this.

By 2007 we estimate that (excluding the value of housing in the private rental sector) home-owners had housing wealth of about £3,500 billion.

Falls in house prices through to early 2009 then had a marked effect on the nominal wealth of households, which has only been partially reversed subsequently.

Chart 1: Housing wealth held by outright owners and mortgage borrowers, £bn

Much of the reduction in housing wealth has been felt by mortgage borrowers. The effect is overstated to some extent, because of a continuous stream of borrowers fully redeeming their mortgages, and then being re-classified as outright owners (shrinking the gross and net housing wealth of remaining mortgage borrowers).

Although outright home-owners did suffer a “dip” of more than £100 billion in their housing wealth, the partial recovery of house prices and rising numbers of outright home-owners means that this group has more or less fully recovered since. At the end of last year, we estimate that outright owners had housing wealth of £1,430 billion, fractionally above the corresponding 2007 level.

The same is not true for mortgage borrowers.
There have been substantially fewer first-time buyers in recent years, and this has contributed to declining numbers of home-owners and declining gross housing wealth. The impact is more ambiguous with respect to net housing debt because of more conservative LTVs.

Taken together with the fact that house prices are still some way below their peak, this has reduced the housing wealth of mortgage borrowers to £1,840 billion – down 12% from 2007.

With mortgage debt levels more or less stagnant since 2007, this has significantly eroded the amount of “housing equity” (housing wealth not subject to a mortgage) that mortgage borrowers hold. We estimate that it is now three quarters of the 2007 peak.

Another way of looking at this is to say that the aggregate loan to value of residential property subject to a mortgage has climbed to 57-58% over the recent past from around 50% in 2007.

But the unmortgaged housing wealth of borrowers still stands at almost £800 billion.

However you look at it, this means that mortgage borrowers overall have a large equity cushion, even in today’s uncertain times. But given that households have incorporated housing within their wider financial decision-making and behaviour, it is not just the aggregate position that is important but how housing equity is distributed across home-owners.

**New methodology**

We have previously estimated how much housing equity households have by taking the mortgage amounts initially borrowed and projecting these forwards in line with contractual mortgage payments.

The resulting estimate of outstanding mortgage debt has then been compared with the original valuation made at the time the loan was advanced and uprating this in line with Halifax regional house price developments. The methodology is spelt out more fully in our [2009 research paper on negative equity](#). The house price index used will inevitably affect the results, as there are always variations between the movements of each of the main indices, and more so when transaction volumes are low as has been the case in recent times. This latest calculation is based on indexed valuations using Halifax regional house price data, as per our earlier published analysis. We could, equally, have chosen to use the Nationwide index which is currently showing a stronger house
price recovery across the UK than the Halifax index and would likely have resulted in lower estimates of negative equity than those presented in this paper.

The loan outstanding used to calculate current LTV is based on new data provided to us by a large subsample of the RMS reporting group (covering about 7.3 million (79%) of the 9.3 mortgages originated over the period from April 2005 through to September 2010). This additional data provided details on the subsequent performance of loans (both live and closed accounts), as well as the total balance outstanding as at December 2010 of each live account, including any arrears, charges or further advances added to the loan balance during the period.

This represents a substantial improvement on the previous methodology, and the resulting estimates will be more accurate than, but not directly comparable to those published previously.

Further modest steps have been taken to update the analysis through to the end of March this year. Specifically we have assumed that:

- The current balance of active loans in the RMS subsample that were not then in arrears assumes that contractual payments have continued to be made in recent months;
- The balance of active loans in the RMS subsample that were in arrears have not changed in recent months;
- Loans not represented in the subsample, that is loans advanced in 2010 Q4 and 2011 Q1 revert to the former methodology of the current balance being based on the contractual mortgage payment.

**Findings**

A striking feature of our analysis is that the vast majority – 86% - of loans originated since Q2 2005 which are still outstanding continue to be in positive equity (Chart 2). Nearly half of continuing mortgages have an equity cushion of at least 30%. And a further quarter have cushions of between 10% and 30%.

The remaining quarter of loans comprise mortgages where there are relatively low levels of equity or where the borrower is in negative equity - that is where the mortgage outstanding exceeds the current value of the home.
In some respects we would draw little distinction between these two groups, as many of
the borrowers with only small amounts of equity may find it difficult to move house or
remortgage unless they have savings to draw upon.

But negative equity cases attract a lot of media interest, not least because of a
presumption that borrowers who find themselves without an equity interest in their
property might be expected to behave differently if their personal circumstances
deteriorate.

**Chart 2: Current equity estimates by year of origination, % of regulated
loans**

![Chart](chart.png)

Source: CML Regulated Mortgage Survey, CML estimates

It is worth noting that estimates of negative equity vary considerably depending upon the
underlying assumptions made and the methodology followed.

We had previously estimated that there were 900,000 mortgaged homeowners in
negative equity at the end of 2008, but that this had shrunk to about 650,000 borrowers
less than a year later. The same methodology would now point to a modest
deterioration to just over 700,000 currently.

Our latest estimate is that 827,000 households had some negative equity as at Q1
2011. This is likely to represent a modest deterioration over the recent past, although
the change in methodology means that these figures cannot be directly compared with
our earlier estimates.
Drivers of negative equity

For the majority of borrowers, their current housing equity position will be most strongly influenced by the original LTV and subsequent house price developments. The original loan parameters define the starting point, but it is house price changes that determine the direction and magnitude of change.

The further out one looks, the weaker the association with house prices becomes, as a result of possible changes in mortgage terms (eg taking out a further advance, switching from interest only to a repayment loan or vice versa) and broader changes in personal circumstances which may affect the borrower’s ability to keep up their mortgage payments.

Chart 3: Incidence of negative equity by year of origination

Focusing specifically on negative equity, we can see that when the loan was taken out has a dramatic impact on the incidence of negative equity (also a hallmark of our 2008 analysis). Half of negative equity cases relate to loans taken out in 2007, when lending conditions were at their most competitive and house prices at their peak. Nearly a third of continuing loans from 2007 are in negative equity.

Chart 3 suggests that relatively few mortgages written before 2005 are likely to be in negative equity. If true, this would imply that fewer than 8% of all home-owners with a mortgage currently face negative equity.

Negative equity is to some extent associated with borrower type, reflecting the variation in typical LTVs. During the first half of 2011, for example, a typical LTV for first-time
buyers has been close to 80%, whilst for home movers the corresponding figure has been less than 70% and remortgagors somewhere in the low 50s.

Such differentials inevitably mean that first-time buyers are more vulnerable to experiencing negative equity during a period of softer house prices, although the conservative LTV criteria prevailing since 2007 has helped to protect more recent first-time buyers.

**Table 1: Negative equity cases by type of borrower**

<table>
<thead>
<tr>
<th>Borrower Type</th>
<th>% of active loans</th>
<th>Negative equity cases</th>
<th>% of active borrower type</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTB</td>
<td>21%</td>
<td>326,000</td>
<td>26%</td>
</tr>
<tr>
<td>Home Mover</td>
<td>31%</td>
<td>250,000</td>
<td>14%</td>
</tr>
<tr>
<td>Remortgage</td>
<td>46%</td>
<td>223,000</td>
<td>8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>826,800</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: CML estimates  
Note: Figures exclude a small number of loans where borrower type is not known

Our latest estimates confirm that first-time buyers do have a materially higher propensity to be in negative equity. They account for nearly 40% of all negative equity cases, almost double their proportion of active loans.

We saw a similar pattern when we looked at the position of borrowers at the end of 2008.

Given the pivotal role played by house price developments, another key feature is the geography of negative equity.
Since the credit crunch, different parts of the UK have experienced markedly different house price trends. Prices in London have more or less recovered to their peak levels, whereas prices in Northern Ireland remain at around half of the 2007 peak. In northern England there have been modest recoveries but not to the extent seen further south.

Table 2 shows an estimate of the number of homeowners in negative equity in each region. As can be seen, the incidence of negative equity has a strong geographic dimension and one that correlates closely with differing house price movements.
Table 2: Geography of negative equity, mortgages advanced since 2005

<table>
<thead>
<tr>
<th>Geography</th>
<th>Active loans</th>
<th>Negative equity cases</th>
<th>% of active loans in geographic area</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of UK</td>
<td>Number</td>
<td>% of UK</td>
</tr>
<tr>
<td>East Midlands</td>
<td>7%</td>
<td>71,000</td>
<td>9%</td>
</tr>
<tr>
<td>East of England</td>
<td>10%</td>
<td>57,000</td>
<td>7%</td>
</tr>
<tr>
<td>Greater London</td>
<td>12%</td>
<td>88,000</td>
<td>11%</td>
</tr>
<tr>
<td>North East</td>
<td>3%</td>
<td>42,000</td>
<td>5%</td>
</tr>
<tr>
<td>North West</td>
<td>11%</td>
<td>124,000</td>
<td>15%</td>
</tr>
<tr>
<td>South East</td>
<td>15%</td>
<td>64,000</td>
<td>8%</td>
</tr>
<tr>
<td>South West</td>
<td>9%</td>
<td>39,000</td>
<td>5%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>8%</td>
<td>72,000</td>
<td>9%</td>
</tr>
<tr>
<td>Yorks and Humber</td>
<td>9%</td>
<td>130,000</td>
<td>16%</td>
</tr>
<tr>
<td>Wales</td>
<td>4%</td>
<td>36,000</td>
<td>4%</td>
</tr>
<tr>
<td>Scotland</td>
<td>9%</td>
<td>61,000</td>
<td>7%</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>3%</td>
<td>44,000</td>
<td>5%</td>
</tr>
<tr>
<td>UK</td>
<td>100%</td>
<td>826,800</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: CML estimates
Notes: Numbers may not sum due to rounding

Unsurprisingly given the large falls in house prices, Northern Ireland has the highest negative equity rate; we estimate that 28% of mortgages advanced since 2005 that are still active are in negative equity. Northern parts of England also have an above average incidence of negative equity, around 20% of mortgages advanced since 2005 that are still active in the north east, north west and Yorkshire and Humber are estimated to be in negative equity. Regions in the south of England have a below average share of households in negative equity.

The regional distribution of negative equity will be highly sensitive to the house price index used in the analysis. These estimations use the Halifax index which is currently showing weaker prices than the Nationwide index.

**Significance of negative equity**

There is a common misconception that there is a direct and powerful causal link between negative equity and mortgage default.

The view gained ground in the recessionary conditions of the early 1990s, when substantial house price falls triggered widespread negative equity (estimated at 1.6
million households or higher at its worst). Many households experienced acute financial pressures, as a result of an increase in unemployment of more than a million and associated drop in earnings and record high mortgage rates.

Despite extensive negative equity and protracted economic difficulties, the vast majority of borrowers met their mortgage payments in full and on time every month.

And, as we pointed out at the time and repeatedly since – most recently in our discussions with the Financial Services Authority in the context of its ongoing mortgage market review – mortgage payment problems predominantly stem from unexpected changes in circumstances, such as unemployment, accident or relationship breakdown, and not from being nominally in negative equity.

The evidence suggests that households adopt a very wide range of coping strategies in order to stay in their homes, flexing their budgets by reducing discretionary expenditure and giving priority to meeting their housing costs. Further actions include calling on savings and renegotiating credit payments. Lenders also offer an extensive range of forbearance policies to help borrowers recover from temporary payment problems.

Simply giving up and walking away is rarely the best option for struggling borrowers, not least because they remain liable for any shortfall debt that remains post-possession. The legal position is very different across much of the US, where negative equity has triggered widespread mortgage default. This is because mortgages in many states are on a non-recourse basis, and prompting the lender to foreclose represents a clean break for the borrower.

The experience of the early 1990s was that, generally speaking, households appeared not to be unduly concerned about nominal reductions in housing wealth, unless they wanted or needed to move home. Where households needed to sell their home, this was the point where they faced the psychological hurdle of selling for less than they had paid for, crystallised what had until then only been a notional shortfall and typically had to lay down savings to finance the transaction.

The unsurprising upshot was that many households simply stayed put - in many cases for several years - while they sought to increase their savings or waited for more positive house price movements to bridge the shortfall.
Today, the greater availability of private rental property gives households extra strategies when they wish to move, for example for job-related reasons, but even so we have seen a sharp reduction in property turnover. Restrictive lending criteria will have exacerbated this, but it is difficult to separate out the impact of lower housing equity from the wider effects associated with economic recession and falling household real incomes.

Further information on Housing Finance

Housing Finance is an authoritative online journal which provides in-depth articles on a wide range of mortgage related issues. For free online access to other recent articles and a subject index see http://www.cml.org.uk/cml/publications/research. For further information on Housing Finance articles contact the editor Bob Pannell at bob.pannell@cml.org.uk.