Mortgages

Made Easy

Towards the LIBF Syllabus
2023-2024

Revision Guide

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The Mortgages Made Easy Revision guide is to be used in addition to the main accredited Textbook and will never replace the detail contained there.

It was written as a breakdown of the syllabus with an intention to support the reader's understanding of the main aspects of the text and will serve as an appropriate revision guide to help pass the CeMAP 2 & 3 Exams.

The Mortgages Made Easy Revision guide published in June 2022 provides information for the LIBF 2023/24 Mortgages Syllabus. While the team has used all their efforts in preparing this book to the highest standards, there are no promises or warranties in respect of the accuracy or completeness of the content of this book with updated changes from the appropriate financial bodies.

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ABOUT OUR MADE EASY GUIDES

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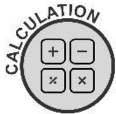

CALCULATIONS

This icon appears areas where calculations and formulas are explained.

KEY POINTS

Based on LIBF syllabus and mock papers these are Key Areas to acknowledged.

PLEASE NOTE

These sections are notes, summaries and areas that need to be noted based on changes or amendments.

EXTERNAL LINKS

As in the LIBF Syllabus some areas are too large and cannot be broken down to be placed in the manuals or may change throughout the financial year. Here you can find links to the relevant resources.

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UNIT 3
MORTGAGE LAW, POLICY, PRACTICE AND MARKETS

TOPIC 1 PROPERTY AND MORTGAGE MARKETS

By the end of this topic you should have an understanding of:

- how the property and mortgage markets have performed since the late 1980s.
- the interrelationship between the economy and property markets.
- key factors that affect the demand for mortgages.
- the main providers of mortgage finance.

1.1 Introduction

The UK has a mature property market with home ownership seen as both desirable and essential; in many cases it is seen as an investment. The UK mortgage market is intensely competitive due to increasing demand and easy access to information for comparing features and prices to shop around for the best deal. Consequently, a wide range of mortgage products is available from various financial institutions.

1.2 How did the credit crunch affect the mortgage market?

UK demand for mortgages stalled in early 2008, primarily as a result of the 'credit crunch' 2007 and remained at a relatively low level for several years until a property price boom in the early 2000s partly fuelled by low interest rates. A number of factors led to the credit crunch:

- Many lenders relaxed their lending criteria and encouraged people with a poor credit history to take out a mortgage are known as 'sub-prime'.
- Lenders began to sell in bulk mortgages on their books to other lenders, known as securitisation, to remove those loans from their balance sheets and allow them to borrow more.
- Riskier borrowers began to default on mortgages, income streams reduced and several US lenders failed.
- Confidence and trust in the markets disappeared and banks pulled back on lending and became reluctant to lend to each other meaning Interbank interest rates increased and the housing market ground to a halt.
- Share prices fell across the world as the lending crisis began to hit businesses outside the mortgage sector and with cash flow dropping, markets stopped working due to the lack of available credit.
- Northern Rock had a high proportion of risky mortgages due to its aggressive pursuit of market share and had taken advantage of securitisation and in September 2007 they asked the Bank of England for emergency funds to aid cash flow because even though being in a relatively solvent position, it was unable to raise sufficient funds in the capital markets to provide liquidity. By February 2008, despite abortive attempts to find a buyer and a number of funding guarantees, the government decided to nationalise Northern Rock and then Bradford & Bingley.
- Simultaneously, the world economy was hit by huge rises in the price of commodities, at the time when the markets were nervous.
- In the UK, a number of banks were bailed out by the government. Billions were pumped into the banks to increase liquidity and world interest rates were slashed to stimulate lending.

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1.3 What happened to the UK mortgage market after the credit crunch?

The property market remained poor after the credit crunch. A number of factors contributed to this:

- The UK economy went into recession during the financial crisis with companies having to release staff or impose pay freezes or cut workers' hours.
- In the housing market itself would-be buyers were reluctant to jump into the market when prices could go down further.
- Banks remained reluctant to lend, either to each other or to prospective homebuyers; instead they were concentrating on building up their reserves. To address the problem, the government launched its 'Funding for Lending' initiative in August 2012, under which the Bank of England lent money at below-market rates to financial institutions. This initiative enabled lenders to cut their interest rates a little, and inject more capital into mortgage loans. However, the focus of the Funding for Lending scheme was changed in November 2013 to provide funding for small businesses only.
- Lenders still active in the mortgage market adopted a safety-first approach, requiring much higher deposits and looking much more closely at potential borrowers' ability to repay their loans. The lenders' approach was reinforced following the Mortgage Market Review, which required lenders to apply more stringent affordability criteria from April 2014.

1.4 How does the contemporary market look?

From 2013 the UK housing market was recovering as confidence started to return to the market, though it took until middle of 2014 for average prices to reach the peak that had in 2007.

Since then, general prices have increased significantly, however they did not take place evenly, with prices in London far exceeding those in other areas of the UK so London market should not be used to assess typical house prices. There are also other areas in England, such as Manchester, where house price increases have been significantly higher than the average.

Key factors include:

- house prices increasing well ahead of wage rises;
- limited supply driving prices up;
- a lack of affordable homes;
- potential London buyers deciding to buy in the home counties, driving prices up in those areas when the market is thriving.

There has been a decline in UK average house price growth in recent years, as opposed to a fall in prices.

Several factors have contributed to this deceleration in house price growth in 2022 and the anticipation of price declines in 2023. These factors include:

- Temporary increase in the threshold for stamp duty land tax for most buyers between July 2020 and June 2021. This led to heightened demand and a subsequent price increase as individuals capitalized on potential savings. The threshold gradually reverted to its original level between July and September 2021.
- Escalation in the rate of inflation. This prompted the Bank of England to incrementally raise the Bank interest rate throughout 2022, resulting in higher mortgage rates. The situation was exacerbated in September 2022 by the impact of the 'mini-Budget,' causing market turbulence and heightened borrowing costs for lenders. This, in turn, prompted lenders to raise their mortgage rates and, in certain cases, withdraw numerous mortgage products from the market.

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First-time buyers

Today's first-time buyers are typically of an older age and are confronted with the necessity of accumulating a significantly larger deposit compared to previous generations.

Despite the challenges that first-time buyers encounter in the property market due to more rigorous affordability assessments, the need for substantial deposits, and escalating property prices, their numbers are on the rise.

This increase can be attributed to factors including lower interest rates and government-driven incentives such as exemption from Stamp Duty Land Tax (SDLT) and regulations mandating the inclusion of affordable housing in new development projects. These measures have played a role in invigorating the housing market for first-time buyers.

1.5 What issues affect the mortgage market?

Interest rates

Interest rates directly affect the cost of repaying a mortgage with higher the rate the harder to meet repayments. When interest rates are low, people find mortgage repayments affordable and will usually be prepared to commit to higher mortgages.

This willingness to borrow lifts prices generally, resulting in a property boom, although other economic factors, such as recession may lead to lower property prices even when interest rates are low.

> Bank Rate Vs LIBOR
> Although mortgage interest rates are broadly linked to Bank rate, they are more directly affected by interbank lending rates. This means that, in normal conditions mortgage rates go up and down broadly in line with the Bank rate. However, in difficult market conditions the differential can be wider.

Many lenders have moved away from the traditional variable-rate mortgage in favour of tracker mortgages that follow Bank rate or interbank rate. Modern trackers have a wide margin, offering rates as high as 3% above Bank rate.

Sonia

The significance of Libor as a benchmark has reduced. There are two main reasons:

- The 2008 financial crisis led to banks relying less on the interbank market for borrowing, with Libor seen as less relevant than before.
- Misconduct relating to Libor and similar benchmarks, which came to a head in the UK in June 2012, when Barclays Bank was fined £270m for allowing some of its derivatives traders to attempt Libor manipulation.

A working group recommended using the 'Sonia' benchmark as the preferred risk-free rate that is based on wholesale market overnight interest rates and seen as close to a risk-free measure of borrowing costs and is based on actual transactions, which makes it difficult to manipulate the figures.

The Bank of England, together with the FCA and market participants, collaborated on the transition from Libor to Sonia as the primary interest rate benchmark for sterling markets which was completed at the end of 2021.

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Inflation

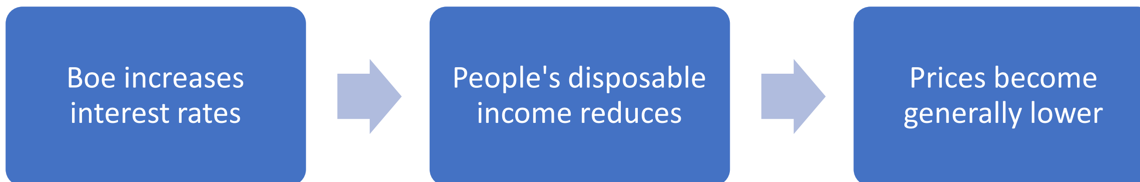
There are two elements to inflation in the property market:

- **General inflation** – the decrease in the spending power of money over a period.
- **House-price inflation** – relates to the increases in the price of houses over a period.

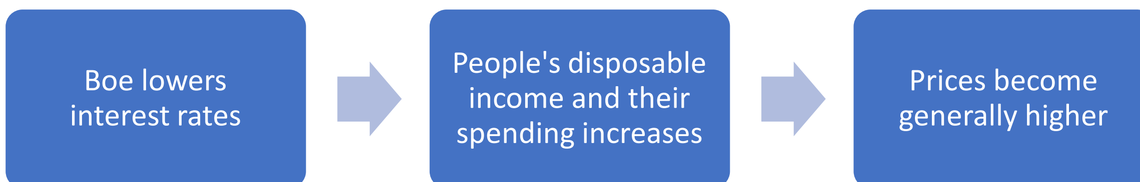
It is accepted that a small amount of inflation is good for the economy, with the government setting the Bank of England a target for inflation of 2%, as measured by the Consumer Prices Index (CPI).

The Bank of England can control general inflation, to some extent, through its Monetary Policy Committee (MPC).

How can the Bank of England reduce inflation?



How can the Bank of England increase inflation?



The state of the economy

The economic climate, whether marked by robust stability and low interest rates or characterized by uncertainties such as job concerns and recession fears, holds a significant sway over individuals' confidence in making mortgage-related choices.

Up until mid-2022, the financial panorama has been marked by a sustained period of low interest rates and controlled inflation, resulting in historically favourable mortgage rates.

Since the reverberations of the 2007-2009 financial crisis, apprehensions surrounding personal debt levels, job security, and the spectre of future interest rate hikes have cast a shadow on consumer assurance. These apprehensions have been further exacerbated by the onset of the cost-of-living challenges in 2022, coupled with notable upswings in both inflation and interest rates, dealing another blow to consumer confidence.

Supply and demand

Property is no exception to the laws of supply and demand, whether categorised by geographical area or type of property. Simply, if there are more buyers looking for one-bedroom flats in an area than there are flats available, the price will be driven up. Similarly, if there are too many executive detached properties, the lack of demand will drive down prices. Property prices in London and the south have been consistently higher than the rest of the UK; much of this is due to the dense population and lack of appropriate housing.

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Government action

Examples of how government action can affect the property market:

- July 2015 summer budget: changes to mortgage interest tax relief on buy-to-let property
- First-time buyer SDLT exemption
- November 2015 autumn statement: a 3% stamp duty land tax surcharge on buy-to-let property

As a result of the changes to taxation of buy-to-let (BTL) property, investors are likely to have to pay more tax, this reflecting the government's desire to mitigate the impact of BTL investment since demand from BTL investors is seen to be fuelling an increase in prices and contributing to the difficulties first-time buyers face in purchasing a home.

Borrowing for purposes other than property purchase

Another factor that influences the amount of mortgage borrowing is the increasing use of mortgage-secured borrowing for purposes other than property purchase with mortgages providing funding at better rates, spread over a longer term than many other forms of finance.

In an environment of rising house prices, consumers also use second mortgages on their existing property to release the increasing equity tied up in the value of their home to support a better lifestyle.

1.6 Which types of provider offer mortgage finance?

Banks

Intense competition in the UK banking sector has led to an extension in the range of products on offer with banks now actively seeking residential and commercial mortgage business, which is seen as relatively safe and profitable. As large institutions, banks also enjoy considerable economies of scale; they benefit by virtue of their size, being able to raise money more cheaply and take advantage of efficiencies created by the effective use of information technology.

Building societies

Building societies must still devote a minimum of 75% of their total lending activities to residential mortgages, although they can convert to plc status if they wish to enjoy the same freedom as banks.

Despite their additional powers, many building societies are content to remain as specialists in residential lending. Some have ventured into corporate lending secured on land, although many feel this sector of the market presents an unacceptable risk.

Insurance companies

Insurance companies can be general insurers, life assurers or composites offering both types of business. Traditionally, life companies have occupied a small corner of the mortgage market. As the competition for mortgage business has intensified, insurers have lost some ground in the provision of loans, but have undoubtedly gained by selling services alongside mortgages offered by other providers.

Specialised mortgage companies and challenger banks

Specialised mortgage companies (known as 'centralised lenders') are normally limited companies and are either independent providers or subsidiaries of larger financial institutions with few, if any, branches and operate primarily through intermediaries. They are funded from the wholesale market and lend on a centralised basis.

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The rise of challenger banks (new entrants to the banking arena) has also changed the face of the lending market and led to increased competition. Both challenger banks and specialist mortgage lenders have increased their mortgage lending at a higher rate than more traditional lenders, and some of the original challenger banks are now seen as part of mainstream banking offering a branch network, though not as extensive as the major players.

Specialised lenders and challenger banks built a reputation for innovative mortgage products at attractive rates. However, the nature of their funding makes them more vulnerable to increased wholesale interest rates or when funding available from wholesale lending markets 'freezes up' due to difficult financial conditions. It is therefore common for specialist lenders to securitise their loan books by packaging up a number of existing mortgages and sell them to other organisations in return for a cash sum used to improve the original lender's balance sheet, reduce its risk profile and reduce the amount of capital it needs to meet capital adequacy requirements.

The purchaser will receive all interest and capital payments from the borrowers, which will ensure a revenue stream for them over time. In most cases the original lender will agree a contract to administer the new mortgage, and so will generate regular income from that as well, though little changes for the borrower and the terms of the mortgage cannot be changed.

Mortgage packagers

Mortgage packagers are, in effect middlemen who operate between the ultimate lender and the intermediary or customer. Their role is to undertake much of the administrative work, tailoring mortgage arrangements to specific situations but not give advice.

Typically, a mortgage packager will make its money by charging between 1-2% but it may pass some of this on as commission to the intermediaries who use its services.

Sub-prime and other specialist lenders

Certain potential borrowers have difficulty meeting the lending criteria for mainstream lenders, lending to such borrowers is called 'sub-prime lending'.

These include borrowers:

- with a poor credit history.
- who have difficulty proving certain elements of their income.
- who do not fit the lender's 'normal' borrower profile in terms of occupation, age, residency, type of income, etc.
- who are self-employed and either have a short track record in the business or cannot supply the required number of previous years' accounts.

This does not mean they are a poor business proposition for the lender, but they require different and more specialised assessments, and the lender may choose to charge a higher interest rate to compensate for any additional risk presented.

Following the 2007–08 credit crunch sub-prime market significantly reduced meaning the end for a number of companies that specialised in the adverse credit market. However in recent years a few sub-prime lenders have reappeared to mop up the demand for mortgages from applicants unable to get any form of credit.

'Sale and rent back' arrangements involve a company buying a property from its owner, usually at below market value, and then renting it back to them and must be given a fixed tenancy agreement of at least five years. These arrangements, which are regulated by the FCA, can represent a viable option for those with unmanageable mortgages. Short-term secured loans can help those wishing to repair their credit.

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Buy-to-let

The buy-to-let market is generally regarded as a specialist market, and there are a number of lenders with particular expertise and product offerings for that market. Some of these, such as NatWest, are also substantial mainstream mortgage lenders, but many have established intermediary mortgage divisions, such as BM Solutions and Platform (part of the Co-op Bank), for which buy-to-let lending is a major part or the sole focus of their business. There are also brokers who focus on buy-to-let and/or commercial mortgages.

Other providers

Finance houses provide finance to those wishing to raise loans on the security of their property. Such loans will often be at fixed rates of interest for a limited term and may be for such things as home improvement. Some providers specialise in providing second-charge loans and others in providing bridging finance.

Second-charge loans

A second charge is a loan secured on a property but registered after a mortgage (first charge). It will rank second in line for repayment on sale or repossession so will be repaid from any money left over after the first-charge holder has been repaid. If there is insufficient money to repay the second-charge holder, the lender will lose out.

Bridging finance

Bridging finance may be required when a borrower wishes to move house but has not managed to sell their existing house, or the funds from the sale will not be available at the time completion of the new purchase is due. It is short-term lending that is repaid when the original property is sold and the owner is able to secure a mortgage on the new property.

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