Financial Services Authority

Mortgages

Product Sales Data (PSD)

Trend Report | 2005-2011

August 2011

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Contents

1. Highlights 2010-2011

- Mortgage sales between 1 April 2010 and 31 March 2011 reached their lowest level since the FSA began recording data in Q2 2005. Overall, mortgage sales declined by 7% from 2009/10 to 2010/11. This fall is consistent with unfavourable economic conditions for potential borrowers: higher unemployment, declining consumer confidence and falling real household income. It is also compatible with the decline in both the number of selling and provider firms between Q2 2010 and Q1 2011.
- Of all the lenders that reported mortgage sales using PSD, the top five accounted for about 62% of all sales by volume, the top 10 for 83% and the top 20 for 94%. These figures reflect the trend towards increased firm concentration as a result of mergers and acquisitions and because firms have been leaving the market.
- Looking at sales by type of provider firms, the top seven mortgage providers account for a substantial 83% of the market, followed by building societies and credit unions (8.6%). The remainder is accounted for by non-deposit takers, overseas banks and small provider firms. A number of non-deposit takers have left the market because of the difficulties they faced in obtaining funding.
- Sales of mortgages to first-time buyers, remortgagers and home movers all fell in 2010/11 compared to 2009/10.
- Since mid 2007, there has been a sustained decline in equity withdrawal remortgages. Sales of equity withdrawal mortgages have stabilised recently, showing a slight increase between Q2 2010 and Q1 2011.
- Although still the most popular type, the proportion of new fixed interest rate mortgages declined significantly from 63% in 2009/10 to 53% in 2010/11. Initial rates on fixed interest rate mortgages have been consistently higher than variable rates but the gap is shrinking.
- The proportion of interest-only mortgages with an unknown repayment vehicle has continued to decline from 13.5% in Q2 2010 to 10.8% in Q1 2011.
- Sales of certain types of mortgages that are considered risky remain low or continue to decline in proportional terms.
- The proportion of mortgages sold with advice has decreased in the last year. This is consistent with our observed decline in the relative importance of intermediaries, who tend to sell with advice.
- The average age of first-time buyers has remained virtually unchanged in 2010/11 versus 2009/10 at 30.8 years. In general, it seems the tougher the lending conditions and the general environment for first-time buyers, the older they are when they enter the mortgage market.

2. Introduction

In December 2005, the FSA made a commitment to the industry to publish aggregate Product Sales Data (PSD). We published the first data in June 2007, covering the period April 2005 to March 2007, and have continued to publish trends reports on an annual basis ever since. Last year's report (August 2010) included, for the first time, tables covering the five-year history of the dataset (from Q2 2005 until Q1 2010).

Our analysis concentrates on the key developments affecting the mortgage market. We also publish PSD trends reports on retail investments and pure protection contracts.

If you have any comments on the content of this document, or suggestions as to how we might improve future issues, please contact us at: **product.sales@fsa.gov.uk**. We welcome your feedback.

3. What is Product Sales Data (PSD)?

Since 1 April 2005, product providers have been required to provide us with transaction level data on all sales of regulated mortgage contracts, retail investment products and certain pure protection products to retail and private customers. This covers direct sales by firms' own sales forces and sales made by intermediaries. Between April 2010 and March 2011 some 539 firms provided PSD reports, with 181 reporting mortgages, 367 reporting retail investment products and 67 reporting pure protection products. Some firms report on more than one product area and a number of firms provide nil returns.

Reporting firms are required to submit quarterly PSD reports. By 31 March 2011 we had received PSD for 24 calendar quarters, covering over 31m transactions, including 17.3m retail investment products, 4.3m pure protection products and 9.6m mortgages.

PSD provides an important source of information that helps our risk-based supervision strategy in relation to retail firms and markets. The nature of the data means we can use it both at the detailed level to identify individual sales by firms and also at the aggregate level to monitor product and market sales patterns.

Mortgage PSD has often been used to provide statistical data, evidence or background information to support FSA policy making. For example, for the Mortgage Market Review (MMR), the FSA used PSD for its initial Discussion Paper DP 09/3 and in its Consultation Papers, CP 10/16 on Responsible Lending and CP 10/28 on Distribution & Disclosure.

4. Interpreting the data

Please note the following points:

1. This report focuses on the volume of transactions; values are considered at a less detailed level.
2. Some totals may show slight discrepancies due to the rounding of figures.
3. Since 1 April 2006, all PSD reporting firms have been required to state whether customers received advice at the point of sale, therefore all analysis involving advised sales will relate to this date onwards. For more information on what constitutes an advised sale, please refer to the appendix.
4. PSD only captures new sales; transfers, top-ups, alterations, increments and renewals are generally not included.
5. Some of the figures may be seasonally adjusted by applying the x12 filter.[1] Seasonally adjusted figures are followed by an '(s.a.)'.

5. What information is available from mortgage PSD?

Details of loans for house purchases and remortgages are captured by mortgage PSD, but data relating to further advances are not. Additionally, mortgage PSD only covers regulated mortgage contracts and therefore excludes products such as second-charge lending, commercial and buy-to-let mortgages.

Only completed transactions (where the funds have been transferred from lender to borrower) are reported in mortgage PSD.

Definitions of terms relating to mortgage PSD are included in the appendix.

6. How does mortgage PSD compare to other published data?

The data submitted by each lender for mortgage PSD are the same as the data submitted to the Council of Mortgage Lenders (CML) for their Regulated Mortgage Survey (RMS). However, the figures published from the RMS will differ from mortgage PSD because a small number of mortgage lenders do not submit data to the CML.

Other sources of mortgage data that are published by the FSA, such as that derived from the Mortgage Lending and Administration Return (MLAR), may not be directly comparable to mortgage PSD due to differences in data coverage. For example, further mortgage advances are included in the MLAR but not in the PSD. Users of this report are therefore advised to take care in comparing mortgage PSD with other related data.

7. The overall trend in mortgage sales

Mortgage sales of almost 0.87m were reported between 1 April 2010 and 31 March 2011 (versus 0.93m a year ago). Of all the lenders that reported mortgage sales using PSD, the top five accounted for about 62% of all sales by volume, the top 10 for 83% and the top 20 for 94%.

During the year between 1 April 2010 and 31 March 2011 mortgage sales reached, yet again, their lowest level since the FSA started to record the data in Q2 2005. Mortgage sales were 6.8% lower in 2010/11 than in 2009/10. After the end of the stamp duty holiday for properties valued at £175,000 or less in Q4 2009[2], there was a significant fall in mortgage sales in Q1 2010 (by 15% s.a, qoq[3]), followed by little movement in the mortgage market. Between Q2 2010 and Q1 2011 the number of mortgage sales fell by 1.6% (s.a.), reaching its minimum in Q3 2010, with 215,740 mortgages (s.a.).

Economic factors still underpin the lack of mortgage sales. At the same time, although they are still in negative territory (mortgage sales contracted again in Q1 2011 by 0.7% yoy), the rate of contraction is much lower than at any point over the last fifteen quarters (with the exception of Q2 2010, where mortgage sales actually expanded by 1.0% yoy – see Figure 1).

The increase in VAT to 20% in Q1 2011 contributed to consumer price inflation of above 4.0% yoy in the quarter, eroding already vulnerable household incomes. Household incomes in real terms have

1 See http://www.census.gov/srd/www/x12a/.

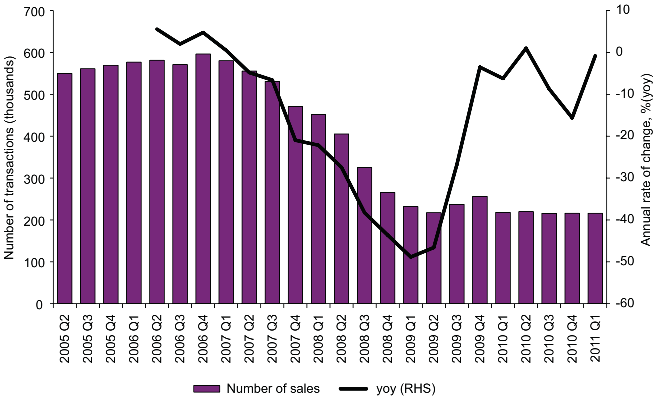
2 There was an extension for first-time buyers into 2010.

3 From now onwards, yoy stands for annual rate of change (year over year) and qoq stands for quarterly rate of change (quarter over quarter).

been under stress since the crisis, with poor nominal income increases and high CPI inflation (not only linked to indirect taxes). Since low savings could only be used to a limited extent to finance spending and household income was expected to remain subdued, funds available for the purchase of mortgages remained limited.

Mortgage funding has been reduced, house prices have fallen for two consecutive quarters and the unemployment rate, at 7.7%, is high by recent standards. More importantly, uncertainty around job prospects (especially in the public sector) is likely to weigh negatively on spending decisions. Still, not all economic news has been gloomy – indeed, there was an increase in the UK Economic Sentiment Indicator (published by the European Commission) from 90 in 2009/10 to 101 in 2010/11. However, this improvement in sentiment did not extend to the consumer. Consumer confidence has in fact deteriorated significantly since Q1 2010. It is therefore no surprise that total mortgage sales declined by 6.8% in 2010/11 relative to the previous year.

Figure 1: Trend in mortgage sales



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Overall mortgage market trends will reflect both supply-side factors (lenders) and demand-side factors (consumers). Although these factors cannot be separated in PSD, evidence from the Bank of England Credit Conditions Survey on Secured Lending suggests that demand factors may have played an important role in recent trends. On the supply side, credit became slightly more available to households in 2010/11 than in 2009/10 (the net balance of response[4] on the availability of secured credit for households rose from 4.9 to 5.2). The net balance of response on the approval rate for credit applications averaged -3.1 in 2009/10 and rose to 0.5 in 2010/11. On the demand side, the survey also recorded a significant decline in secured credit demand, with the net balance of response falling from 12 to -17.

Table 1: Selected macroeconomic indicators

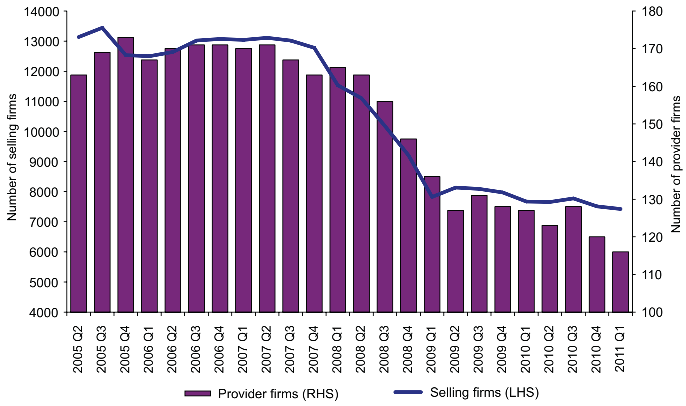
	RICS survey, Average sales per chartered surveyor *,	UK Halifax, House Price Index all houses, all buyers, % yoy	GFK Consumer Confidence Barometer, s.a., % Bal	CPI inflation, % yoy	GDP growth, % qoq	Unemp. rate
Q1 2010	17	4.6%	-15	3.3%	0.4%	7.8%
Q2 2010	16	6.3%	-18	3.4%	1.1%	7.9%
Q3 2010	17	2.8%	-20	3.1%	0.6%	7.8%
Q4 2010	16	-1.6%	-20	3.4%	-0.5%	7.9%
Q1 2011	14	-2.8%	-28	4.1%	0.5%	7.8%

Sources: Office of National Statistics (ONS), Halifax, Royal Institution of Chartered Surveyors (RICS), Financial Times/Haver. Note: (*) Completed sales per surveyor.

Number of lenders

All mortgage products in the market are created by what we refer to as 'provider firms' whilst selling firms are those which simply sell mortgage products. Selling firms can sell either a product they have created or one created by another firm. Thus, each transaction has two firms attached to it: the seller and the provider. For direct sales, the seller and the provider will be the same firm; for intermediated sales, they will be different firms. There are far more selling firms than provider firms. In the period 2010/11, there was an average of 7,592 selling firms and 122 provider firms per quarter.

Figure 2: Number of mortgage lenders – provider and selling firms



Source: FSA Mortgage PSD.

4 Net percentage balances are calculated by taking the difference between the weighted balance of lenders reporting that, for e xample, demand was higher/lower or terms and conditions were tighter/looser. The net percentage balances are scaled to lie between -100 and 100. A positive balance indicates that lenders, on balance, reported/expected demand/credit availability/defaults to be higher than over the previous/current 3-month period, or that the terms and conditions on which credit was provided became cheaper or looser.

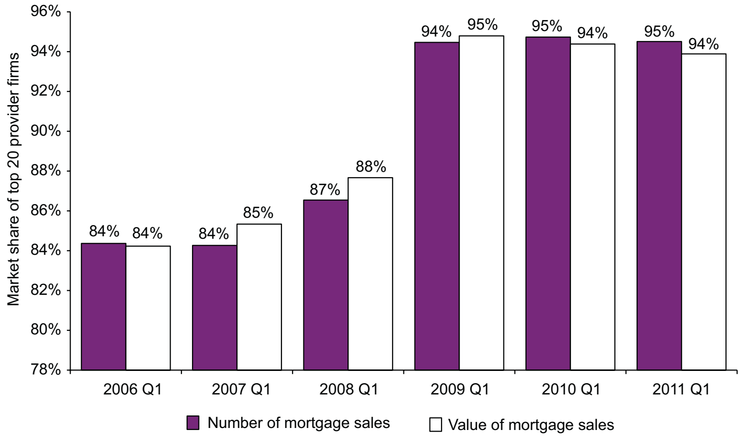
The number of provider firms[5] declined by 4.7% between 2009/10 and 2010/11. This is mostly due to mergers and acquisitions[6] and because firms have been leaving the market. The number of provider firms rose in Q3 2010 and has fallen ever since, in Q1 2011 reaching its lowest level (116) since firms started reporting PSD (see Figure 2). In the same period, the number of selling firms[7] also declined by 5.2%. In the last three quarters, the fall in the number of provider firms exceeded the fall in selling firms (9.4% versus 4.5%). This is partly because several of the non-deposit takers which are also provider firms (such as specialised mortgage lenders which offer credit to customers with impaired credit history) have been unable to obtain funding to continue with their mortgage business. Finally, we should also factor in the number of mergers and acquisitions that have taken place in recent quarters (see footnote 6). These factors have worked towards reducing the number of provider firms.

Market share of top providers

The evolution of market share (both in terms of number of mortgages sold and in terms of the value of mortgages), also illustrates the trend towards consolidation. The mergers and acquisitions (and cancellations) of mortgage lenders, especially in Q4 2008 and in 2009, have translated into an increase in the degree of concentration (here measured as the market share of the top 20 provider firms at any point in time).

An increase in the market share of the top 20 firms by number of sales has been sustained, amounting to 11 percentage points between Q1 2006 and Q1 2010. The maximum was reached in Q1 2010 (with 95%), but there has been a slight decline in the ratio ever since. Overall, the increase in concentration (for the top 20 providers) between Q1 2006 and Q1 2011 measured as the value of mortgage sales amounted to 9 percentage points.

Figure 3: Top 20 mortgage provider firms – market share in Q1 of each year



Source: FSA Mortgage PSD

Type of firms

We now look at the evolution of mortgage sales over time, across type of firms. We differentiate between five categories of firm[8]:

a) Large banking institutions – this comprises the largest banks and building societies that provide mortgages in the UK: Barclays, HSBC, Nationwide, Santander, Lloyds TSB, RBS and The Co-operative Bank Plc.

b) Medium-size banks – such as Northern Rock or Clydesdale Bank.

c) Major intermediaries – this includes both networks and mortgage brokers (smaller intermediaries are categorised under 'other sellers').

d) Building societies and credit unions.

e) Other sellers – this comprises financial advisors and appointed representatives.

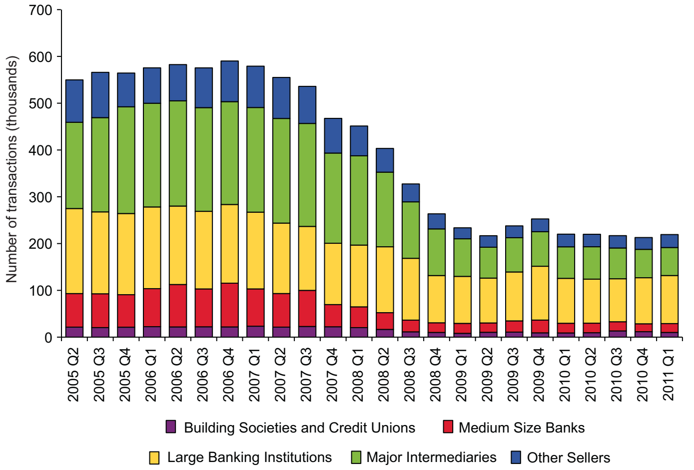
5 See appendix at the end of the document for further clarification.

6 We have recorded eighteen major mergers or acquisitions since the beginning of the sample, several of them in 2008 and 2010.

7 Please note that the count of "selling firms" is based on how many firms sold mortgages that year. Changes in the population do not, therefore, necessarily represent firms going bankrupt, merging or even exiting the industry.

8 Firms are categorised according to their FSA internal supervisory area.

Figure 4: Mortgage sales across types of selling firms over time



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Note: Institutions are categorised according to their status in Q1 2011. For example, due to mergers this means that a number of building societies are now inside "large banking institutions".

Figure 4 shows mortgage sales across types of **selling firms** (as opposed to provider firms). Between Q2 2010 and Q1 2011, large banking institutions gained 4 percentage points of market share at the expense of major intermediaries and, to a lesser extent, medium-size banks.

The market as a whole remains subdued when compared to its pre-crisis state: the number of transactions carried out by mortgage sellers is significantly below the 2007 level.

Perhaps more interesting is to look at the same information from the point of view of the **provider firms** (firms that actually create the mortgage products), thus excluding mortgage intermediaries.

We now differentiate between four categories[9]:

a) Large banking institutions.

b) Medium-size banks.

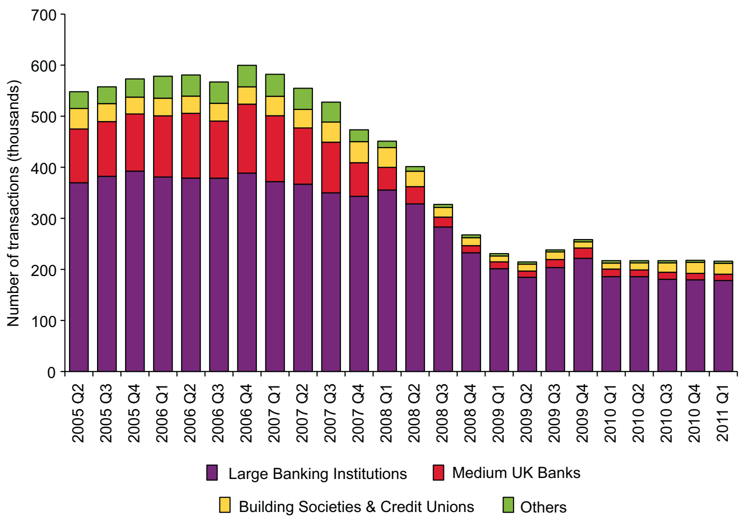
c) Building societies and credit unions.

d) Others, comprising overseas banks and non-deposit takers such as specialised mortgage lenders (for example, those providing mortgages to borrowers with impaired credit history).

Note that banks and building societies can also have an arm specialised in providing lending to borrowers with specific characteristics (such as impaired credit history). On the back of funding constraints and high uncertainty, large banking institutions may have decided to concentrate on the more traditional lending segments.

Large banking institutions remain by far the most dominant group and provided 83% of mortgages in 2010/11, followed by building societies and credit unions, which provided 8.6%. Between Q2 2010 and Q1 2011, while large banking institutions lost market share (by 3 percentage points), building societies and credit unions gained 3.5 percentage points. All providers remain at greatly reduced levels of lending compared to their pre-crisis state. 'Others' especially have found it difficult to obtain funding: many non-deposit takers have been forced to leave the market since the crisis.

Figure 5: Mortgages sales across types of provider firms over time



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

As noted in the Bank of England's January Trends in Lending report[10], before the crisis it was possible for institutions to rely on short-dated unsecured borrowing and the securitisation market to meet some of their wholesale funding requirements. The crisis saw a fall in liquidity as the market became increasingly uncertain about banks' solvency, causing a contraction in short-term unsecured borrowing. Furthermore, securitisation markets have only partially recovered. This has led to diversification,

9 Firms are categorised according to their FSA internal supervisory area.

10 http://www.bankofengland.co.uk/publications/other/monetary/TrendsJanuary11.pdf

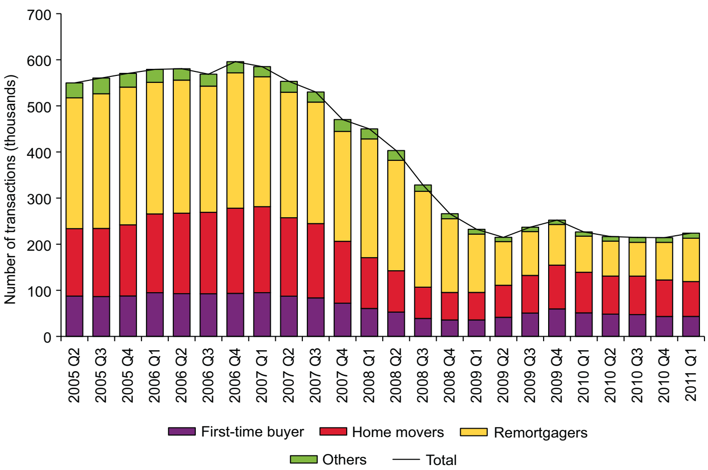
as lenders search for new sources of funding. This ongoing difficulty in obtaining funding, together with higher capital requirements, might explain in part the low levels of mortgage lending from large banking institutions. Although they are gaining share in terms of selling mortgages, they are losing it in terms of providing them. In contrast, building societies have gained market share as providers. Traditionally, they have been more reliant on the retail market than the wholesale market to obtain funding. This renders them more resilient to turbulence in the wholesale market.

8. The characteristics of new mortgage sales

8.1 Borrower type – number of sales

New mortgage purchases by remortgagers during the period April 2010-March 2011 declined by 9.6% yoy. For first-time buyers, new mortgages declined by 10%, as did home movers (by 3.3%). The number of council and registered social landlord tenants exercising their right to buy expanded by a modest 1%. The relative importance of remortgagers and home movers (second time or subsequent buyers) is equalising. While in 2009/10 the former represented 39% of new mortgage purchases, they now account for 37%, broadly the same as home movers, which in 2009/10 represented less than 36%. Sales to first-time buyers represented 21% of new mortgages.

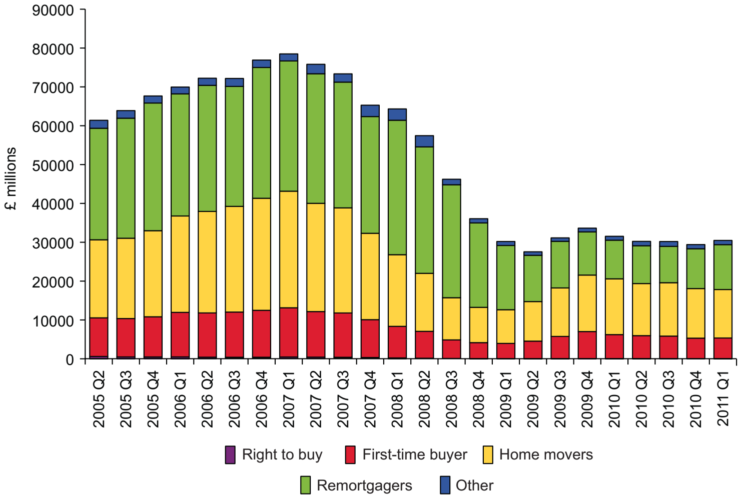
Figure 6: Mortgage sales by borrower type



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

8.2 Borrower type – value of sales

Figure 7: Mortgage values by borrower type



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

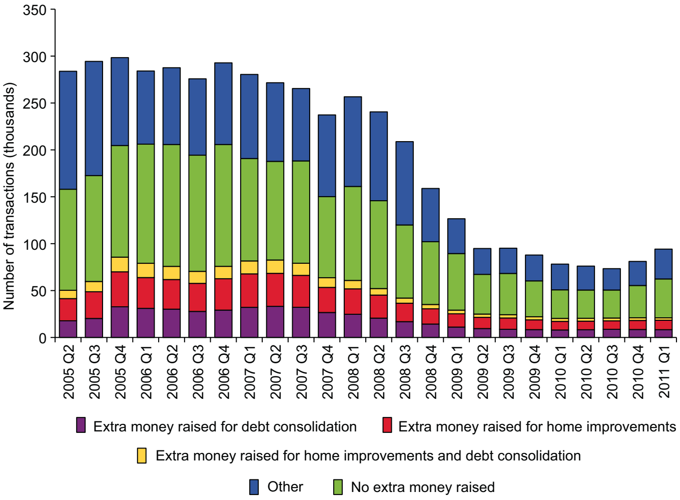
The difference between volume and value trends tends to be insignificant. Looking at mortgage values, rather than volumes, we see a similar slump during the recession and only limited recovery since then; the total value for 2010/11 stands at £120,444m compared to £298,890m in 2006/07. The total value of mortgages contracted in 2010/11 relative to the previous year by 2.9%. However, the rate of contraction was smaller than when looking at the number of transactions. As a result, the average loan value increased to £138,000 from £133,000 the previous year.

Activity among remortgagers and first-time buyers contracted significantly between 2009/10 and 2010/11. However, for first-time buyers the hit was harder in number of sales than in values, suggesting that average mortgage values have increased for this type of borrower. This is consistent with the observed rise in the relative importance of high-value bands for first-time buyers (see Section 8.8).

8.3 Remortgage purpose

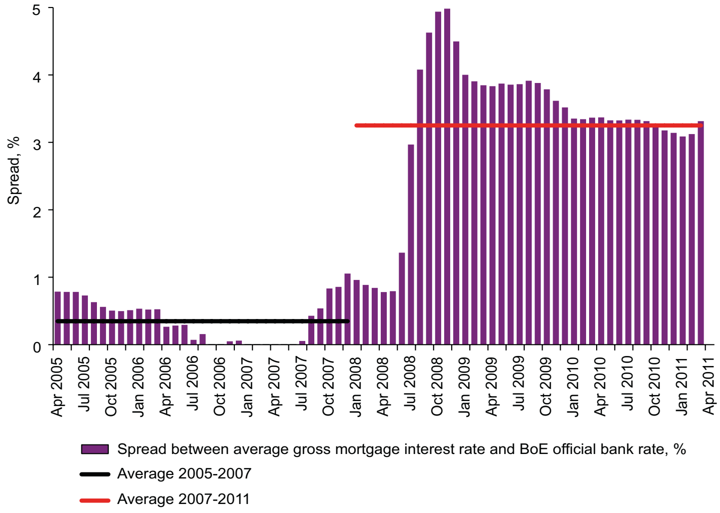
The fall in mortgage sales to remortgagers partly reflects the end in interest rate reductions. The average initial interest rate paid by all borrowers in 2010/11, where recorded, was 3.4%, very close to the 3.6% of a year ago. This compares to 4.7% in 2008/09 and 6.1% in 2007/08. There is anecdotal evidence that potential remortgagers may not be able to purchase new mortgages (either because they are in negative equity, or because they do not meet the tighter lending criteria). At the same time, if expectations of higher interest rates subside, there is also less interest in remortgaging.

Figure 8: Remortgage sales by purpose of loans



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Figure 9: Mortgage spreads over time



Source: FSA Mortgage PSD.

There are two main types of remortgagers: those who withdraw equity and those who do not. The latter is represented here as 'no extra money raised' while in the first category we differentiate between those who raise extra money for home improvements, for debt consolidation or for a combination of both. Remortgaging with no extra money (perhaps even de-leveraging) has become more popular in the last few quarters, with mortgage sales of this type of product expanding by 37% between Q2 2010 and Q1 2011, reaching 44% of all remortgage sales.

Since mid 2007, the trend has been for a sustained decline in the sales of equity withdrawal mortgages. However, sales of this type of mortgage have stabilised recently, showing an increase of 2.3% between Q2 2010 and Q1 2011. Numbers of remortgages to raise money for debt consolidation and home improvement fell by 16% during the same period.

8.4 Lending spreads

Mortgage spreads (calculated as the difference between mortgage rates and the Bank of England base rate) have declined only slightly in 2010/11 to 3.2% from 3.3% the previous year. They still remain relatively high by historical standards. Throughout the year, some mortgage lenders reported that higher long-term funding costs had contributed to a rise in spreads on long-term fixed rate mortgage products.[11]

8.5 Types of interest rate

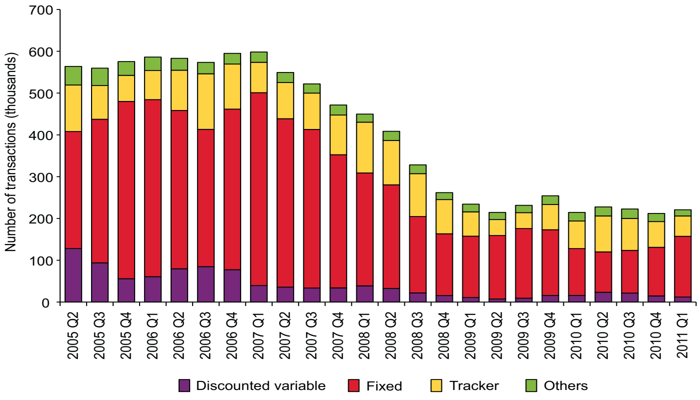
There is a clear preference for customers to contract fixed-rate linked mortgages versus variable ones such as trackers and discounted variable rates. Fixed interest rate mortgages accounted for about 53% (s.a.) of all mortgages sold in the period 2010/11, while trackers accounted for 31.4% and discounted variable rates for 8.2%. The inclination for fixed rates may reflect consumers' eagerness to lock in deals at low rates at a time when interest rate hikes are expected. Economic uncertainty, especially around the timing of interest rate rises, has also increased the appeal of fixed rate deals.

However, in 2009/10, fixed interest rate mortgages represented 63% of all mortgages, more than in 2010/11. Sales of fixed interest rate mortgages fell significantly in Q1 and Q2 2010, in favour of mortgages linked to discounted variable rates. This might have been a lagged reaction to the increase in the rate paid on fixed-rate mortgages (from 4.8% in Q3 2009 to 4.9% in Q4 2009). The subsequent fall in fixed-rate mortgages, according to mortgage lenders, is related to the fall in swap rates.[12]

11 See "Trends in Lending", August 2010, Bank of England.

12 See "Trends in Lending", September 2010 from the Bank of England.

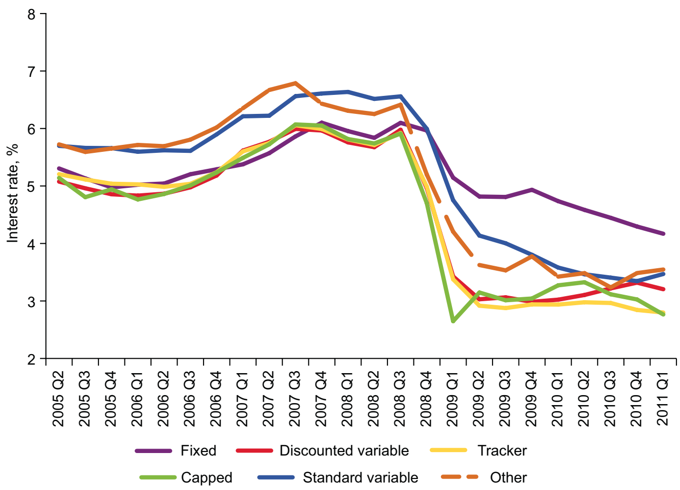
Figure 10: Mortgage sales by type of interest rate



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

In comparison, initial rates linked to discounted variable rate mortgages during the same period (Q3 2009 and Q4 2009) declined by a similar amount (from 3.0% to 2.9%). As a result, we now have a situation where although initial mortgage fixed rates are significantly higher than variable rates (by as much as 140bp in Q1 2011, see Figure 11), the spread has declined consistently since late 2009.

Figure 11: Initial mortgage rates by types



Source: FSA Mortgage PSD, Haver.

It is clear by looking at Figure 11 that the reductions in the base rates in 2008 have not affected all borrowers in the same way. The spread between fixed rates and trackers were 10bp in late 2007, they rose to almost 200bp in 2009 Q4 and fell to 137bp in Q1 2011. This narrowing of the spread could be one of the reasons behind the recent expansion in fixed-rate mortgages: between Q2 2010 and Q1 2011, purchases of fixed interest rate mortgages have expanded by 50%, (s.a). In comparison, trackers contracted by 43% (s.a) and discounted variable rates by 49%.

8.6 Repayment method

A continuing trend is a move away from interest-only products towards more conservative (e.g. capital and interest) repayment methods. In fact, sales of new mortgages with capital and interest repayment methods have expanded by 5.9% (s.a.) between Q2 2010 and Q1 2011 versus a contraction of 20% (s.a.) for interest-only mortgages[13]. The proportion of interest-only mortgages with an unknown repayment vehicle has declined from 13.5% in Q2 2010 to 10.8% in Q1 2011. This follows a downward trend that started soon before the collapse of Northern Rock in Q3 2007 when the proportion was 25.5%.

PSD also allows us to examine how the repayment method varies according to the purpose of the loan. There has been a slight shift by all borrowers towards capital and interest mortgages and away from interest-only products in 2010/11. It is not clear whether this is due to borrower demand or a change in approach by lenders with an eye on affordability and a less sanguine assessment of the long-term risks on interest-only mortgages. Some major UK banks have recently revised their interest-only policy.

Table 2: Mortgage sales by repayment method type of borrower – April 2010 to March 2011

	Capital and interest	Interest only with an unknown repayment vehicle	Interest only with a repayment vehicle	Mix of 'capital and interest' and 'interest only'	Other repayment method
Total	663,647	104,123	52,998	40,382	6,513
Remortgagers	72%	14%	8%	6%	0.0%
Home Movers	74%	14%	7%	5%	0.1%
First-time buyer	92%	4%	3%	1%	0.0%
Right to Buy	89%	4%	6%	1%	0.0%
Other	56%	21%	4%	1%	17%

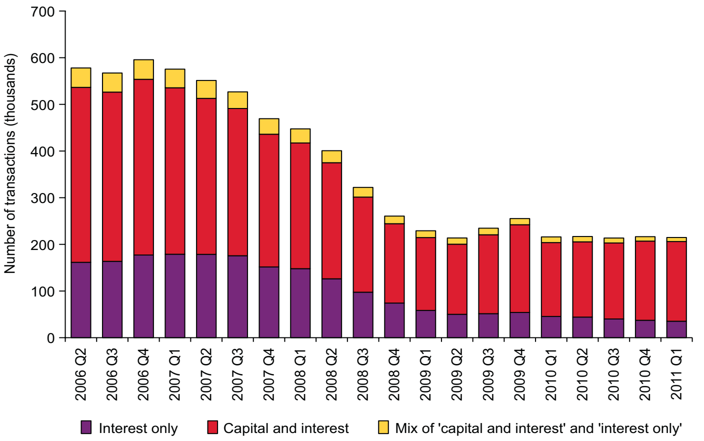
Source: FSA Mortgage PSD.

Table 2 shows that the capital and interest repayment method is particularly popular among right-to-buy buyers and first-time buyers (89% and 92% respectively chose this method). Both proportions have increased with respect to last year (86% and 89%). Sales of interest-only mortgages with unknown repayment method have become less popular across all types of borrowers. There has been a substantial increase in the

13 This includes interest only mortgages with known repayment vehicles (ISAs, endowments and pensions) and unknown repayment methods.

proportion of remortgagers that contract a capital and interest mortgage with respect to last year (from 65% to 72%). This could be related to the reluctance of mortgage lenders to remortgage unless LTV restrictions are met. Some potential remortgagers may have lost equity after the crisis (or not gained enough equity to meet the criteria).

Figure 12: Mortgages sales by repayment method

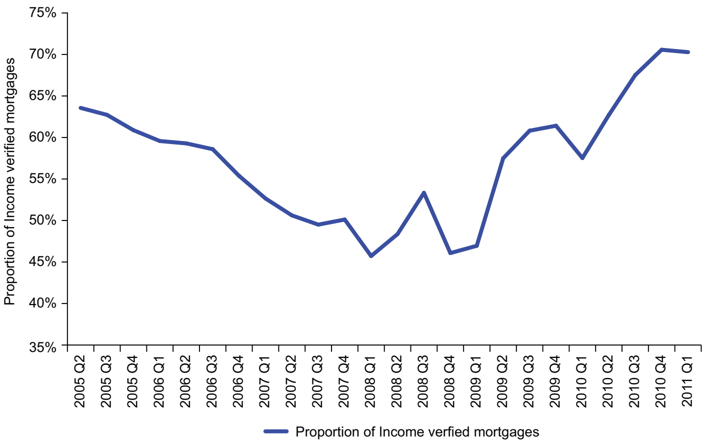


Source: FSA Mortgage PSD. Data have been seasonally adjusted.

*Note: Interest only consists of interest only with and without repayment vehicles.

8.7 Income verification and higher-risk lending

Figure 13: Mortgages sales by income verification



Source: FSA Mortgage PSD.

The FSA outlined concerns around affordability (in particular, for mortgages where income had not been verified), in its responsible lending consultation paper 10/16: MMR 'Responsible Lending'. In the period 2010/11, about two thirds of mortgage sales were made to customers whose income had been verified[14] (68%) versus 59% in 2009/10 and 49% in 2008/9. More responsible market practices are apparent in the trends relating to income verification, with the proportion of income-verified sales increasing since the crisis. This trend seems set to continue: in Q1 2011 sales of non-income verified mortgages contracted by 30.6% yoy, while sales of income- verified mortgages expanded by 21.1% yoy.

A similar observation can be made concerning mortgages to impaired and non-impaired credit borrowers. The former contracted by 14.5% yoy in Q1 2011 while the latter declined by a much lower 0.8% yoy. Mortgages to borrowers with impaired credit history represent a very low proportion of total mortgages (0.34% in Q2 2011). Finally, mortgage sales to self-employed borrowers, who are considered to be more exposed to the business cycle[15], have contracted in Q1 2011 by 8.1% yoy while sales to employed borrowers expanded by 1.4% yoy. Mortgage sales to retired customers contracted the most in Q1 2011 (by 19.3% yoy).

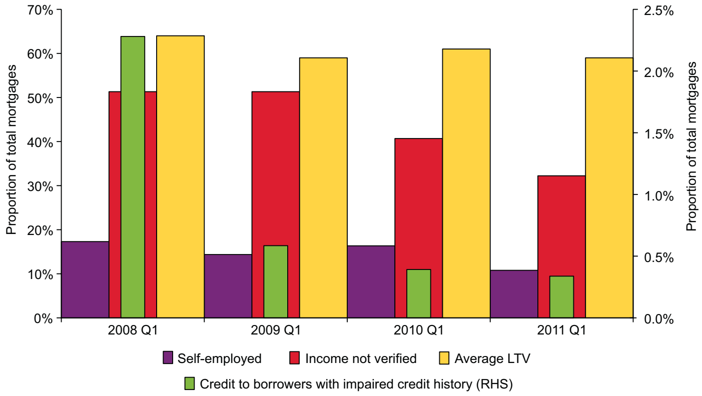
Even the average loan-to-value ratio (that we will look at more in detail in the next section and can also be understood as a measure of 'risk') has been falling since 2007/8 when it averaged 63%. It reached its minimum in Q1 2009 with 59% and has since shown some volatility, but it is now again close to its minimum, at 59%.[16]

14 There are two types of non-income verified mortgages: self-certified and fast track. The FSA has found strong evidence to suggest that self-certified is more risky than income-verified mortgages. However, PSD does not allow us to differentiate between both types of non-income verified mortgages.

15 Loans to the self-employed are statistically more risky than those to the employed. See eg. Mortgage Market Review: Responsible Lending, Consultation Paper 10/16 Exhibit 3.1. Self-employment is just one of a number of risk factors.

16 This is a broad estimation. The figure on average LTV should not be taken at face value.

Figure 14: Mortgages with specific characteristics as a proportion of total mortgages



Source: FSA Mortgage PSD. RHS stands for right hand side axis.

An alternative way of looking at this trend is by considering the proportion of mortgage sales with specific characteristics over time (see Figure 14). We look at the relative importance of mortgages which may be perceived as more risky[17] because: they are highly responsive to the business cycle (such as those offered to self-employed people, who do not always have a steady income and who cannot be 'hoarded' by employers when economic conditions worsen); the income of the customers has not been verified; the credit history of the person contracting the new mortgage is impaired or because the LTV ratio is relatively high. Figure 14 shows that the trend has been towards reducing the relative importance of mortgages with 'risky' characteristics (or to more risky borrowers). This could be due to a combination of factors, including a change in preferences by mortgage lenders and borrowers, and a continuation of credit tightening.

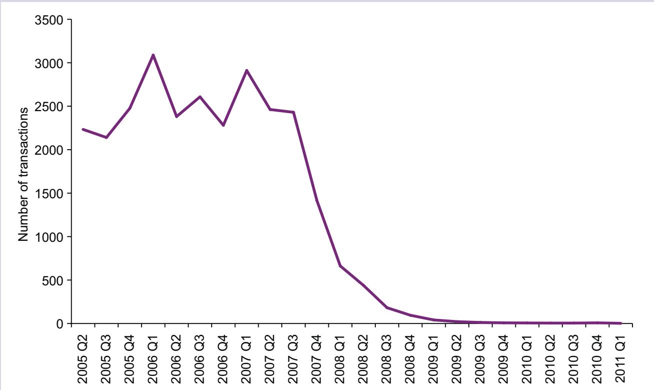
BOX I – Risky mortgages

In the mortgage market, there are certain characteristics which can result in a loan or a borrower being perceived as more risky.

Examples include:
- high LTV ratios (which are more likely to overstretch borrowers or result in negative equity);
- lending to borrowers with an impaired credit history (empirical evidence shows that there is a higher probability for this type of borrowers to default or incur arrears); or
- non-income verified mortgages (borrowers may have an incentive to exaggerate their means in order to gain a higher loan, but are also more likely to default or incur arrears when a shock occurs).

Combinations of some of these risky elements generate even more risky mortgages. Take for example lending to borrowers with impaired credit history. CP 10/16 contained analysis showing this kind of lending to be riskier than prime lending. Further to this, there are certain combinations which would seem to increase risk further. Mortgages with LTV in excess of 85% have been offered to borrowers with unverified income and an impaired credit history in the past. This lending has all but vanished following the crisis, with 2,684 such loans made in 2007 Q3 and only 2 in 2011 Q1.

Credit to individuals with impaired credit history, non-verified income and LTV above 85%



Source: FSA Mortgage PSD.

Broadly speaking, all indicators show less risk now than in the pre-crisis period. The average LTV has declined, as has the proportion of mortgages to people with impaired credit history or non-verified income. At the same time there are some elements of normalisation, for example when looking at the structure of income multiples or of ages for first-time buyers. It is unclear to what extent this is due to a fall in borrowers demanding such mortgages and to what extent it is due to a change in stance amongst lenders revising mortgage practices.

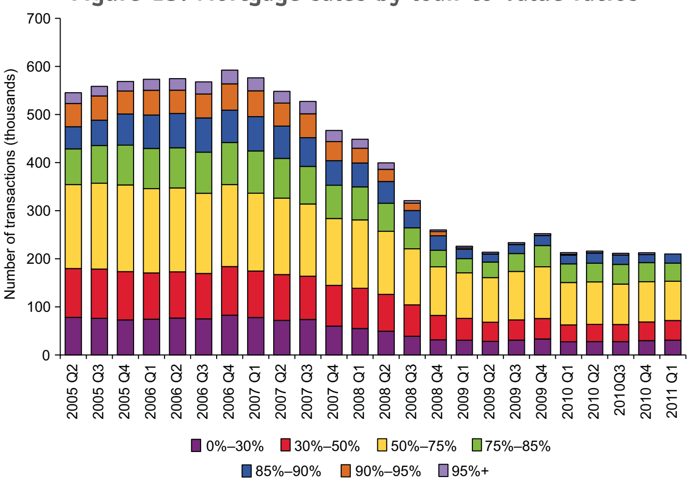
17 These are well-established risk indicators, see eg '*Relative Indicators of Default Risk Among UK Residential Mortgages*' Rida Zaidi, Atanasios Mitropoulos, December 22, 2009.

8.8 Loan-to-value (LTV) ratios

Figure 15 shows the evolution of mortgage sales by LTV ratios. The decline in mortgage sales has not affected all LTV bands equally. For example, mortgage lenders virtually stopped offering mortgages with a LTV at or above 95%, in late 2008. In Q1 2011, the most common LTV ratio band was the 50-75% band, but while this accounted for 41% of mortgage sales in Q1 2010, the ratio had fallen to 38% by Q1 2011. In comparison, the proportion of mortgages in the 30-50% LTV band increased from 16% in Q1 2010 to 19% in Q1 2011.

In short, in the period 2010/11, the band that contracted most was 90-95% (by 33%) and 95%+ (26.8%) followed by 50-75%. In contrast, the fastest rates of growth relates to the 75-85% and 85-90% bands (by 3.2% and 4.8% respectively). Together they represent about 27% of total mortgage sales.

Figure 15: Mortgage sales by loan-to-value ratios



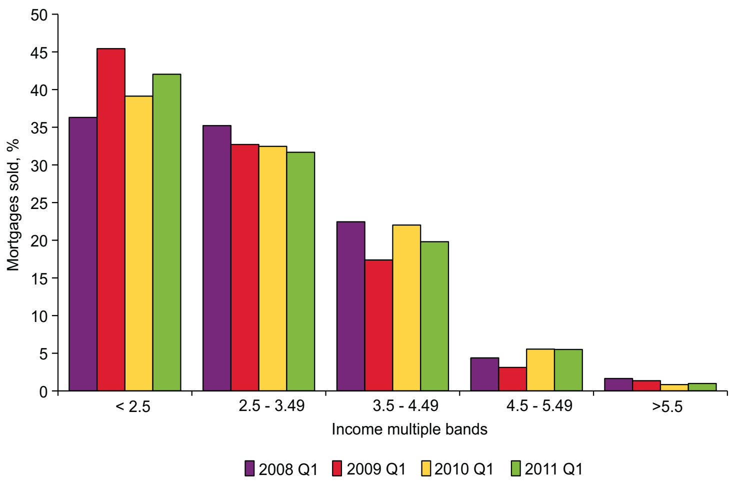
Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Anecdotal evidence reinforces the view that mortgage lenders have acted in a more conservative manner, with tighter lending criteria and the need for borrowers to put up significant deposits.[18] Uncertainty about the future of house prices may have contributed to the preference of mortgage lenders for lower LTV ratios.[19]

8.9 Income multiples

A look at the structure of income multiples shows that the trend over the last year has been for some 'normalisation' within several of the bands, with a bias towards more conservative (or less reckless) income multiples. The proportion of mortgage sales to customers with income multiples above 5.5x reached 1.6% in Q1 2008, declining to 0.8% in Q1 2010 and showing some reversal in Q1 2011, when it rose to 1.0%. The same can be said of the 4.5-5.49 band (although there was no material change in the proportion between Q1 2010 and Q1 2011). However, the less than 2.5x income multiple has become more popular now than before the crisis: in Q1 2008, this multiple represented 36.3% of all mortgage sales versus 42% in Q1 2011 – in any case lower than in Q1 2009. For the 2.5-3.49 band, the trend has been very much towards a sustained decline since Q1 2008.

Figure 16: Mortgages by income multiples



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

8.10 Lifetime mortgages

There has been a slight increase in the sales of lifetime mortgages between Q2 2010 and Q1 2011. Those mortgages tend to be bought by older customers, who receive a payment for their property ahead of vacating it (see appendix for definition). The proportion of lifetime mortgages over total mortgages increased slightly by 0.1 percentage points to 2.2% during this period; however, the biggest rise took place between Q1 2008 and Q2 2009 (from 1.1% to 2.4%), at the

18 Following Basel II, there is an incentive for Banks and Building Societies to reduce their average LTV ratio because of capital requirements for loans with LTV greater than 80%.

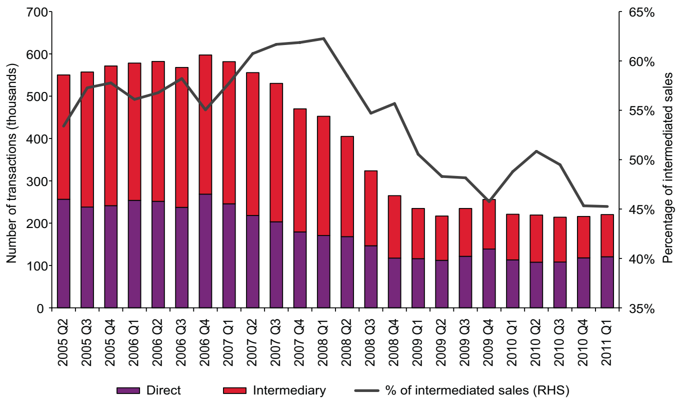
19 http://www.telegraph.co.uk/finance/newsbysector/constructionandproperty/7970908/Need-for-big-deposit-hits-home-sales-hard.html

height of the crisis. Between Q1 2008 and Q2 2009, total sales of mortgages contracted by 52%, while lifetime mortgages expanded by a modest 0.3%. For these borrowers, this might have been the only source of income, particularly if they could not afford to live on their pensions.

8.11 Sales channels

Since Q2 2010, there has been a clear decline in the proportion of intermediated sales in the mortgage market (from 51% to 47% in Q1 2011). Since intermediaries are more likely to provide advice, we would expect a decline in the number of mortgage sales with advice. Direct sales[20], on the contrary, expanded by 11.9% (s.a) during the same period.

Figure 17: Mortgages by sales channel



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Sales by intermediaries were very popular before the crisis, in 2005-2008. Back then the majority of mortgage sales were made via intermediaries (as high as 64% in Q1 2008). This changed in H2 2008 and the quarters that followed, with the result that now selling via intermediaries is less common (47% of sales in Q1 2011).

8.12 Advised sales

Customers of new mortgages typically receive advice when buying these products. Interestingly, the proportion of mortgage sales with advice has decreased in the last four quarters (from 74% in Q2 2010 to 68% in Q1 2011). This is consistent with the observed decline in the relative importance of intermediaries; since they typically sell with advice (97% of their sales in 2010/11 were with advice).

9. A closer look at first-time buyers

Possibly the most interesting category within type of borrowers is first-time buyers. The flow of new buyers is key to the overall health of the market. In this section, we focus more specifically on this particular type of borrower.

First-time buyers and types of interest rate

Table 3 shows that 64% of first-time buyers opted for fixed-rate mortgages in 2010/11. This proportion has decreased significantly from 2009/10, when it reached 78%. In contrast, the proportion of first-time buyers who opted for trackers rose by 10 basis points to 26% in 2010/11. This may be related to the comparatively cheaper variable rates (see Figure 11).

Table 3: Mortgages sales by type of borrower and type of interest rate – April 2010 to March 2011

	Remortgagers	Home Movers	First Time Buyer	Right to Buy	Other
Borrower Type Total	323,335	322,146	182,677	3,030	36,475
Fixed	52%	45%	64%	67%	45%
Tracker	32%	34%	26%	29%	18%
Discounted variable	8%	9%	8%	1%	2%
Standard variable	7%	10%	1%	1%	14%
Capped	1%	1%	1%	1%	0%
Other	0%	0%	0%	0%	22%

Source: FSA Mortgage PSD.

First-time buyers and type of income

First-time buyers are still more likely to take a sole income than a joint income mortgage. However, the trend has been for an increase in the proportion of first-time buyers who combine incomes to buy a home (from 44% in Q2 2010 to 47% in Q1 2011) – perhaps as a result of the more stringent conditions to enter a mortgage contract.

First-time buyers and LTV ratio

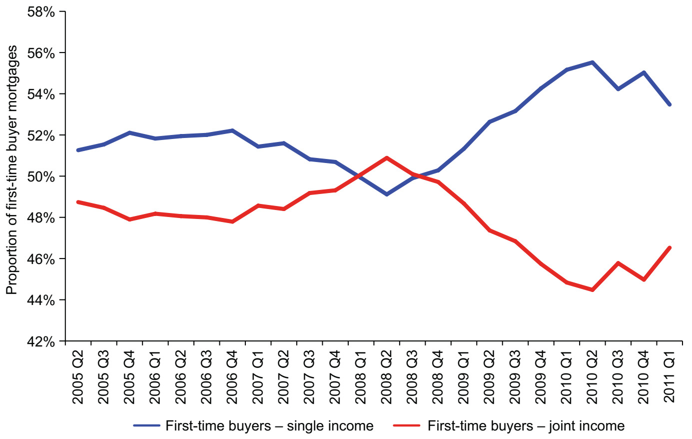
As expected, first-time buyers needed relatively higher LTV ratios than other types of borrowers. Only 9% of mortgages in the period 2010/11 were given with a LTV of between 85-90%; and 19% with a LTV of between 75%-85%. This compares to 25% and 29% respectively when we focus on first-time buyers.

When looking at LTV bands, mortgages to first-time buyers show similar trends to those observed for other types of buyer. The contraction in the LTV bands of 0-30%, 30-50% and 50-75% was more

20 Sales where the provider firm and the selling firm is the same. In other words, the product is sold to the customer directly by the provider. See appendix at the end of the document.

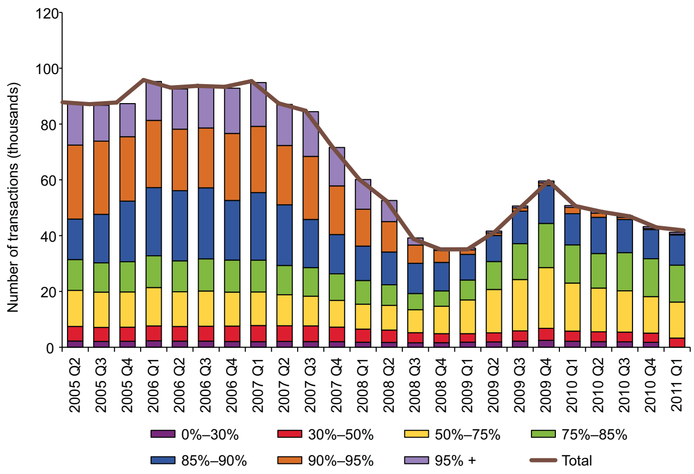
pronounced, while the expansion in the 75-85% and 85-90% was more subdued. The average LTV ratio in mortgages to first-time buyers has increased mildly between 2009/10 and 2010/11 from 71% to 72%. This compares to an average LTV ratio which has remained virtually unchanged at a lower 59% for the market as a whole.

Figure 18: First-time buyers by type of income



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

Figure 19: Mortgage sales by loan-to-value ratios. First-time buyers



Source: FSA Mortgage PSD. Data have been seasonally adjusted.

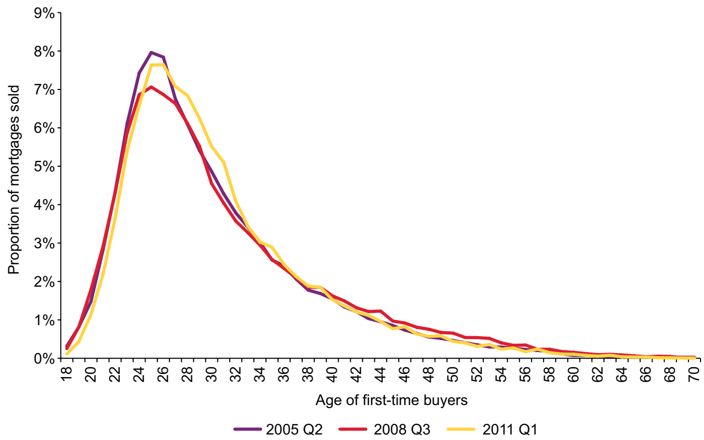
First-time buyers and age

The average age of first-time buyers rose from its minimum of 30.4 years in Q2 2005 to 31.1 years at its maximum in Q3 2008 – at a time when lending constraints in the mortgage market were significant. Since then, the trend has been for a gradual decline, down to 30.7 years in Q1 2011. Typically, there is a dispersion in the age of first-time buyers of between 8 and 9 years (around the average), but the market includes buyers from 18 to 60+ years.

It is interesting to see how the age structure of first-time buyers has evolved since the beginning of the sample. The majority of first-time mortgagors are still around 25-26 years of age. Most sales are to customers aged 30 or younger. However, when the impact of the crisis was at its highest, in Q3 2008, this proportion dropped to 59.4% versus 62.1% in Q2 2005. Equally, those over 40 accounted for 12.8% in Q2 2005, rising to 15.9% in Q3 2008 and declining to 12.7% of total mortgage sales in Q1 2011.

Overall, it seems that the tougher the lending conditions and the general economic environment for first-time buyers, the older they are when they enter the mortgage market – which is not surprising since borrowers need to save for longer in order to meet the LTV ratios imposed by the mortgage lenders. In Q1 2011 (when 34,561 mortgages were sold), the age structure was slightly different from that in Q2 2005 (when the figure was 90,946): there has been a shift of the probability distribution towards the right hand side, reflecting the increased average age of first-time buyers.

Figure 20: Mortgage sales by borrower age. First-time buyers

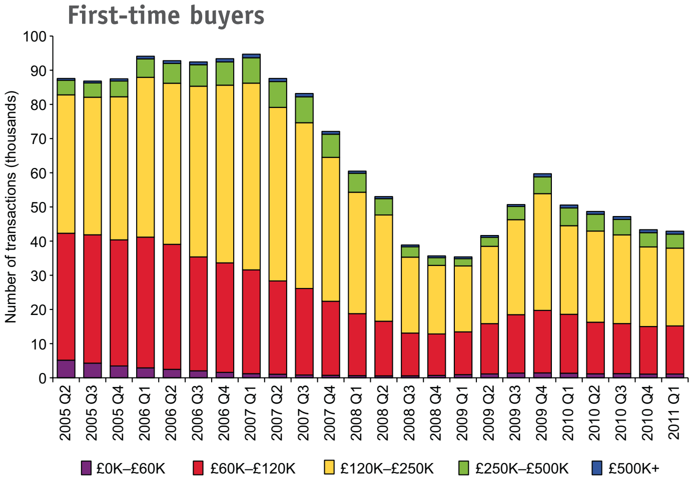


Source: FSA Mortgage PSD.

First-time buyers and property value

When looking at property values for first-time buyers, we see that £120,000-£250,000 is the most popular band (accounting for 53.1% in Q1 2011), followed by the £60,000-£120,000 band (which accounts for 33%). For all types of borrower, the £120,000-£250,000 is also the most popular band, but this is followed by £250,000-£500,000. Those who have been in the property market for some time can benefit from the capital gains linked to the sale of their current residence and upgrade to a bigger, more expensive property. These will be captured under the home-movers category.

Figure 21: Number of sales by property value bands. First-time buyers



Source: FSA Mortgage PSD. Data are seasonally adjusted.

Before mid-2008, while liquidity was relatively abundant and market conditions more supportive of growth, there was a sustained increase in the relative importance of mortgages sold to first-time buyers with properties in the £120,000-£250,000 band (the proportion rose 12.4 percentage points to 58.6%) to the detriment of properties in lower bands. From Q2 2008 to Q1 2011, the opposite has happened. We observe an increase in the relative importance of properties within in £0-£60,000 and a decline in the proportion of mortgages for properties in the £120,000-£250,000 region.

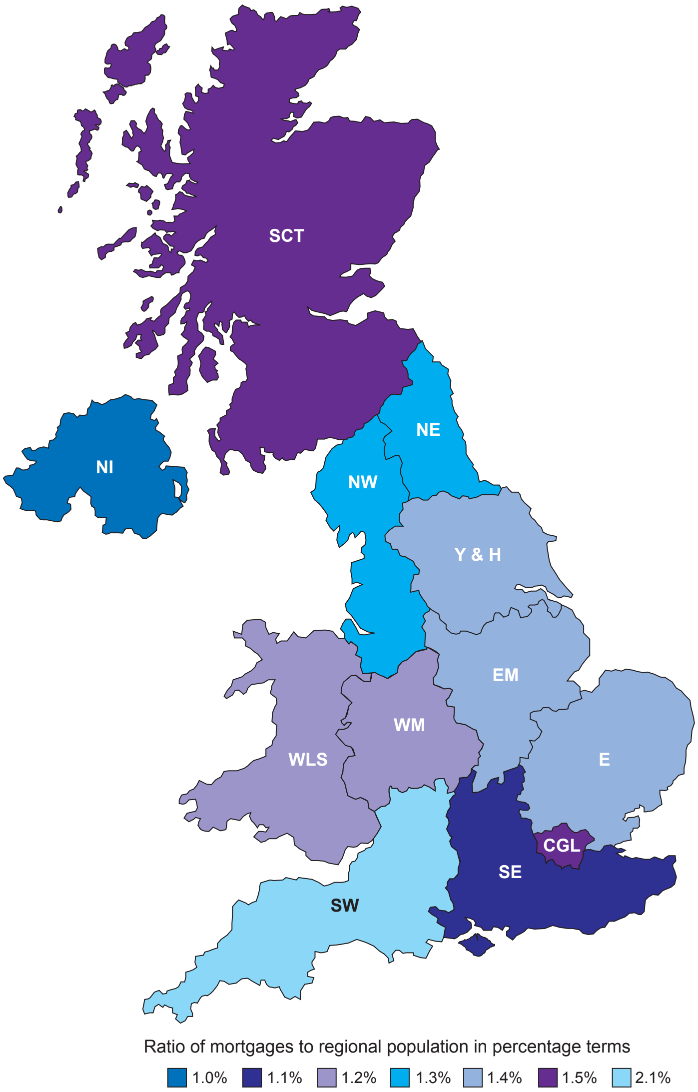
More recently (between 2009/10 and 2010/11), there has been an increase in the relative importance of the 'high value bands') such as £250,000-£500,000 and £500,000-£750,000 to the detriment of the more modest £60,000-£150,000. Again, although the levels that are currently being sold in the market are rather low by historical standards, there seems to be a process of normalisation as regards the structure of the market.

10. Regional analysis

Information on new mortgage deals can be disaggregated by postcode areas across the UK. In every region, the number of new mortgages sold during 2010/11 was lower than in 2009/10. The smallest contraction was recorded in Wales (3.3%), and the largest in Northern Ireland (16.3%).

The ratio of new mortgages to regional population has declined from 2009/10 to 2010/11 in every region except Wales, where the figure has remained constant. The largest fall was 0.2 percentage points, recorded in the Eastern region, the South West and Northern Ireland. The South West remains the region with the highest ratio at 2.1%, the lowest, at 1.0%, is Northern Ireland. This reflects employment trends: unemployment in the South West during April 2010/March 2011 averaged 6.1%, versus 7.3% in Northern Ireland.

Figure 22: Mortgages to the UK regional population – April 2010 to March 2011



Sources: FSA Mortgage PSD and Office of National Statistics.

Note: CGL stands for Central & Greater London, EM stands for East Midlands, E stands for Eastern, NE stands for North East, NW stands for North West, NI stands for Northern Ireland, SCT stands for Scotland, SE stands for South East, SW stands for South West, WLS stands for Wales, WM stands for West Midlands, Y & H stands for Yorkshire and the Humber.

11. Appendix

PSD definitions[21] – mortgages[22]

Advised/ non-advised sales

An advised sale occurs when an adviser of a regulated firm gives a personal recommendation to the customer after assessing the customer's needs and circumstances. This is specific and individual advice to the customer and is not generic.

A non-advised sale occurs when no personal recommendation is made to a customer. The customer receives information on the product to enable them to make an informed decision about whether it meets their own needs and circumstances. Non-advised sales include 'execution only' and 'direct offer transactions'.

Capped and collared

A variable interest rate that is guaranteed not to exceed a stated maximum rate (the capped rate) for a specific period of time. Also includes products where the interest rate is subject to a minimum rate (the collared rate).

Consultation and Discussion Papers

The FSA uses discussion papers (DP) and consultation papers (CP) in order to engage with the financial services industry, trade bodies and consumers about changes to its rules.

A discussion paper proposes changes to regulation in general terms and invites feedback. The FSA publishes its findings in a feedback statement and may consult (in consultation papers) on policy changes.

The FSA proposes specific changes to its handbook rules in consultation papers and, following feedback, will then announce any rule changes in a policy statement or handbook notice. There is no requirement for a discussion paper prior to a consultation paper. If required changes are clear, the FSA will proceed with a consultation paper without a discussion paper.

Direct/intermediary

When a firm that has created a product is also the firm which sells it, we refer to this as a direct sale. When a selling firm did not create the product (and thus is selling another firm's product), this is considered an intermediated sale.

21 The definitions in this appendix have been compiled from various sources including the FSA Handbook Glossary, FSA Policy, Supervision Manual, Chapter 16 Annex 20G and the Council of Mortgage Lenders Housing Finance Issue, July 2005 and November 2006.

22 Mortgage PSD includes regulated mortgage contracts only, therefore excludes unregulated products such as second charge lending, commercial and buy-to-let mortgages.

Discounted rate
Where a discount is applied to a lender's standard variable rate, usually for a limited period.

Fixed rate
Where the interest rate is fixed for a stated period.

Home reversion plan
An equity release arrangement where the occupier of a property sells the property (or a part interest in it) to the reversion provider and receives a lump sum and/or an income in return. The occupier retains the right to live in the property under a lease of life or until a specified event occurs.

Lifetime mortgage
A regulated mortgage contract, which is targeted at older customers and is repaid by selling the property when the customer dies, goes into long-term care or otherwise vacates the property.

Impaired credit mortgage
Mortgage lending to a borrower who does not have a standard credit history, ie a recent history of either:

(a) arrears on a mortgage or secured loan. This applies to secured loans where the borrower(s) has arrears on a previous (or current) mortgage or other secured loan within the last two years, where the cumulative amount overdue at any point reached three or more monthly payments; or

(b) arrears on an unsecured loan. This applies to unsecured loans where the borrower(s) has arrears on a previous (or current) mortgage or other secured loan within the last two years where the cumulative amount overdue at any point reached three or more monthly payments; or

(c) Individual Voluntary Arrangement (IVA). This applies where the borrower(s) has been subject to an IVA at any time within the last three years; or

(d) bankruptcy. This applies where the borrower(s) has been subject to a bankruptcy order at any time within the last three years.

(e) County Court Judgement (CCJ). This applies where the borrower(s) has been subject to a CCJ greater than £500 within the last three years.

Standard variable rate
The rate that is the lender's underlying variable interest rate. This rate is a basic variable rate charged to borrowers with no discounts or other special deals. It is also the rate used by the lender as a reference rate when defining a discounted variable rate product (eg, discounted product ABC is 0.50% below the lender's standard variable or basic rate). This is the rate that mortgage deals will often revert to after a special rate period.

Total gross income
This is the total of the gross annual incomes (before tax or other deductions) of each of the individual borrowers whose incomes were taken into account when the lender made the lending assessment/decision. For these purposes, each borrower's gross income is the sum of that person's main income and any other reckonable income (eg, overtime and/or income from other sources, to the extent that the lender takes such additional income into account in whole or in part).

Tracker
Where the interest rate is guaranteed to move in line with either the Bank of England Base Rate (BBR) or another index such as London InterBank Offered Rate (LIBOR). The rate can track above, below, or at the same level as the index rate.