

We need to solve the mortgage problem before interest rates rise

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*With a Bank of England rate rise expected next year, many UK households with mortgages may face unaffordable repayment schedules. In a [new report](#), **Matthew Whittaker** estimates that around 2.3 million households will be spending more than a third of their disposable income on mortgage repayments if interest rates move as expected. Of these, around 770,000 may be unable to cope, becoming 'mortgage prisoners'.*



The question of when interest rates should begin to rise has been much-discussed in recent weeks, and after five years of sitting at the rock-bottom level of 0.5 per cent, a gradual increase is expected from next year onwards. This has implications for the UK's 8.4 million mortgagors, one in ten of whom risk being imprisoned by borrowing deals which are likely to make their repayments unaffordable when rates start to rise.

Regulatory approaches to the mortgage market, including the recent Mortgage Market Review (MMR), have focused overwhelmingly on fixing the flow of new borrowers – that is, trying to make sure only those who can afford one get a mortgage – but there has been less attention paid to existing mortgage borrowers. Our [new research](#) has shown some borrowers are likely to face problems as interest rates rise. The assumption is that gradual rate rises, income growth and access to a competitive mortgage market will mean that most can navigate the expected 'tricky period'.

However, prospects for real-term income growth don't look particularly promising for many. Even if rates do no more than follow the path currently expected of them, then our analysis has shown that one-in-four mortgagors – 2.3 million households – could be spending a third of their disposable incomes on mortgage repayments by 2018. This would push them over the standard affordability threshold, leaving them 'highly geared'. This is worrying, but doesn't mean that one-in-four mortgagors won't be able to cope. Many will have the resources to ride out the rise in repayments and many will be able to find new mortgage deals, typically refinancing by moving on to fixed deals – providing certainty about their future payments.

For those who face an unaffordable future but are not in a favourable position for re-financing, such options might be off the table. We estimate that a third of the highly geared households we identify – 770,000 – will not only face unaffordable repayments but are also 'mortgage prisoners'. Members of this group may have no option but to stick with their lender's standard variable rate, which will rise alongside the Bank's base rate. Across the UK, many in this most vulnerable group are at the lower end of the income distribution, giving them little leeway to deal with rising mortgage costs.

Dealing with the wider problem of affordability is likely to require a range of solutions, from trading easy on rate rises, to starting conversations with borrowers about planning for rising costs. For some, it will mean ultimately looking at mechanisms for leaving the housing market altogether. In order to address the more specific potential mortgage prisoner problem, two steps are required: releasing prisoners where possible (by providing a choice of other options, such as a fixed rate deal that would prevent monthly repayments rising along with the interest rates) and protecting them when a re-negotiation of terms is not possible.

There is still a window of opportunity to think creatively about the best way of reducing the risk to this vulnerable group while we still have ultra-low interest rates. But that era is coming to an end relatively soon and the legacy of easy credit and the associated debt-overhang still has to be reckoned with. Financial institutions and policy-makers must consider now how best to minimise the scale of the adjustment problems these families face when interest rates start to return to normal.

The report, [Mortgaged Future](#), is part of a year-long project to be published next month by Resolution Foundation that investigates the UK's high level of household debt and how to manage it when interest rates start to return to normal.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our [comments policy](#) before posting. Homepage image credit: [Natesh Ramasamy](#)

About the Author

Matthew Whittaker is Chief Economist at the Resolution Foundation.

