Lending with Confidence: A Data-Led Analysis of the Mortgage Market

Foreword

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The UK's property market jolted back into life this summer after an enforced quiet period during the Covid-19 lockdown. Mortgage applications in recent months have been significantly above the levels seen last year as people, and lenders, look to make up for lost time.

People moving home is good news. It's not just new keys and new beginnings, activity in the property market provides a much-needed boost for all the industries associated with it.

However, lenders have a responsibility to ensure the mortgages they extend today are sound decisions for them, and affordable in the long-term for homebuyers.

This report provides a view of the macroeconomic situation today and shows a complex picture on affordability. To make sustainable decisions for each homebuyer, lenders must gather insights from a wide range of data sources.

Moving back towards pre-Covid demand

The number of mortgage applications was significantly down during the lockdown period, but our statistics show activity has increased markedly in the summer months. The number of mortgage applications made in July 2020 was 13% higher than in the same month last year, accelerating further in August when applications were up 25% year-on-year. Several factors are driving this:

- The freeze on stamp duty implemented in July
- Pent-up demand built up during lockdown
- Completion of mortgage deals that began before lockdown
- A general re-evaluation of household needs as people spend more time at home

Based on 2017-2019, we estimate that we'll see a total of 1.2 million loans agreed in 2020, at a value of £216 billion compared to a typical 1.5 million loans at a value of £250 billion. Although, given the recent boom in activity, actual data may well show higher.

But this level of activity is unlikely to be sustainable. At the same time, affordability is expected to fall once the government support schemes for employment become more targeted and, in some cases, come to an end.

The challenge lenders face is to balance their products with the increasing risk of lending. Lenders are understandably cautious about high loan to value (LTV) products and borrowers' ability to afford repayments in the future. Therefore, the number of products and rates available to borrowers has tightened.

The challenge for lenders

The effects of Covid-19 mean even people with historically good levels of affordability may be entering new territory. Lenders must be able to understand the new circumstances people are in, and standard risk indicators may not tell the full story.

Payment holidays could be:

- a shrewd and tactical measure to bridge a temporary income gap
- a sign of vulnerability that's effectively postponing the inevitable

Those on furlough could find themselves:

- reinstated on their full previous salary
- employed for fewer hours on a reduced wage
- out of work as the scheme comes to an end

When it's not clear what will happen going forward, data and market insight can help inform sensible next steps.

Evaluating the signs of risk and resilience

Our analysis shows that there is both risk and resilience in Emergency Payment Holidays borrowers. Here's what we know about the 1.9 million mortgage accounts currently subject to a payment holiday:

The average balance of their mortgage accounts is

30% higher

than an up-to date account (£150,000 versus £114,000)

Their average monthly payments are also

20% higher

Their average terms are longer by about

3 years

50%

of them have also seen an income decrease

As a group, they hold an additional

300,000

payment holidays across other credit products

But that's not the whole story. Up to half of the people who took payment holidays haven't experienced a reduction in their disposable income. And 25% of these have seen an increase, aided by factors such as lower or no commuting costs, lower mortgage repayments, and lower monthly outgoings during lockdown.

This suggests that half of the people on payment holidays are experiencing financial strain now, whereas the other half may expect to in the future so are building their own resilience. Lenders need to use data to understand which borrowers are resilient and those who are vulnerable.

People are also still active when it comes to credit applications. Those on a mortgage payment holiday have been responsible for 500,000 new credit applications since March. And those on Emergency Payment Holidays more generally have made 62,000 mortgage applications and opened around 32,000 new mortgage accounts.

A closer look at affordability

Payment holidays are not the only risk lenders need to factor in. One in three people in the UK has experienced a decline in income between March and May.

More than half of the people in this group have seen their incomes fall between 10% and 39%, suggesting they are on furlough. How employers react to the wage top-up scheme is yet to be seen.

Lenders have already reacted to keep their level of risk static by reducing the number of products available, particularly those with higher loan to values. They will need to use real-time data to understand a rapidly changing market so they can make accurate decisions on affordability.

Existing customers will also need monitoring so they can be assisted at an early stage if they get into difficulty.

Mortgage arrears were on a downward trajectory going into 2020. They began increasing in the early stages of the pandemic before payment holidays were introduced and are now rising again as these come to an end. Arrears have increased in older age groups, who were less likely to take a payment holiday.

1 in 3

people have experienced a decline in income

10-39%

the rate of decline experienced by more than half of those who have experienced a drop

Plotting a route forward with data

Looking forward, there is reason for cautious optimism. But economic uncertainty will make itself felt in the housing market for some time yet. And while there's uncertainty, there's increased risk.

The trends we've identified through our data and market analysis point to a challenging period for lenders – not least because the full impact of the pandemic is not yet understood. It's never been more critical for lenders to amend and adjust how they make decisions and monitor customers.

Experian recommends lenders take the following steps:

- Use open banking and other trusted sources of consumer contributed data to gain a more comprehensive understanding of a person's financial situation
- Analyse 12 months of data for a perspective on customers who've experienced a temporary change of circumstances but are now showing signs of recovery
- Assess the risk at the point of application to ensure you're lending to the right people, and have the right product mix
- Accurately forecast and manage changing risk in your portfolio to help spot signs of stress
- Digitise processes to help find efficiencies and deliver the best possible outcome for customers

Even in the most challenging of environments, data and analytics can help lenders to make the highest quality decisions on affordability in the mortgage market.