HOUSE OF COMMONS

Treasury Committee

Oral evidence: Mortgages, HC 1687

Tuesday 11 July 2023

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Watch the meeting

Members present: Harriett Baldwin (Chair); Rushanara Ali; Douglas Chapman; Dame Angela Eagle; Danny Kruger; Andrew Leadsom; Anne Marie Morris.

Questions 1 - 88

Witnesses

I: Andrew Asaam, Homes Director, Lloyds Banking Group; Charlotte Harrison, Interim CEO (Home Financing), Skipton Building Society; Bradley Fordham, Mortgage Director, Santander UK; Henry Jordan, Home Commercial Director, Nationwide; Nigel Terrington, Chief Executive, Paragon Banking Group.

Examination of Witnesses

Witnesses: Andrew Asaam, Charlotte Harrison, Bradley Fordham, Henry Jordan and Nigel Terrington.

Q1 **Chair:** Welcome, everyone, to this morning's session of the Treasury Committee on mortgages, and welcome to our witnesses. I am going to start by inviting you to introduce yourselves.

Nigel Terrington: Good morning. My name is Nigel Terrington. I am the chief executive of Paragon Banking Group. I am also a board representative of UK Finance.

Bradley Fordham: Good morning. My name is Brad Fordham. I am the mortgage director for Santander UK.

Charlotte Harrison: Good morning. I am Charlotte Harrison, interim CEO of home financing for Skipton Building Society.

Andrew Asaam: I am Andrew Asaam, homes director at Lloyds Banking Group.

Henry Jordan: Good morning. I am Henry Jordan, commercial director for home at Nationwide.

Q2 **Chair:** As part of my outreach work as Chair, I had a dinner with the Building Societies Association last week, and there was a representative

from Nationwide there. I am not sure whether anyone was there from Skipton, but I will just set that out for the record.

In terms of initial questions to each one of you, there was a long period where a lot of your customers enjoyed very low rates on their mortgages, and they have now seen very sharp increases in mortgage rates. Can you share with the Committee what reaction you are seeing from the borrowers affected and how that is affecting the quality of your mortgage book? Can you also point out any increases that you may be seeing in arrears or the number of accounts that you have in forbearance, and whether you are seeing a sharp increase in repossessions?

Henry Jordan: I agree that there is a significant increase in rates for customers maturing off their original product. As context, for our mortgage book, it is an increase of around £235 per month, or a third, in their payment. That said, we have not really seen any material movement in our arrears performance. Certainly within our prime residential portfolio, arrears are stable.

We have seen a roughly one basis point increase in arrears over the past 12 months. That is on a measure of three months in arrears. We have seen a slightly higher increase in early arrears, particularly on the buy-to-let book, mainly because those customers are predominantly on interest only already and, therefore, have fewer options available to them.

Forbearance is down slightly year on year, so customers are generally taking action. We have seen an increase in overpayments and term extensions, but no material increase in arrears yet.

Q3 **Chair:** Nationwide has a pretty significant market share, as does Lloyds. Do you recognise the picture that we just heard there from Henry? What are you seeing? UK Finance data for the first quarter of this year showed a tick-up in mortgage arrears. What are you seeing?

Andrew Asaam: We are seeing very similar to Nationwide. Undoubtedly, households and customers are feeling the effect of not just mortgage rates increasing but the wider cost of living crisis. As we look at the impact on arrears, forbearance and repossessions, we saw, very similarly to Henry, an uptick, but arrears remain very low in a historical context and still below what we would have seen pre covid.

Charlotte Harrison: I have a similar story to tell. The trend in the percentage of customers who are in arrears remains flat year on year. We have not seen any uplift. Just referring to your point on UK Finance data and Q1 seeing a small uplift, we have seen some seasonality in trends in customers entering arrears.

We saw a modest increase in Q1. Arrears have come back down since then. Some of those factors are sometimes around the seasonality of the holiday season and the Christmas period, and we tend to see an uplift in January. We also had the shorter April month and bank holidays, and

some of those factors will play into arrears performance, but the trend over the longer term is that we have seen a small uplift and then that trend has come back down.

Bradley Fordham: Ours is a very similar picture, with a small tick-up in arrears. We are still 20% below pre-pandemic and 70% below 2009 post the financial crisis, so relatively low levels. Similarly, in terms of payment increases for customers, customers are typically coming off 2.3% and going this year on to an average rate of around 4.5%, with a payment increase of over £200 per month. As interest rates increase, so can that increase in payments. It is a broadly similar picture.

One thing to point out is that, over the last 10 or 12 years, and certainly for us at Santander, we have stressed the affordability of 95% of mortgage customers who have joined us and understood whether they can afford the mortgage payment today as well as in the future. We have affordability stress tests at a higher interest rate. Typically in the market, that may have been around 6% over recent years. At the time of application—and I stress "at the time of application"—we have understood that customers can bear a higher interest rate, and that seems to be bearing out at this moment in time.

Q4 **Chair:** That is very interesting. Paragon's business is mainly buy to let. Is there a portion of your business that is not buy-to-let and which you would want to comment on in the context of what you have heard your colleagues say?

Nigel Terrington: Where we do business that is not buy to let, we are quite active in financing housebuilders, as well as small businesses. Our comment and observation there is that we are seeing very stable arrears positions across all those portfolios. Would you like me to comment about buy to let specifically?

Q5 **Chair:** We will get to some more detailed questions on buy to let as we go down. We are also doing an inquiry on small business lending, so it is interesting to hear your evidence on that.

If I can now start asking the question in a slightly different way, which is around the provisioning that you are likely to put in place in terms of your loan losses this year, we are coming up to reporting of second-quarter results. I appreciate that you will not be able to share anything that is not out there in the public domain, but are you going to be provisioning to reflect what you have just told us about the quality of your mortgage book?

Bradley Fordham: I do not have specific numbers to hand. Of course, we are in a closed period currently. We would expect provisions to rise very slightly in line with arrears, as customers move into different stages for reporting purposes. We would expect a small increase. While I do not have those figures, I will happily share them with the Committee in writing, once available.

Charlotte Harrison: I would echo Bradley's comments. Provisioning will reflect the quality of our book. Again, we would expect a small increase in that, but it is reflective of the position of arrears performance to date.

Andrew Asaam: We report in two weeks' time, so we are in a closed period. Similarly, the provisioning will reflect the underlying quality in arrears that we are seeing in the portfolio.

Henry Jordan: I can provide a bit more detail. I should have said that, like Santander, our arrears rates remain below pre-pandemic levels, so we have not really seen a material movement in arrears. We have applied some model adjustments to reflect borrower affordability impacts that increased our provision in our full-year results, which were published in April. Our provision coverage ratio is 0.14%. That is more skewed towards buy to let than residential.

Q6 **Chair:** Looking ahead to the second half of the year, it has been reported that there are a lot of people who took out two-year fixed rates that will be coming to an end. They took out those two-year fixed rates when there was the stamp duty holiday to reflect the pandemic conditions. Do you model what you have upcoming? Is the picture that you have painted for us today going to change markedly if we see you again in six months' time?

Charlotte Harrison: There are a few drivers around the performance of book for customers entering financial difficulty. Bradley has touched on some of them. We stress-test customers at a higher interest rate environment. We stretch affordability in that assessment to ensure that we are future-proofing as much as possible that customers can maintain and afford those repayments.

We also know that, for customers who will mature this year, whether from a two-year or a five-year fixed period, they have, for the most part, been making capital repayments against that, so the balance will have been reducing over time.

We also know that we have just come out of double-digit house price growth and, therefore, while those customers have been repaying the capital balances on their mortgages, they have also benefited from movements in HPI and, therefore, afforded more equity in the properties.

I expect that, over the next six months, we will see more customers with financial stress, but I expect that to be relative to the market. There are options available to those customers as well, and so, when they are experiencing financial difficulties at maturity, we explore to understand what kind of forbearance measures may be appropriate for different individuals.

I would expect that, in this higher interest rate environment, we see more financial stress than we have to date, but I also understand that that will be spread and felt quite differently across households.

Chair: Does anyone want to say anything different to that?

Bradley Fordham: It is important to recognise what the payment increase means for customers. Currently, mortgage rates in the market are somewhere between 5.5% and 6.5%, depending on the lender. At 6%, the payment increase for customers coming off a rate of circa 2.3% is £350 per month, so it is significantly more. Therefore, in this environment, you would expect, to Charlotte's point, more customers to have some financial difficulty.

Andrew Asaam: Similarly to everyone else, we stress-test customers to make sure that they can afford a much higher payment than they would be paying today. We also allow customers to lock into a rate six months ahead of their product maturing, which gives them options not only to lock in a rate today but to start planning for that higher rate six months ahead. That gives customers some opportunity to start planning if they have an increase in rate coming down the line.

Historically, mortgage arrears have been highly correlated with unemployment. Undoubtedly, the cost of living crisis and inflation are really challenging, but, while unemployment is still low, that provides people with options. Finding different ways to manage their payments is challenging, but unemployment is still low.

Chair: That moves us nicely into the subject of the mortgage charter.

Q7 **Rushanara Ali:** Good morning. I wondered if you could quickly run through how much of an impact you expect the mortgage charter to have.

Henry Jordan: "To be seen" is the honest answer. We saw a really high take-up rate of payment holidays during covid. It was a different option and a different period. To put that into context, we saw over 25,000 people take a payment holiday in the first few days of the option being there in March 2020, 100,000 in two weeks and over 200,000 over the duration of the availability of those options. That gives a bit of a benchmark. It is hard to fully say what the take-up rates will be. My personal view is that they will be lower than that.

To put this into context, all the options in the mortgage charter are available today, including an interest-only concession, for example. The key change is that those options, and particularly interest-only concessions, will be available without an affordability assessment and without an impact on credit file. At the moment, we see about 100 customers a month taking that option, but we know that the credit file impact is a barrier to people taking that up. That gives you the range that it could be.

The important component that customers need to understand is that, if they do take an interest-only concession for six months or they extend term, they will ultimately pay more interest. That is something that we are including within the application process for those options. The

message from me would be to take these options only if you need to, because there will be a long-term cost.

Andrew Asaam: We welcome the mortgage charter. It is helpful for consumers and customers to have a clear idea of what banks will offer them, and this provides that. Similarly to Henry, we provide a number of these options to customers already. I mentioned the opportunity to fix six months before maturity, but it does provide consumers and customers with a deal of clarity on what they can do and can expect from the lenders.

Charlotte Harrison: To build on that point, in terms of the level of take-up and customers seeking those options, it remains to be seen. To Henry's point, I would also expect that that would be lower than what we saw with payment deferrals during the pandemic.

Touching on one of your points, Andrew, around customer certainty, it is a different environment that we are in today. There was very little certainty during covid around what that meant for finances and for employment and work. Customers now understand what that certainty of payment might look like over the next 12 to 24 months and the options available. I would expect it to be lower, but we are also, equally, preparing for customer inquiries coming to us.

Bradley Fordham: I have a point to add to the one Henry raised. What we have seen most recently is that fewer than 4% of customers who have a mortgage product that is expiring over the next few months are inquiring about a mortgage charter-type solution—this is obviously pre mortgage charter—so a term extension or a conversion of their mortgage to help affordability. Again to Henry's point, we would expect the numbers to be lower than the pandemic in terms of the payment holiday situation.

Q8 **Rushanara Ali:** They are more likely to extend terms or the length of the repayment.

Bradley Fordham: It would depend on the customer's circumstances. We would encourage customers to contact us as lenders to talk through and understand all the options before they decide. If a customer can afford the increased payments, it is better for them over the longer term, because they will pay less interest.

Nigel Terrington: We are a specialist buy-to-let lender and the mortgage charter does not apply to buy to let. However, we are following the charter and would be very happy to sign it if we were required to.

Q9 **Rushanara Ali:** Should you be included? The evidence suggests that there is distress in that sector as well.

Nigel Terrington: I do not know why buy to let was excluded, but we are very happy to sign the charter.

Henry Jordan: Because a high proportion of buy-to-let customers are already on interest only, the options around extending term or moving to interest only do not really apply in that situation.

Q10 **Rushanara Ali:** What about the extension? Can they already do that?

Henry Jordan: It would not make a difference to an interest-only mortgage either. I should have mentioned that we already offer the option for customers to extend term out to retirement. We see between 800 and 1,000 of those applications per month. That does not have an impact on credit file or affordability, so that is a benchmark of that sort of take-up going forward.

Q11 **Rushanara Ali:** What is the point of the mortgage charter if you are already doing much of what is written up? Is it just that people know a bit more about where they stand and that it is in one place? Has the Chancellor added anything substantive by coming up with this mortgage charter?

Andrew Asaam: It provides consumers and customers with clarity around what is out there, as well as consistency. Different lenders would have had different approaches, so it does that. Inflation is still high and there is still the ongoing squeeze for customers and consumers, so it is a helpful intervention as things progress.

Q12 **Rushanara Ali:** According to one report, 85% of the market is covered by this voluntary charter, so 15% is not. Do you have a view on whether the Government should reach out to them and encourage or try to influence those for whom it would be appropriate to sign up to this charter, given that you think it is quite a good thing?

Bradley Fordham: Each lender will have its own reasons if it is not signing the charter. To Nigel's point, it may be about being a specialist lender. From a Santander perspective, we are supporting the charter and signing up.

Q13 **Rushanara Ali:** In terms of overall figures, we know that we are going to see 1.4 million households that are set to roll off fixed rates over the course of this year. As the Chair has said, most of them were fixed between two and five years ago and were on much lower rates, so we are going to see much more stress in the system. What could you be doing above and beyond what is in the mortgage charter and what you have been doing to try to minimise the risks of repossession or distress? Even if they do not face repossession, it is going to cause a huge amount of financial distress if your average mortgage is going to go up in London by over £5,500 or, nationally, by just under £3,000. Do you have a view on what more banks can do?

Andrew Asaam: If I outline the way that we have thought about it and what we are doing, that might help with some context of the way that we are thinking about approaching this. There are largely three groups of customers. There are those who are coming off fixed rates. We allow

them to select a product six months before that maturity, which allows them to plan.

We have also looked within that at which customers are potentially at high risk. We phone those customers to allow them not only to lock in but also to extend term if they need to. That is on that group of customers rolling off those fixed-term products. We try to help those customers and are proactively reaching out to those most at risk.

Then there is a group of customers on variable rate products. Every single customer gets at least one communication a year that tells them what other products are available. If you can make a saving at all, we will send you another communication and tell you that you can make a saving by moving to a different product. For example, if you could save £100 a month, we will say, "You can save up to £100 a month," so we are really explicit in that communication.

Again, for those customers who we think are at most risk from the cost of living, we do outbound calling. We have called 35,000 customers to let them know that there is the potential to move to another product.

Finally, there are customers in financial difficulties. We have a suite of tailored forbearance activities for those customers to try to keep them in their homes, and we use repossessions only as a last resort.

Nigel Terrington: We use quite an extensive suite of early-warning indicators. Rather than wait until a customer has not paid, our view is always to try to anticipate that and deal with it early. We listen and reach out to customers in a similar way to that described by Andrew, but we also use a lot of quite smart technology to try to identify early signs of stress in an individual's life that may not be evident yet in their payment performance. If we see that, we reach out to the customer and try to understand the issue and then offer help where it is needed.

Q14 **Rushanara Ali:** Do any of you know about mortgage prisoners and what the implications of the rising interest rates are going to be for them? Do you have people who are trapped in the mortgage prisoner category? Also, do you have a view on the fact that the extension of mortgages—or the break, if you like—means that the overall cost burden will be pushed back to later on in life? What are your thoughts on that? People are still going to be worse off. It is just about deferring the pain, if you like. Do you have any thoughts on either of those points?

Henry Jordan: I will pick up the second point. People are extending term now, for example, to manage their payments. When they come to renew their product in the future, it may be that the rates have reduced at that point. As part of the product switch journey that we have, we encourage people to review their term again then. At that point, when rates have come down, they can potentially reduce their term and, therefore, reduce the total amount of interest that they pay.

Q15 **Rushanara Ali:** But they will still be worse off.

Henry Jordan: They will have incurred more interest during that initial period, but the earlier they do that, the less they pay.

Bradley Fordham: On the mortgage prisoner front, from a Santander perspective, we offer rates to all our customers, similarly to Andrew in terms of the contact strategy for customers on variable rates, so that they are aware of other products that they can fix on to, if that is what they prefer. At the moment, 90% of our customers are on fixed rates and only 10% on variable.

Q16 **Rushanara Ali:** This Committee pushed for affordability changes from absolute to relative tests for those who are trapped as mortgage prisoners. Have you have used that as you have done the assessments?

Bradley Fordham: There is a second piece of work under way at UK Finance to look at mortgage prisoners, and particularly to try to better understand the data from those closed-book lenders, so that we can tailor our approaches. That work is ongoing currently with UK Finance.

Q17 **Rushanara Ali:** I have been campaigning on this for years in this Committee. The FCA had revised the guidance from an absolute test to a relative test for affordability. We were assured that things would then change and that people would be able to have access to mortgages and favourable rates, and be able to switch, but the work that is under way to get this going seems very slow, and one of you is on the FCA board. People are stuck in this situation with rising interest rates and it is going to be even worse for them. Can we have some urgency, please?

Andrew Asaam: We have no mortgage prisoners in our portfolio. Every customer can get a front-book rate. We have adjusted our affordability for mortgage prisoners. We see very little coming through. When we looked at it previously, we saw that there were a number of customers applying to us from closed-book lenders but not necessarily categorising themselves as mortgage prisoners.

Q18 **Chair:** In terms of the mortgage charter, you are going to be subject to the consumer duty from the end of July. Do you see any contradictions between what you are being required to do by the consumer duty and what you are being required to do as signatories of the mortgage charter, or do you think that they are completely aligned?

Charlotte Harrison: The key point for the charter is around customer awareness and understanding. That is the key component in making sure that, when customers are choosing to move temporarily to interest only or a term extension, it is really clear up front that there might be cost implications and what those cost implications can be. If the customer is then comfortable to proceed with that, that is okay. That clarity is much needed, and we are currently working to build that into the process, so that customers have a real awareness of what that means in terms of the longer-term financials.

Chair: Lloyds and Santander both mentioned that they are contacting

customers proactively about a lot of this. Yesterday, in our campaign as a Committee to increase savings rates, we heard that one reason that banks were not increasing savings rates is that they could not contact their customers to tell them that higher savings rates were available, due to restrictions around GDPR. We think that that is a very implausible excuse and would just like you to feed that back to your employers.

Q19 **Douglas Chapman:** Good morning. I will start with a quote that I have from Citizens Advice Scotland, which says that 11% to 14% of people cannot make it to the end of the month on their pay due to a combination of the cost of living, energy costs and, now, mortgage increases. Henry, in your opening answer, you said that you are not seeing a huge spike in the level of debt, which was echoed by other members on the panel. At what level of mortgage will you begin to see a spike in underpayment or no payment being made towards people's mortgages, given the pressure that is on households?

Henry Jordan: It is hard to give an exact rate. It would be different for each individual.

Q20 **Douglas Chapman:** One high street bank that I have been talking to said that, once rates get to 7%, that may be the cut-off point where we will see an exponential rise.

Henry Jordan: The increase of £275 a month that I referenced at the start is assuming a 5.5% pay rate, coming from a 2.25% pay rate currently. We talked about the impact of the mortgage charter. Extending term would reduce that increase to about £134 a month, so it takes about £100 off that increase. If they convert to interest only, they could move to a lower payment than they have currently. Even though their rate will increase, moving to interest only will more than offset that increase. That remains true until you get to somewhere between 6.25% and 6.5%, so that might be the tipping point at which options like interest only will not be sufficient to offset the increase in payments that customers will see.

Q21 **Douglas Chapman:** Andrew, do you have any comment on that?

Andrew Asaam: The fact that unemployment remains low means that, although there is definitely a real challenge for households in terms of spending, there are still choices that customers can make to try to stay in their homes. We support them in that through the things Henry has outlined, such as a move to interest only or term extensions.

Q22 **Douglas Chapman:** Some of the options that you can offer customers are changing the balance between interest and capital repayments every month, or interest only, or some form of holiday that they could take. Charlotte and Bradley, people are trying to find ways of paying all these bills, and dealing with inflation and all the other things that they have to deal with at the moment.

What are people using to pay their mortgage and other bills? Are you seeing any trends in terms of people maybe using up savings? What

percentage of people are moving to a different term or changing the conditions of their mortgage? It is all very well saying that people have options to do that, but if we understand the trends and how many people are doing it, that may be quite useful from the Committee's perspective as well.

Charlotte Harrison: From Skipton's data to date, we are not seeing a material uplift in customers choosing or requiring to choose those options. The number of our customers entering into arrears has remained consistent, so we are not seeing an uplift in that. We also know that, within the data, when we are talking to customers who are experiencing financial difficulty, that is more driven by life events such as illness or unemployment than by the rate environment. I suspect that, when we see higher rates, we will start to see more of an uplift in customers choosing these options, but we are not seeing that today.

Bradley Fordham: It is a similar picture for us at Santander. From an understanding of the data on turnover in bank account customers, we see some customers who are looking to cancel subscriptions and that sort of thing, which would be an early sign. We do not see any particular deterioration in our customers who have unsecured debt, so there do not seem to be, at this moment in time, any lead indicators that they are struggling to pay there.

From our perspective, we are just looking to support our customers. Similarly to other members on the panel, we have contacted, through targeted outreach, 1.8 million customers this year who we feel are at risk of having financial difficulty, and encouraged them to contact the bank to discuss any issues that they have so that we can support them. We have a range of measures in place to support those customers through that period.

Q23 **Douglas Chapman:** What about new customers as well? To what level are you stressing their interest payments and general mortgage repayments, if they are new customers to the bank or the building society?

Bradley Fordham: Similarly, in terms of what we have done previously, we still stress mortgage customers' affordability at a higher rate than the pay rate. Typically, dependent on the customer, it may be 2% or 3% above their pay rate. At this moment in time, lenders in the market will be stressing somewhere between an 8% and 9% pay rate to ensure that customers have future affordability.

Charlotte Harrison: Another component of that is that, when we look at affordability, we will look at interest rate risk and stress-test for that. We will also look at expected household expenditure. These new customers to lenders will also be undergoing a full affordability assessment, which assesses both elements. That will factor in current inflationary costs and what it costs to run a household as well. That will be factored into an affordability assessment.

Q24 **Douglas Chapman:** Are you seeing at Skipton any increase in the number of rejected applications on the basis of affordability?

Charlotte Harrison: We are not seeing that in our data currently in terms of decline rates. However, 90% of customers who come to the society are introduced via brokers, who will run an affordability assessment up front, so it is in the intermediary market that there would be a variation in that data as to where you would or would not accept cases. Once they are placed, we are seeing a similar level of accept rate.

Henry Jordan: Exactly to that point, brokers will filter the applications. Our accept rate is steady, at about 80%. The other thing that we are seeing is borrowers, and particularly first-time buyers, saving for a bigger deposit or buying a slightly different property.

There has been an impact on affordability. We have a two-tier approach. Our standard affordability is stressed at just under 9%—there are rules around your revert rate plus 1% that drive that—where we specifically target our extra support for first-time buyers. Where they take a five-year fix or longer, you can apply a different view of stress rates. We apply a lower stress rate in that situation to try to support first-time buyers through this period.

Q25 **Douglas Chapman:** Andrew, are first-time buyers still involved in the market? Are they still coming forward to purchase new properties or enter the market?

Andrew Asaam: Lloyds Banking Group sees around one in five first-time buyers, so it is an important part of the market for us and one that we are really committed to. The market is smaller in 2023 than 2022, because 2021 and 2022 were very large years due to the race for space post covid, where people changed their living habits and living styles. Then you had the stamp duty holidays, so that drove two very big years, and it is understandable that the market is going to be smaller this year than those two years. It is more aligned to 2019.

It is down, but it is more normalised in its size. Within that, first-time buyers have also reduced, as you would expect. As Henry said, people are either putting down a larger deposit or buying a smaller property because affordability is tighter. We will not let people borrow as much now, with rates where they are, as we would have done historically. People are moderating what they can afford to buy.

Q26 **Douglas Chapman:** Because of that, are we seeing any changes in house prices, even if they are regional?

Andrew Asaam: We publish the house price index and you can see a moderation in house prices, but, again, it is small. In our Q1 results, we said that we expected them to fall by around 5% this year.

Q27 **Douglas Chapman:** Let us move on very quickly to the buy-to-let sector. Nigel, what changes are you seeing within that sector? Are you

experiencing lenders, or whoever, stress-testing anybody who wants to move into that sector? I know that there are a lot of issues around the sector as a whole at the moment, but I just wondered what your view was in terms of buy to let and where that sits at the moment.

Nigel Terrington: Stress-testing applies equally in buy to let. The model is different because you have rental income as opposed to normal employment income to consider. We and the industry employ stress tests in order to assess whether the affordability is achievable, not just today but at higher interest rates as well. They will vary, depending upon the customer and the customer type, and whether they are a single or multiple property landlord. Equally, it also depends on the tax rates, so it is a little more complicated than the owner occupied market.

However, what we have seen more generally is that there is certainly a weaker level of demand out there, which is probably not surprising, given general trends in the economy, the housing market and the like. There is also perhaps a tendency for individuals to stick with their existing lender a little longer. They stay on the books and take a product transfer, so they take another fixed rate, but within the firm.

We have seen changing dynamics within the wider buy-to-let market or the wider private rented sector, where demand for rented property remains very strong. I am sure that, at some point, you will want to talk about what has happened in the rental market. In terms of the affordability tests that we establish, you typically want a minimum of around 150% rent to debt service coverage ratio, so that you have a buffer to allow for increases in interest rates and increases in costs to manage those properties. Typically, we run it at around 200% now, so you have capacity to absorb those higher interest rates and costs in managing the properties as well.

Q28 **Douglas Chapman:** I think you said earlier that a lot of the buy-to-lets are on an interest-only basis. Is there any concern within the sector in terms of falling house places and the capital that they might have invested into a property?

Nigel Terrington: There is a certain perception around buy to let that it is a riskier product. I would dispute that. I have probably built a career out of trying to dispute it; I have not necessarily succeeded. The average loan to value is 62.5% on our portfolio. It is very different to what life was like before the financial crisis, but our loan to values are not untypical of the industry as a whole.

One of the reasons why lenders do not typically do much more than 75% loan to value is that you want to ensure that the landlord has an investment in the property. It is not the roof over his head, but you will want to make sure that he is invested in the property, and so, typically, the maximum loan to values that you will do will be lower. Again, it is not just a Paragon thing but across the industry as a whole.

Charlotte Harrison: To echo that from a Skipton Group perspective, where we have the Connells estate agency and letting arm, we see the same trends. Some 70% of buy-to-let properties are mortgaged and 30% are not. Of those that are mortgaged, 90% are less than 70% loan to value, so there is a significant amount of equity in the property.

Nigel Terrington: I would point out that, while the perception of buy to let is that it is a riskier product, buy-to-let arrears for the industry stand today at 0.43%. That compares to the owner occupied market at 0.78%, so it is almost half the level. You might think, "Is this just a one-year wonder?" If you go back to every year since data was recorded, it has been the same.

Buy to let has seen a lower level of arrears than owner occupied, with one exception. That was 2009, when we all remember what happened, but that was largely created by Bradford & Bingley, whose arrears stood at 6%. If you take them out, you get back to the same trend line, hence one of the reasons why people misunderstand the credit standing of landlords in the buy-to-let market. The evidence points to it being much stronger than the perception.

Chair: Thank you very much, and we will be asking more questions on buy to let. I am sure, Nigel, that you would want to acknowledge that landlords can also be women and say "he or she" when you are referring to them.

Q29 **Anne Marie Morris:** Can we now turn to the availability of mortgages? Douglas has looked at the affordability, but we have seen very volatile positions where rates have been offered and then withdrawn. There is a concern among many who want a mortgage as to the point at which they lock in. For many, there is a question mark about whether they want a fixed or some form of variable tracker-related product.

When you look at the availability of mortgages now, what are you seeing and what are you intending to offer in your portfolio to reflect that changing demand of what individuals want and your challenge with inflation and interest rates changing very quickly?

Bradley Fordham: As we have already touched on, in terms of new availability, typically, the first question that first-time buyers or people moving house will ask a broker—because 85% of the market for origination of new mortgages comes via intermediaries—is, "What is the maximum that I can borrow?" They know, when they go and view properties, what their budget is and how much equity they have and, therefore, they have a price in mind.

What we are clearly seeing now in terms of the way that we stress affordability, to Charlotte's point around the fact that customers' general bills for food, fuel and so on are higher, is that customers' maximum borrowing is less than what it was a year or 18 months ago. Clearly, that is going to constrain customers' choices and what properties they can

afford. To Andrew's point, we can see some signs where customers are either putting more deposit down or looking for a smaller property.

In terms of availability of products, it has been a very volatile period. Base rates and swap rates have been increasing, which are generally the funding costs for banks. Therefore, there have been price increases by lenders. We are super conscious of that and we give brokers notice in advance that our products will be changing. If products are being withdrawn and new ones launched at higher rates, it gives brokers the opportunity to book those rates for customers before they are withdrawn or changed, so that customers have at least some option of, "I know that this is the price today. Maybe that is changing tomorrow." We have given notice and, therefore, the broker can book that.

Similarly, to Andrew's point, we allow existing customers to pre-book their rates. We write to them before their deals mature and allow them to pre-book. As part of the charter, although available before, we have committed to customers that, if those rates go down and they have pre-booked a rate because their new rate is ending in three or four months, they can change that rate and take the lower rate before their new deal starts.

Q30 **Anne Marie Morris:** The way that you are talking leads me to conclude that you are still very much focused on a fixed-rate type of mortgage arrangement, rather than anything more flexible. Andrew, do you share that view? Is there now a demand for, and maybe an appetite on the part of the banks to look at, that sort of product, or do you see that as high risk and something that you are going to try to persuade borrowers not to look at?

Andrew Asaam: We offer two-year, five-year and 10-year fixed, and we have a tracker product. Trackers were completely out of favour in the market for a number of years, and everyone went for a two-year or five-year fixed. Post the mini-Budget, when there was volatility in the market, trackers became very popular. We did not have a tracker in the market at that particular time, so we introduced it in January to recognise the customer demand for that product. It is a helpful product for volatility. It worked for some customers in October and November, because it was volatile, and rates did come down. It gave people the flexibility that a tracker offers.

We are offering a full suite of products that customers would find useful and want at this point in time. The advice process that customers go through is critical in determining which product is suitable and appropriate for them.

Q31 **Anne Marie Morris:** Charlotte, you earlier, quite rightly, referred to the number of owners who do not have mortgages. As the cost of living crisis begins to bite, do you see an increasing number of older people wanting to take out new mortgages? Do you see the sector beginning to address this issue? You have not only individuals who may want to be borrowers,

not for the first time but as they get older, but also those who are already with mortgages, still working well into their 70s and 80s, and more than capable because they are still waged, if I can put it like that, of repaying their mortgages? Is that being addressed in the structure of the mortgages you are offering?

Charlotte Harrison: To your second point around lending into what would be retirement age, if people are working and able to evidence through regular income, we will lend in that space.

Q32 **Anne Marie Morris:** With no age barrier. If you are in work, it does not matter how old you are. You can still take a product.

Charlotte Harrison: We assess individual circumstances in terms of how far we go into what would be retirement. If there is evidence of sustainable income, we would look at that for customers.

On the first point around customers who are currently mortgage-free and looking to release equity from their property, the market exists today. In terms of equity release, it is not something that Skipton lends on. Will we see that as a growing market? We may, and it may not be to service their own households, but we might see more intergenerational lending with people supporting sons or daughters and family. That may be a growing market.

Q33 **Anne Marie Morris:** Bradley, I suspect that you do offer equity release, so do you see this as a growing way of people being able to manage their finances going forward? In the original structure, many saw it as being quite destructive because of the amount of equity that effectively went to the lender, but the market seems to be changing.

Bradley Fordham: We do not currently offer equity release via the Santander brand. We have an arrangement with a third party to which we refer customers if that is the type of lending. Similarly to Skipton, we lend to age 75, providing that customers can evidence income up to that age and it is affordable for them. If a customer wants lending past retirement, such as equity release or later-life lending, we have an arrangement with a third party that we would refer them to, so that they can explore those options.

Q34 **Anne Marie Morris:** Henry, we have talked a little bit about first-time buyers and the availability of mortgages. Clearly, they are buying smaller properties, and the relativity between the equity and the loan is changing. What sort of advice are you giving and what sorts of things are you offering to the first-time buyer? They have many years ahead of them, but it is a crucial decision to make at this point. Are you looking at evolving a different range of products? What availability specifically are you looking at putting in place for the first-time buyer?

Henry Jordan: Our product offering has not really changed. We have talked about higher rates, but the range of products available is unchanged. I mentioned earlier our support for first-time buyers. We

have a specific proposition called Helping Hand, which lends up to 95% and up to five and a half times income in order to help first-time buyers through this period and ensure that they can get on to the property ladder.

We would not provide advice on whether now is a good time to buy. That is an individual decision, depending on circumstances. In terms of offering, as Andrew said, we are still seeing demand from first-time buyers.

Q35 **Anne Marie Morris:** Nigel, buy to let is a very different market. Here, I am not looking at affordability but availability. A lot has changed in that sector over the last decade in terms of tax treatment. We now have the Renters (Reform) Bill on the horizon. All sorts of things are impacting that market. In terms of the availability of buy-to-let mortgages, do you foresee any changes? Is the sector saying, "Because of all the complexity that is coming down the line, this is a product we do not want to continue offering in the same volumes as we did before"?

Nigel Terrington: I do not see a reduced appetite from the industry. I would say that the competition, as it were, is as intense as ever in that space, and there is plenty of capital available from the industry to support that market now and going forward. If anything, there might be a shortage of landlords. We probably see that most evidently through the shortage of the stock of properties available to rent, which has other consequences that we can, no doubt, talk about later, but there is no shortage of supply of funding or capital from the industry as a whole, including specialist lenders.

Is it more complicated? Yes, it is. We choose to focus on being a specialist lender, because much more of our business is towards professional landlords. They have to wrestle and deal with 169 different forms of regulation and legislation, and they have to understand and apply it, so we need to make sure that we are experts at that as well in order to deliver the products and services to customers at the same time. It is more complicated, for sure.

Q36 **Anne Marie Morris:** Andrew, to what extent is your sector baking into its thinking the likely impact of the current economic position on house prices? The prediction is that they are going to fall. Clearly, that impacts your calculation in terms of the products that you offer. To what extent and how are banks and building societies taking that into account in the way that they structure their offerings?

Andrew Asaam: The place that this probably bites most is for first-time buyers who are typically at high LTVs. Henry touched on this. It is a completely individual situation, but we still think that, for most people, owning a home is better than renting. Therefore, we want to keep products available at higher LTVs for first-time buyers, but we need to make sure that those first-time buyers are resilient—that is, they can afford to stay in their home through a two-year period where house

prices might be falling, for example—and are aware that they could end up in negative equity.

We do not want customers being completely unaware of the risk of house price falls and finding themselves in negative equity and vulnerable to unemployment, for example. We are thinking deeply about who we lend to and the disclosures that we make sure customers have about the potential for any house price falls. That is how we are thinking about that at the moment.

Q37 **Andrea Leadsom:** Good morning. You are all sounding incredibly reasonable and fair, and you all have excellent systems to support your customers, but I would just like to put out there that I have a constituent who was ill and, therefore, could not, as a self-employed person, achieve his income. He was assured by his bank that, as well as giving him a payment holiday, it would not impact on his credit file, and so he accepted the bank's offer. It did impact on his credit file and he could not re-mortgage, which left him in a very dark position.

Hearing all that you are saying, there is a slight pinch of salt there, because, as a parliamentary representative, trying to get the bank, which I will not name here, to be fair to that constituent has not been possible so far. It is always worth remembering that, while you say that you have the systems and that you are reaching out to people if they are potentially getting into difficulties, your systems do not always do as you wish them to. I do want you all to take that on board and give that consideration, particularly when people come to you with their particular cases.

This session, I believe, is being streamed live on the BBC, and so there will be lots of people sat out there, throwing things at the television and saying, "This is not my experience of borrowing money." Complacency is just not an option in the current situation.

I did, however, want to question you about property prices. Mr Jordan, one of your colleagues, Chris Rhodes, told us last November that Nationwide's central scenario would result in house price falls of 8% to 10%, but potentially up to 30%. Could we please hear from each of you about what your central forecast is for house prices, whether you are already experiencing negative equity and how you will deal with homeowners who go into negative equity?

Henry Jordan: To Andrew's earlier point, we have similarly already seen some fall in house prices of roughly 4% from their peak in August last year. We would expect some further slight falls to around 6.5%. That would be our expected peak movement. To your question about negative equity, we have a very low exposure to it currently—it is 0.1% of our book—and so we are not seeing those movements in house prices really having any specific bearing.

Q38 **Andrea Leadsom:** If house prices drop by 6.5%, what will that do to your negative equity?

Henry Jordan: It will not increase materially. About 2.5% of our book is above 90% LTV, so there is headroom because of the house price growth that we saw through the pandemic and lending standards around higher LTV lending.

From a customer perspective, again as Andrew mentioned, if they go into negative equity and maintain their payments, that might be for a fairly short period and would not have any direct impact on them. Clearly, if they are having wider payment problems at the same time, that is where the other support measures that we have talked about would also kick in.

Q39 **Andrea Leadsom:** Mr Asaam, are you seeing any particular regions where there is more impact of negative equity or impact on house prices?

Andrew Asaam: The region that has been most impacted is London and the south-east at the moment, according to our index, and that was a pattern pre the fall. We saw the biggest increase in house prices where there was most affordability, and now we are seeing London fall, potentially because that is where affordability is most stretched.

Q40 **Andrea Leadsom:** Can you expand on that a bit? Does that mean that London and the south-east will suffer more as a result of bigger falls in house prices, or are you saying that there is more headroom in the affordability for consumers?

Andrew Asaam: We saw larger falls in London than in the rest of the UK.

Q41 **Andrea Leadsom:** Does that therefore mean that you are likely to see more families in negative equity, and potentially more financial difficulty?

Andrew Asaam: Not really. The LTVs on our portfolio are around the high 40s, so very low. The average loan to value in the portfolio again means that we do not expect to see large amounts of negative equity.

Q42 **Andrea Leadsom:** Essentially, property prices went up more quickly and have now come back down again, so there is less gain on the value of your property as opposed to a negative equity situation.

Andrew Asaam: That is right.

Q43 **Andrea Leadsom:** Ms Harrison, what about Skipton's situation?

Charlotte Harrison: It is a similar view. Again, from the estate agency arm, we have seen about a 2% reduction in new instructions to the market since June last year, so on a year-on-year basis. Equally, the average loan to value of our mortgage book is around 53%, so a lot of customers have significant levels of equity in their mortgage. Equally, for those customers who come to rate switch and perhaps are in negative equity, we are not seeing that, but if that materialises we have products available for them as well.

Q44 **Andrea Leadsom:** Is the situation similar for you, Mr Fordham and Mr Terrington?

Bradley Fordham: It is very similar. Our average loan to value is 51% for customers. Less than 1% of our customers have a loan to value above 90%. Again, house price reductions would have a limited impact on negative equity.

Q45 **Andrea Leadsom:** That 51% seems very low. It suggests that you have not sold many properties recently at high multiples of income, or is that because house prices have rocketed? Why is that so low?

Bradley Fordham: That is our existing customers who may have been with us for some time. From a new business perspective, the new business average is closer to 70% LTV.

There are two aspects to it. Obviously, one is house price increases, but also most customers—90% or so—take a repayment mortgage. Over time, they are paying the capital down, which therefore increases their equity as well, so you get a dual effect.

Q46 **Andrea Leadsom:** On the one hand, you are saying you are lending people large amounts against a property, but the loan to value is very low. That does not quite stack up with new customers, does it?

Bradley Fordham: Customers have a range of LTV points. Our average for new customers is 67% LTV. There will be some customers who we lend 90% or 95% to, and obviously some customers with a very low LTV who have more equity, possibly moving home rather than first-time buyers.

Q47 **Andrea Leadsom:** Is that their choice or are you forcing that upon them?

Bradley Fordham: No. Again, similarly, we have a range of products, up to 95%, for our customers. We rely on our advisers and intermediaries to give customers advice to understand what is the best product for them, which might be the availability of putting down a little bit more deposit. We see more gifted deposits now than historically for customers who are getting help from family generally. Parents or grandparents help with deposits, which can therefore make the mortgage affordable if they put more deposit down.

Q48 **Andrea Leadsom:** Arguably, the difference between now and the 2009 scenario is that people are perhaps more risk-averse and less willing to take on a huge loan-to-value ratio themselves. Would you say that is the case, or have the lenders themselves become more much conscious of affordability?

Bradley Fordham: Lenders are definitely more conscious. There is regulation that has supported that. We talked about the affordability stressing above the pay rate. Also, from a lender, there is a PRA rule where you can lend only 15% of your new lending to customers above an income multiple of four and a half times. There is some regulation in play to make sure that it is responsible lending.

Q49 **Andrea Leadsom:** Does that, therefore, lead to the conclusion that that is what makes it so difficult for young people to get on to the housing ladder?

Bradley Fordham: No, there are a number of factors. Currently, affordability is more difficult than what we have seen in the past, which we have touched upon. It is about ensuring that we are responsible lenders and that customers can afford mortgages both now and in the future. That is the most important point.

Q50 **Andrea Leadsom:** How are housing transactions holding up generally? Are we seeing a decline or an increase in house transactions as the value of them goes down a bit?

Nigel Terrington: Housing transactions are down. They are probably at around 20% to 25% of where they were at the back end of last year.

Q51 **Andrea Leadsom:** Is that seasonal?

Nigel Terrington: It has probably been affected by the rise in interest rates. There was a disruption around what happened in the mini-Budget, but you have also had a couple of years-worth of high levels of distortion in the housing market.

If you go back to a time before disruption, like 2019, then you are still looking at housing activity being lower today than it was in 2019. You had a big surge at various points during covid, but it is still lower and likely to remain lower this year.

Q52 **Andrea Leadsom:** Is there any change in consumer behaviour for new purchases? Are people looking for longer-term fixes? Are they tending to stay on variable-rate mortgages in the hope that interest rates will come down?

Andrew Asaam: We have seen customers take longer mortgages. The proportion of customers taking mortgages over 25 years has increased.

Q53 **Andrea Leadsom:** That is repayment terms. What about the fixed-rate aspect of that? Are they fixing for longer?

Andrew Asaam: Sorry, that is what I meant. No, they are not fixing for longer. The split between two and five-year fixed has moved more to two years.

Q54 **Andrea Leadsom:** They are fixing for a shorter period in the hope that interest rates will come down.

Andrew Asaam: Yes.

Q55 **Andrea Leadsom:** Are any of you offering longer-term fixing such as seven or 10-year fixed rates?

Andrew Assam: We offer a 10-year fix, and we have offered that consistently. Our 10-year fix is at a lower rate than our two and five-year fix.

Q56 **Andrea Leadsom:** Are you all in the same situation? Are you all offering seven and 10-year fixed rates?

Henry Jordan: Not seven but 10-year, yes. We typically see very low take-up rates of that at less than 2%. It is 2% to 5% in some periods. Despite the fact that, as Andrew outlined, it is our lowest-priced product, we see very low take-up.

Andrea Leadsom: But you are not offering it.

Henry Jordan: We offer 10-year but not seven.

Q57 **Andrea Leadsom:** Are you all offering 10-year fixed rates?

Charlotte Harrison: We are not currently offering 10-year fixed rates. We have in the past and, again, there has been very little take-up.

Q58 **Andrea Leadsom:** Are you finding that customers are shopping around for the best deal more often than they used to? Is there much more mobility of people choosing to refinance with a better, cheaper provider?

Charlotte Harrison: We are seeing, to my mind, similar levels. Again, I go back to the point that 90% of our business that is introduced to us comes via a broker, so they will always be actively searching for the best deal for their customers. We are seeing more switching of products between the point of application and point of completion, so that is a trend that we are starting to see more of. As we had interest rate movements within fixed rates, people are choosing to switch to a different alternative closer to the time of completion if it is cheaper for them. That is a small trend that we are seeing.

Q59 **Andrea Leadsom:** How easy is it to refinance with another provider once you already have a mortgage with one provider? Is it still incredibly costly and difficult to do that?

Andrew Asaam: No, it is easy. The market is highly intermediated, so there are lots of brokers, as everyone has said. Some 85% of new mortgages go through a broker. The broker will find the right deal for the customer.

Q60 **Andrea Leadsom:** This is re-mortgaging. This is consumers saying, "I don't like this mortgage provider. There is a cheaper deal over there." How costly and complex is it to do that?

Andrew Asaam: Most of those deals have free legal services and free valuations associated with them.

Andrea Leadsom: It should be easy to do. A message to consumers tuned in today would be to shop around. You could even switch mortgage provider and get a better deal. Talk to your mortgage broker.

Andrew Asaam: Yes.

Q61 **Dame Angela Eagle:** Mortgage costs have today risen to the highest

level for 15 years, with the average rate on a two-year fixed-rate mortgage now passing the peak of what happened in the aftermath of the mini-Budget. The Bank of England says that the rate on new mortgages in this country is much higher than it is in other countries, at 4.56%—although I suspect it will be higher now—compared to 3% in France and 3.95% in Germany. Why?

Andrew Asaam: The way that we price the mortgage product has a number of components in it, such as costs and operational capital. Then the big driver over recent months has been the external funding costs of the two-year swap or five-year swap.

Q62 **Dame Angela Eagle:** You are talking about the price of gilts. That is having a direct effect on why our mortgages are so much more expensive than mortgages you could get in other European countries. Is that a fair point to make?

Charlotte Harrison: That is the link, yes.

Q63 **Dame Angela Eagle:** That is where the pricing comes from. Does everybody agree with that?

Witnesses *indicated assent.*

Q64 **Dame Angela Eagle:** Everyone is nodding. I want to talk about the buy-to-let sector. I know, Mr Terrington, you specialise in the buy-to-let sector, so I am going to be asking you some specific questions. Does everybody else have a buy-to-let section? Do you all offer it?

Witnesses *indicated assent.*

Q65 **Dame Angela Eagle:** You all do. Great. What I am trying to get a handle on now is the passthrough from mortgage interest increases into rental increases for people who happen to be in the rental market. How quickly do you think rate rises on buy-to-let mortgages feed through to rents?

Nigel Terrington: There is less of an immediate and direct effect than people might think. If you look, there are about 5.5 million properties in the private rented sector. According to UK Finance, there are 2 million mortgages in that sector. That represents only 37%, so clearly there are 63% of people who do not have a mortgage. They are not experiencing an increase in their funding costs.

Separately, the vast majority of lending into the buy-to-let market is similar to what you have heard elsewhere. It is on a fixed-rate basis. About 90% of our lending is on a fixed-rate basis.

Q66 **Dame Angela Eagle:** It is mainly interest only.

Nigel Terrington: It is interest only.

Q67 **Dame Angela Eagle:** That makes it more sensitive, pricewise, to rises in interest rates.

Nigel Terrington: Yes, but to compensate that we have some very strict affordability tests, and we typically lend at low LTVs.

Q68 **Dame Angela Eagle:** That is for the person who is buying the property using rental income to do so with a mortgage, but, if their costs rise, the ones who have mortgages could very quickly pass those on to renters at the end of the six-month period that the contract lasts for.

For example, there has been a 5% increase in rent in May, which is the highest increase in seven years and well ahead of earnings growth. Is there not quite a big passthrough?

Nigel Terrington: There is typically a very clear long-term correlation between wage increases and rental inflation. You can track this back decades to look at it. Obviously, there are leads and lags in that. Things do not always happen in the same year, but that is what typically happens.

There was labour market data out this morning where wage inflation is running at around 7.6% in the private sector, and a little lower in the public sector. The rental increases there—5% on ONS data—are therefore not out of line with the general trend in wage inflation.

Q69 **Dame Angela Eagle:** Rents have gone up 20% in three years; wages have not gone up 20% in three years.

Nigel Terrington: As I said, there are leads and lags to this. If you look at the experience during covid, rents declined during that period.

Q70 **Dame Angela Eagle:** There was regulation on rental increases during covid, so let us look at the period before that unusual period to see what is happening. We are seeing a relentless increase in rents, which is exacerbating the cost of living pressures for people who cannot get on the housing ladder because the barriers to entry are too high for them. They seem to be suffering higher levels of volatility and increases, particularly in areas where property prices have gone up, such as London.

Nigel Terrington: As I said, there is a very clear correlation between wage increases and rents. If that relationship is being disturbed at the moment, one of the factors behind it is that there is a significant shortage of rental property. Everywhere you go and everywhere you look, you see long queues of tenants looking for a rental property.

The number of landlords in the private rented sector today is probably lower than it has been at any time since 2015. One of the reasons for that is that you have seen a period here where the costs of becoming a landlord have gone up. I do not just mean funding costs, but the overhead of running the property.

In addition to that, there have been fairly significant tax changes that were introduced around the Budget of 2015. That bit on landlords over a number of years, so many are now being taxed largely on the revenue

they receive rather than the profit. In addition to that, there is a 3% stamp duty surcharge, which is a disincentive to buy. Landlords' costs have gone up and it has become a less attractive investment as a consequence, so there is a shortage of property in the private rented sector.

Q71 **Dame Angela Eagle:** Zoopla has done an analysis of the rental market, which shows that rental demand, if you compare it to a five-year average, is up 51%, the stock of homes available for rent is down 33%, and the flow of new supply is down 9%. Rental growth, or in other words the cost of renting, is up 11%, which is running well ahead of wage increases, especially for young workers who have moved away from home but cannot afford to get on the housing ladder and/or are low paid.

To what extent is housing benefit subsidising some of this increase? Has anyone done any analysis of how many renters are relying on housing benefit?

Nigel Terrington: There is a component of the private rented sector that is basically a form of social housing. If you look at the distribution of the types of tenants, probably around 20% of the whole of the private rented sector is in that category.

You have tended to find, though, that that has become less significant in recent years because there has been a freeze on the local authority housing allowance that is available. It has become a less significant component as a consequence. If there is one thing that it would perhaps be useful for the Government to look at, it would be to unfreeze that.

Q72 **Dame Angela Eagle:** It is just more public subsidy of private renters buying extra properties, is it not?

Nigel Terrington: I understand that point, but the issue is that those tenants have to compete with the private sector tenants. If there is no real council house alternative, then that is their only source. Without changing the whole structure of the private rented sector, there is a direct impact, because those social-focused tenants find it a struggle to compete with the private sector.

Q73 **Dame Angela Eagle:** Finally, on average rents for new lets rather than average rents overall, with volatility and price rises going up, new rentals are clearly going to cost more, with the lack of supply that the figures I have just read out imply. Average rents for new lets have increased by 11.1% in the last 12 months, but earnings have increased by 6.7%, and less in the public sector. That is putting an enormous squeeze on those in the rental sector, is it not?

Nigel Terrington: Yes, I agree with you. It is running ahead of inflation. It is running ahead of wage growth but, as I said earlier, there are cycles to this. There are leads and lags.

Q74 **Dame Angela Eagle:** When are you expecting it to even out then? There

is not a lead, is there? There has just been rather a long lag.

Nigel Terrington: Yes. If you look at the rental inflation in the last few months, it has not shown much in the way of a step up. One suspects we might be moving to a point where you start to hit affordability constraints of tenants, in which case it does not matter what think you want to do as a landlord; there will be no real capacity to increase rents.

Q75 **Dame Angela Eagle:** You might then just sell up. Then you reduce the size of the rental market and still do not help those who cannot afford to get on the housing ladder to have anywhere to live.

Nigel Terrington: I agree, and so the fundamental thing is that we need more supply into the sector.

Dame Angela Eagle: Or more social housing.

Q76 **Danny Kruger:** I want to dig a little deeper into the structure of the mortgage market. Dame Angela mentioned the high costs of mortgages in the UK compared to some European countries in particular but, as we have also discussed, there is a real difference in the length of mortgages that people have.

I have a helpful graph here showing how much of an outlier the UK is. Only Ireland seems to be comparable in the proportion of fixed-rate mortgages that are so short term. Only 10% of mortgages are more than five years in this country. Poland seems to have 100% variable; Finland has well over 90% variable, or at least more than 10 years, and that is a pattern across the continent.

This is a question for anybody. I am interested in general thoughts, so just jump in. It has been observed how little take-up there is and how little demand there seems to be for longer-term mortgages. Can anybody explain to us why we have that syndrome in the UK, whereas in Europe it seems to be a different trend? Who wants to explain?

Andrew Asaam: We have been asked this question a number of times about long-term fixed mortgages and why there is no appetite. We survey customers regularly to see whether there would be more appetite. Every time we ask the question, customers come back and tell us about the desire for flexibility and the preference for the shorter-term products. It is potentially due to the fact that taking a shorter-term product would have been the right thing to do over the last 10 or 15 years as interest rates trended down.

Whether that changes as we move through this cycle, we will need to wait and see, but the market for 10-year fixes, before we even think about 15, 20 or 25-year fixed, is around 1% or 2%, so low single digits. That reflects, again, the feedback we get from customers every time we survey them on what their preferences are for mortgage products.

Q77 **Danny Kruger:** Interest rates have been low around the world in the last 10 years, so does that account for it sufficiently?

Nigel Terrington: It is a product of the way in which mortgages are funded in the UK. I did a lot of work on this many years ago looking at what could be done. Part of the issue is that probably the easiest comparison is the United States, where the market is dominated by long-term fixed rates.

When you have a mortgage, you have a clog on the equity, as it is called. Sorry, it is maybe a bit of a legalistic phrase, but it basically means that, as the homeowner, you have a right to redeem your mortgage at any time.

Q78 **Danny Kruger:** It is a ban on early repayment charges.

Nigel Terrington: Yes. There might be some compensation there, but, in the United States, let us say you have a 25-year fixed-rate mortgage at 3%, and rates then go up. No one redeems their mortgage. They stay where they are. They might port it to another house, but their mortgage stays where it is. If the inverse happens and rates come down from a high level, everyone redeems.

Who carries that risk? As banks and building societies, we want to hedge ourselves to protect that interest rate risk. In the United States, there is a price added. It is known as the option-adjusted spread. It is a couple of percentage points added to the interest rate.

Now, if you are offered the opportunity to have a 3% fixed rate for five years or a 25-year fixed rate for 5%—so 2% higher—customer demand is such that there is very little take-up for the higher interest rate. It has been tried by a few banks in the past with significant failure to attract any interest. Like Andrew has said, it has been looked at a number of times in the past. The structure of the way mortgages are funded in the UK is the dominant feature.

Q79 **Danny Kruger:** That is a consequence of regulation the US has and this essential protection against early repayments. Is that something we should be considering here? Do you think that would help?

Nigel Terrington: Some 80 years ago, the US created Fannie Mae and Freddie Mac, which facilitated the ability to create what is essentially a Government guarantee that sits behind the mortgage. The mortgage is then packaged in securities and traded, so it is traded and looked at equivalent to the US treasury or the UK gilt. If you want to create that, then that is another factor, but it has taken them 80 years to get to where they have got to today.

Q80 **Danny Kruger:** To go back to your eminently comprehensible point, consumers have concluded that rates are low and trending downwards over the last 10 years, so why fix yourself for too long? What goes down must come up. We all recognise that and we are seeing it now, but consumers have presumably been persuaded that rates are going to be low fairly indefinitely.

I appreciate that you do not advise households yourselves, but brokers do. Can anybody tell me what they think of the role of the brokers in advising borrowers to stick to the short-term fixed rates? Do they have a role in this? Have they been doing their job right over the last 10 years?

Bradley Fordham: Brokers fulfil a really important role in the market. At the moment, we see what is most important to customers, and it will depend on their situation. As an example, if you are a first-time buyer or you are moving property, it may be that the most important thing is how much you can borrow rather than the actual rate that you pay, within reason, of course. For a customer who is refinancing, coming to the end of their mortgage product and wanting a new product, it is predominantly going to be about price.

To Andrew's point, what we have seen historically is that, when there have been 10-year fixes in the market, for example, they have been more expensive than shorter-term fixes. Therefore, customer advice has been centred around, "What is the cheapest for me now? I want certainty for a period in time, but I also want some flexibility, and I want the best deal in the market." That has primarily driven it. In the future, if long-term fixes were cheaper, then that might drive a different demand, but customer demand currently is certainly for shorter term and flexibility.

Q81 **Danny Kruger:** I recognise that. I am just thinking about the brokers. Presumably, they are incentivised by their own funding model to prioritise turnover or the rates of change of people re-mortgaging. Do you not think that there is a structural incentive for them to encourage people to take short terms and then re-mortgage, and that they would do better that way?

Bradley Fordham: In terms of a procuration fee that lenders pay to brokers, it is the same amount, irrespective of the length of the product, so there is no incentive to get paid more. From an advice perspective, there are clear guidelines applied by the regulator to ensure that it is a good outcome for that customer and fits their circumstances for this moment in time. If that customer needs or wants flexibility, as well as some certainty of payment, then the broker will give that appropriate advice.

Q82 **Danny Kruger:** Ms Harrison, you said that you were offering 10 years, but not at the moment. Is that right? Is there any reason in your business, other than that you just do not see the demand for it, that you should not be offering longer-term deals than you are currently? Is it purely that customers are not asking for it?

Charlotte Harrison: It is demand-led. We do not see the take-up. Equally, with peaks and troughs in terms of rate cycles and what that could look like, customers, as Bradley has just said, are actively choosing against that. They want the cheapest deal available to them, so it is demand-driven.

Q83 **Danny Kruger:** Okay, so it is not your own fear of volatility in future

rates that means that you are keeping to short term.

Charlotte Harrison: No, because with our fixed-rate pricing we hedge against the interest rate risk, hence the cost in terms of fixed-rate mortgages.

Q84 **Dame Angela Eagle:** I just wanted to come back to Mr Terrington. You were saying that a majority of people who own rental properties do not have a mortgage on those properties, but of course they probably put the rents up at the same rate as those who have a mortgage on their properties, since there is a market. Are they not making a lot of money without having extra costs?

Nigel Terrington: They are subjected to the same, more general cost increases whether they have a mortgage or not. Again, I come back to that point. There is a significant shortage of supply of properties into the sector, and in many places it is acute.

The student market is a particular area that we should be concerned about, because there is clearly a regular supply of students coming through year in, year out. There is a bed shortfall, as it is measured, of something in the order of a couple of hundred thousand. It becomes so acute that we have heard talk of some universities reducing the intake in order to cope with the accommodation problems.

I genuinely think that there is a supply issue into the private rented sector, driven by a number of facets, which I highlighted earlier. It is a bit like any other industry. Reading now about the costs of aviation, the cost of going on holiday is going up dramatically because there is a shortage of flights and staff to be able to deal with it. The hotel industry is having the same problems. The restaurant industry is closing on certain days because it does not have the availability. The supply chain has been disrupted in a number of markets; that still exists, and it is happening in the private rented sector.

Q85 **Douglas Chapman:** What are your economists telling you about the longevity of higher interest rates and whether this is going to have a long-lasting impact on the UK economy? It seems to me that we are looking out maybe 24 months or something like that and hoping that all will go well, but there is no guarantee that that will be the case. We could be in this cycle for a good number of years. Are you guys picking up any projections that we, as a Committee, should be concerned about in terms of our linkages with the Treasury?

Henry Jordan: The market-implied view would be that the base rate gets to about 6.5% and then reduces to maybe just under 4% over the next couple of years. That would feel like it does not lead to a long-term impact of high interest rates. I would say there is a lot of uncertainty, though, around exactly what path interest rates will follow going forward.

Q86 **Douglas Chapman:** Are there any outliers on that? You are following the party line as regards the outlook for the economy.

Charlotte Harrison: Yes, that is what our projections look like as well. The base rate will rise up to the end of the year and then, in the longer term, potentially will fall back moderately. We are not expecting that it will go back to what we have seen in 2021-22 in the immediate future.

Nigel Terrington: The market is expecting interest rates to rise further from here, stay up at that level, and then come down. If you look at the swap market as an indicator for that, so the five-year fixed rate today and then the market's estimate of what the five-year fixed rate will be in five years' time—sorry, it gets a little technical in parts here—that is suggesting that rates will be 1.75% lower in five years' time than they are today. That indicates that up, across and down movement.

The economists all have the central thesis here, but the issue is whether it is overdone. When I look at some of the data, the producer price index has fallen rapidly. The consumer price index is struggling to fall, but it usually does; it just lags. It would then play into the expectations and the hope of the Governor and the Treasury that the inflation figures will come down quite sharply from here.

The market has become quite sceptical of believing whether this will happen, but, if it does, then the market will start to look at whether it is overdoing the interest rate expectations. That has to happen, because it clearly has not happened yet. If it follows the path of PPI converting into CPI, then that is inevitable, but it is the second half of this year and more into next.

Q87 **Anne Marie Morris:** Mr Terrington, on buy to let, you are consistently saying, in answer to our questions, that the problem is that the market is shrinking. Therefore, we do not have enough properties available to rent, the consequence of which is that, inevitably, rent goes up.

What might the Government do differently? Do you think it was a bit of an own goal to change the tax regime so that those in that sector as landlords are effectively now paying not on profit but on turnover? Do you think that, if there was a change there, that would make a difference, given that we cannot suddenly create the new houses and build them overnight, which clearly would be a much more socially acceptable answer? Would that be a way forward? What impact has the Renters (Reform) Bill had on this market?

Nigel Terrington: The first thing about the tax changes is that they were announced in 2015 and then phased in over a number of years. For some landlords, it has the effect, as I said earlier, of being taxed on revenue and not profit. The consequence of that is that, despite the fact that you could have a theoretical profit, you are paying more tax than you are earning, which is a strange situation for people to be in.

The 3% stamp duty surcharge also acts as a disincentive. Both of these are disincentives, and they compound with the additional costs that have come into the sector. I am less concerned, because it is good that the

standards in the sector are lifted. We all support the raising of standards in the private rented sector, and we have been very supportive of the Renters (Reform) Bill. In fact, we engaged with the Department for Levelling Up, Housing and Communities as that was being converted into a Bill. As I said, we are supportive. We are supportive of the changes to section 21 and section 8.

There are two things that we are still concerned about. One is on the court process. If you want to go through an eviction process, under the Bill you now have to go to court. The Government have promised that they will change the court process to deal with this, but we know that the court process is already quite full. Therefore, we are nervous about whether there will be enough capacity to ensure that it will not overload the court process, with massive problems that happen as a consequence.

The second point goes back to the student market. At the moment, if any of you have gone through the process of having a child at university, they want to book up their following year's residence a long way in advance, so up to a year in advance. That is great for landlords, because they then get a commitment 12 months forward.

Under the current Renters (Reform) Bill, current tenants only have to give two months' notice. If that is two months before the end of the final term, so maybe in April or May, then that is not long enough for a landlord to find a tenant for the following year, in which case they cannot market their property as being available. They might find themselves without a tenant, and then suddenly there is almost a free-for-all for students trying to find property right at the end of the term. We have discussed it with the Government. They have acknowledged that this may need to be reconsidered, but it is a very real issue that needs to be resolved before the Bill converts into an Act.

Q88 **Andrea Leadsom:** Coming back to consumers once more, in a previous hearing, Charlie Bean talked about the idea that the pain of rising interest rates would be taking a longer time to come through because so many people are on fixed-rate mortgages now. He had a slightly alternative view, which was that, in fact, people will plan ahead. Even if your fixed-rate mortgage does not expire for two or three years hence, it will still affect your day-to-day spending.

Mr Asaam, I know you said that you are contacting customers six months before their mortgage ends, but I just wonder if any of you have a view on that. Is he right? Are you already seeing changes in behaviour, or are people going to think, "I just hope that interest rates will come down"?

Bradley Fordham: It is difficult to know and to predict the future, but what we are seeing anecdotally is customers overpaying. More are overpaying. They are already starting to look forward and think, "My deal is coming up in maybe 12 months' time. It would be better for me if I have some savings to be able to pay down my mortgage." We are definitely seeing that.

We know from the conversations we are having with customers that they are thinking about that. Customers have two years left on their deal and ask about their options. Customers are thinking. I am not sure we yet have the evidence to see what they are acting on, but customers are definitely thinking about that. We are having those conversations. Customers are concerned about what borrowing costs might be in the future.

Chair: Thank you very much to our witnesses. It has been a very interesting session. I know there is a high level of interest from our constituents in the evidence that you have given today. It is fair to say that, in addition to our register of interest, many of us MPs are paying mortgages. After today's evidence session, I just wondered if any of my colleagues want to draw attention to anything in the evidence, going beyond the register of interest, and make any statements about any interests they may have.

Andrea Leadsom: Just for the record, I have a mortgage with my husband. My husband and adult children have a small buy-to-let business.

Chair: I have a five-year fix at the moment.

Anne Marie Morris: I have a mortgage and a buy-to-let mortgage.

Chair: As you can see, it is something that really touches on so many people. We have been very grateful for your evidence today. One of the things that surprised me about your evidence is that you sound quite calm about the quality of your book of mortgages, how your customers are prioritising everything in terms of making sure that they pay their mortgages, and that you are not seeing a particularly marked spike in arrears.

It has been a very interesting and timely session. We are very appreciative to you all for your time.