
Breaking the chain

# It's time to liberate mortgage prisoners and future proof lending

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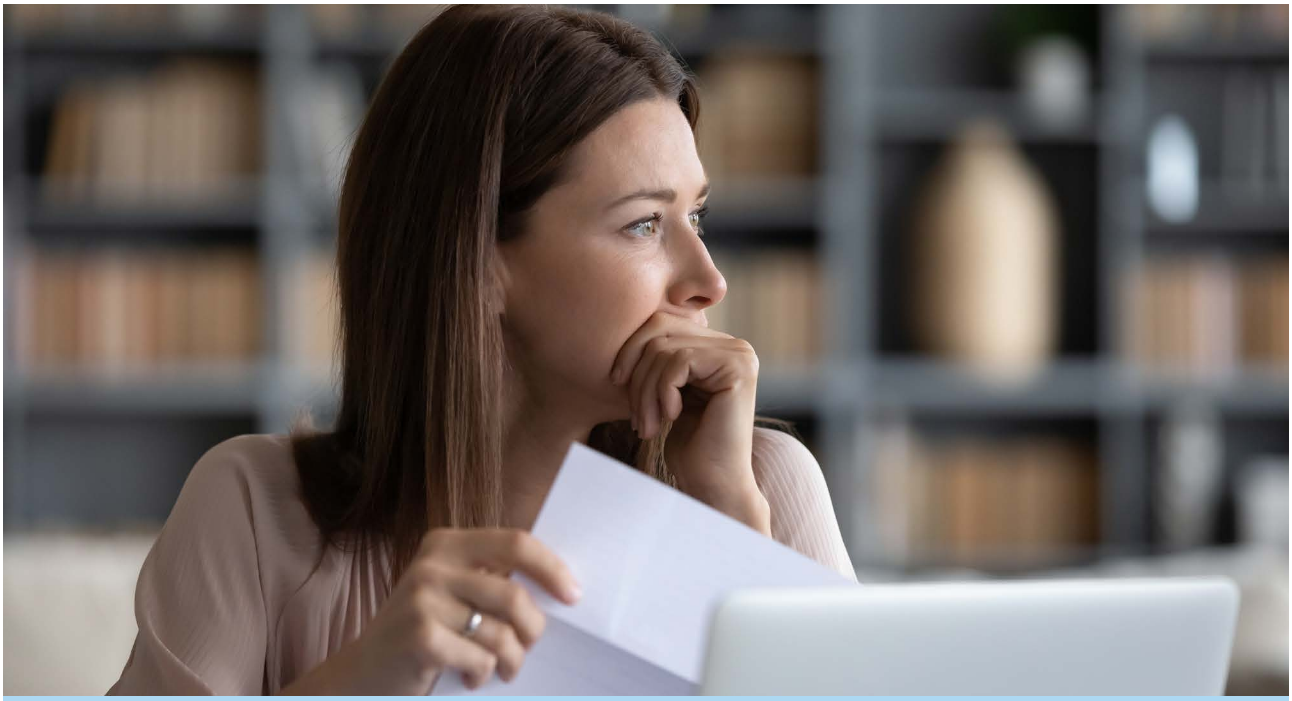
# 'I lie awake at night, and I'm petrified all the time.'

That's the view of just one of **47,000** homeowners stuck in costly mortgages they can't escape. These homeowners are facing unprecedented financial pressure and stress. They borrowed from lenders who went bust or stopped lending after the 2008 crisis. **Many are trapped into paying 8% interest or higher.**

## They are the mortgage prisoners.

(Source: The people trapped paying 8% interest on their mortgages | moneysavingexpert.com)



# Understanding mortgage prisoners

**In recent years, the term "mortgage prisoners" has become all too familiar in the UK housing market. But what exactly are mortgage prisoners, and why is this issue becoming a growing concern?**

A mortgage prisoner is someone who has become trapped in their existing mortgage deal. These individuals are unable to switch to a better deal, even though they're up to date with their payments. Typically, this is because they're with a lender who no longer lends, they have negative equity and/or may have been in arrears previously.

It's a complex issue influenced by economic conditions, government policies, and the regulatory environment. Mortgage prisoners have been penalised through no fault of their own and instead by the impact of irresponsible lending, which took place before the 2008 financial crisis, and then the measures which were put in place post the crisis.

Mortgage prisoners were dealt a further blow in April 2021, after the government rejected an amendment to the Financial Service Bill which would have capped interest rates for those whose mortgages were with 'closed book' or zombie lenders. Or those who no longer offer mortgages to new customers.

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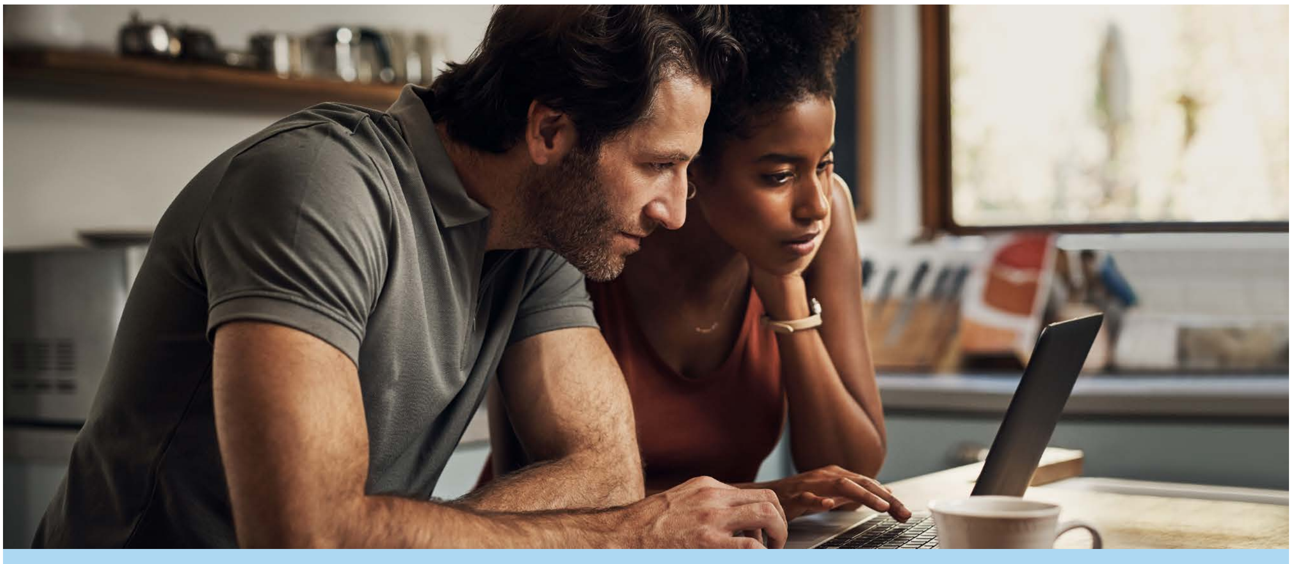
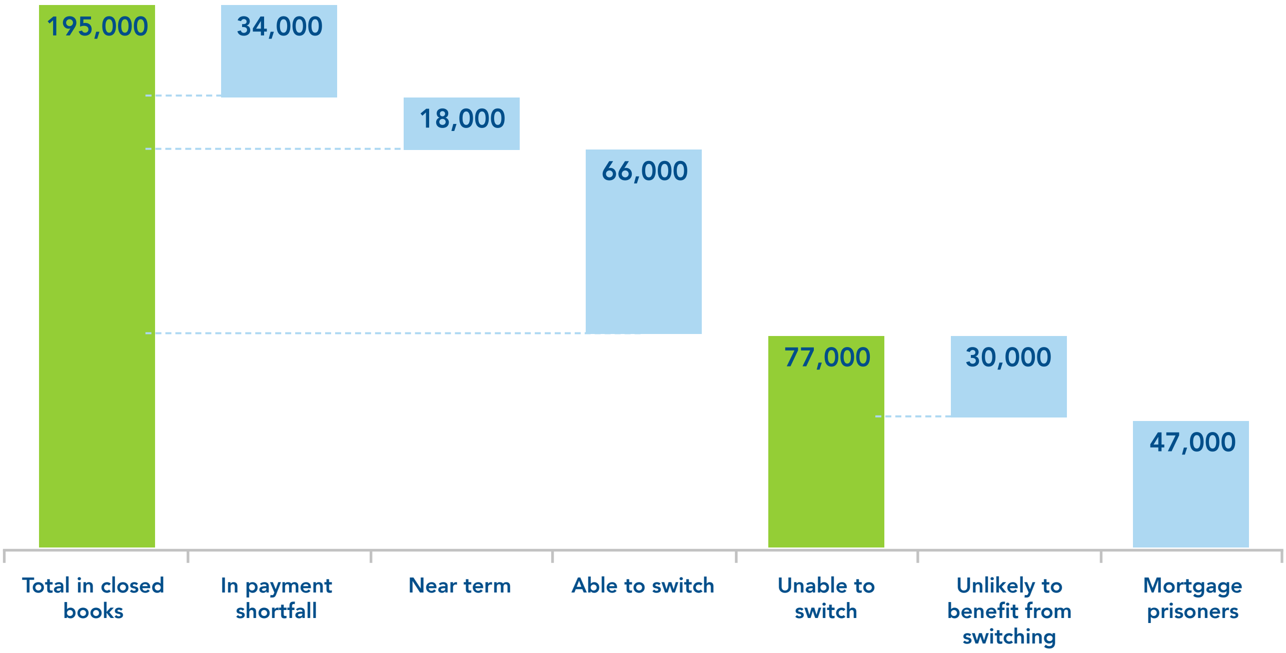


# A sizeable minority

In the definitive Financial Conduct Authority (FCA's) Mortgage Prisoner Review, published in 2021 they predicted of 195,000 borrowers who have mortgages with a closed book or inactive lender, 47,000 were potentially mortgage prisoners[1].

Many industry experts dispute this figure as being much higher. The below shows how the FCA arrived at their estimate of mortgage prisoners.




**Closed book mortgages and mortgage prisoners**
(Source: FCA | Mortgage Prisoners Review)

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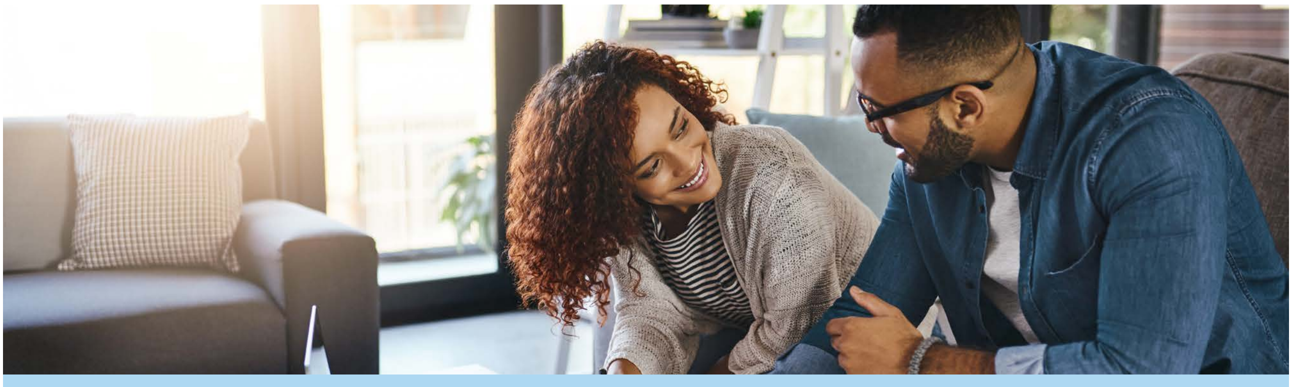

The UK Mortgage Prisoners campaign group claims there are around 250,000[2] mortgage prisoners, while Money Saving Expert suggests the number is 200,000[3]. It's important to note that each of the above use different methodologies to arrive at their figures as follows:

### FCA

**Define mortgage prisoners as borrowers who are unable to switch to a more affordable mortgage deal despite being up to date with their payments.**

The FCA uses data from regulated and unregulated firms to estimate the number of mortgage prisoners and applies its modified affordability assessment to determine who is eligible to switch under its new rules.

### UK Mortgage Prisoners Group

**Define mortgage prisoners as borrowers who are trapped in high-interest rates with lenders who are either inactive or unauthorised.**

The group uses data from its own members and other sources to estimate the number of mortgage prisoners, and advocates for a cap on SVRs and a fair and transparent process for switching.

### Money Saving Expert

**Define mortgage prisoners as borrowers who took out a mortgage before 2008, when lending rules were more relaxed, and are now unable to switch to a cheaper deal because they don't pass current strict affordability tests.**

They use data from their own surveys and other sources to estimate the number of mortgage prisoners, and campaigns for more flexibility and support from lenders and regulators.

Whichever figure you look at, the fact remains that many people are facing real hardship, and unable to switch to the very product that could help alleviate their financial struggles.

Tightening of lending criteria after the financial crisis, the sale of mortgage books to unregulated firms, the lack of competition in the mortgage market, and the impact of the coronavirus pandemic on incomes and employment have all impacted on the rising number of mortgage prisoners.

The problem has been compounded further by the continuing cost-of-living crisis. With 800,000 households set to roll off teaser rate deals in the second half of this year, and a further 1.6mn due next year, in 2024[2], the impact of higher rate products is set to create more financial pressure.

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# A chain reaction

## The financial crisis of 2008 was the match that lit the touchpaper for homeowners and those looking to get onto the property ladder. We've identified the seven main factors that contributed to the emergence of mortgage prisoners:

### The credit crunch

Banks and financial institutions became more cautious about lending. Making it harder for homebuyers to secure mortgages. This was particularly true for those with less-than-perfect credit histories, and low deposits, as well as the self-employed and flexible workers.

### Interest rate rises

The crisis led to a general decrease in interest rates as central banks attempted to stimulate economic activity. While this initially made mortgages more affordable, the overall economic uncertainty led to job losses and reduced income for many.

### Falling house prices

The crisis led to a decline in housing prices in many parts of the UK. This meant that some homeowners found themselves in negative equity. This situation made it challenging for individuals to sell their homes or refinance their mortgages.

### Subprime mortgage fallout

Though not as common in the UK as in the US, there were still cases of high interest mortgage products being offered to borrowers with weak credit histories. Some of these borrowers faced difficulty in meeting their mortgage payments, leading to higher default rates.

### Bank failures and mortgage availability

The financial crisis saw the collapse of several major banks and financial institutions. These lenders included Northern Rock and Bradford & Bingley. Borrowers had their mortgages sold on to providers that didn't offer new deals – leaving them trapped on high interest rates and unable to move to a cheaper product.

### Regulatory changes

In the aftermath of the crisis, there were significant regulatory changes aimed at preventing a similar crisis in the future. These changes affected how mortgages were underwritten, making lending criteria stricter and potentially excluding some borrowers who would have been approved before the crisis.

### Mortgage repossessions

The economic difficulties faced by many individuals because of the crisis led to an increase in mortgage arrears and repossessions. Some homeowners struggled to make their mortgage payments, leading to repossession proceedings in some cases.

Many homeowners who took out mortgages before the crisis found themselves unable to switch to a new deal even if they met the criteria for a new mortgage.

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# The regulatory burden

**The Financial Conduct Authority issued a response to the crisis in 2014[3] in their Mortgage Market Review (MMR).**

The MMR required lenders to conduct a more comprehensive stress test for current and future affordability which extended far beyond the previous salary-based mortgage calculations. Now, lenders had to make a more detailed assessment of a borrower's overall financial situation that included:

- Credit report and credit score
- Employment history and proof of regular income
- Account balance over a set period, including unusual deposits, income, or outgoings
- Savings, and if regular savings were made
- Whether individuals lived within their means or consistently used an overdraft
- What they spent money on, e.g., lottery, holidays or regular outgoings, e.g., rent, childcare, memberships or school fees
- Other credit commitments, e.g., loans, credit cards, hire purchase agreements or other regular outgoings, e.g., Sky TV, Netflix
- Introduction of mandatory mortgage advice, unless the customer proceeded on an execution-only basis.

Crucially, lenders had to apply a stress test of affordability. As well as having enough disposable cash to meet mortgage repayments, borrowers had to show payments could be met at a higher interest rate (usually 7%) within the first five years of the mortgage.

Interest-only mortgages were allowed in certain situations, but only where there was a "realistic and credible strategy for repaying the capital". Lenders wouldn't take income from the sale of the house as a viable repayment option.

The criteria applied to remortgages too. So many people who were previously considered good borrowers failed to meet the new criteria.

## The upshot?

Customers could not switch lenders, even if the new deal offered more favourable terms and lower payments, creating trapped borrowers. For the lender that also increased the risk of growing mortgage arrears.

# The pandemic effect

**Of course, the global crisis was devastating and impacted lives in a way we haven't seen for generations. Freedoms were removed and families estranged as numerous lockdowns were enforced.**

The pandemic did bring other changes which were more positive, namely a change in how and where people worked, transforming the world of work forever.

As working from home became the norm for non-essential workers, people saved considerable money on the daily commute. Lockdowns also reduced spend on hospitality, leisure, and holidays.

Interest rates were reduced to an all-time low, resulting in borrowers being offered very affordable mortgages.

With the extra cash, first-time buyers were taking the next step on the ladder and missing a wrung. They moved from renting in cities to buying in the suburbs, going straight to a family home. They worked from anywhere while still maintaining the city and London salaries.

There was a bit of a boom. In fact, recent research by Halifax found that house prices grew 20% during the pandemic. With the average UK house price increasing by £48,620 to £286,515, between January 2020 and December 2022[4].

**Homeowners were lulled into an artificial and temporary sense of security. Many mortgages taken out in these times are now unaffordable.**

# Interventions, well intended but are they enough?

## The UK Government and the Financial Conduct Authority (FCA) recognised the issue and introduced changes to the 'Responsible lending rules and guidance[5].

The aim was to help mortgage prisoners switch to new mortgage deals by removing barriers to switching to more affordable options. The key changes are:

- Mortgage lenders can choose to carry out a modified affordability assessment ('modified assessment') where the consumer:
  - Has a current mortgage
  - Is up to date with their mortgage payments
  - Does not want to borrow more, other than to finance any relevant product, arrangement, or intermediary fee for that mortgage
  - Is looking to switch to a new mortgage deal on their current property.
- Inactive lenders, and administrators acting for unregulated entities must review their customer books and develop and implement a communication strategy
- Mortgage lenders that use the modified assessment must tell consumers the basis on which affordability has been assessed?
- Mortgage lenders are required to report which sales have involved the modified assessment when they submit Product Sales Data (PSD).

A step in the right direction certainly, still the process remains complex and slow, and the FCA rules only apply to a limited number of mortgage prisoners.

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# The Mortgage Charter

On 26th June 2023, the UK Government introduced The Mortgage Charter, in collaboration with UK Lenders, the Financial Conduct Authority, UK Finance and The Building Society Association amongst others.

The charter set out to provide a set of principles and guidelines for mortgage lenders to adopt in response to the cost-of-living crises. The charter intended to make the mortgage process transparent and fair.

## Key principles[6]

- Borrowers worried about meeting mortgage repayments can contact their lender for help and guidance
- Any contact will not adversely impact customers' credit file and we would encourage you to contact your bank who are there to help
- Customers who are up-to-date with payments are supported to switch to a new mortgage deal at the end of their existing fixed-rate deal, without another affordability check
- Lenders will provide well-timed information to help customers plan should their current rate be due to end.
- Lenders will offer tailored support for anyone struggling. This could mean extending their term to reduce their payments, offering a switch to interest-only payments, as well as a range of other options
- Lenders have agreed that repossession is only considered as a last resort or when it's in the financial interests of the borrower

**The principles bring added complexity for lenders and brokers who may not have the infrastructure, resource, or technology stack to support these interventions.**

# Consumer Duty

Consumer Duty came into force on 31st July 2023. The Duty requires firms to act to deliver good outcomes for retail customers.

The rules set out further rules which mortgage lenders had to follow. The goal was to provide further support to customers. The principle of the Duty was the requirement for:

> Firms to act in good faith towards customers, avoid causing them foreseeable harm, and enable and support them to pursue their financial objectives

**Firms also had to consider the diverse needs of their customers – including those with characteristics of vulnerability.**

# A ticking time bomb

## The Bank of England (BoE) has put up interest rates 14 times since December 2021, driving up borrowing costs for millions.

Though in June 2023 inflation slowed to 7.9%, it's still almost four times higher than the Bank's official 2% target and the UK are in the unenviable position of having the highest rate of inflation in the G7.

By increasing borrowing costs for consumers, mainly on mortgages, the theory is it reduces the amount of disposable income left to spend on other goods and services, lowering demand and reducing firms' ability to raise prices. However, bringing down inflation is not enough, and unsecured lending has increased, spending has not been curbed as expected.

**It could be time for the government to consider a new tax strategy.**

Recent research from the Office of National Statistics (ONS) found that over a fifth of adults in Great Britain (22%, equal to around 11.5 million people) reported borrowing more money or using more credit because of the increased cost of living between 25th January and 5th February 2023[7]. That's up 17% year on year.

Half a million borrowers this quarter have their mortgage rates up for renewal. Under the MMR, lenders stress-tested interest rates as an industry; but crucially we didn't stress-test against:

- Prospect of rising gas and energy prices
- Increase in the Consumer Price Index (CPI) as a result of political unrest
- Supply chain issues.


# Short term solutions for long term problems

**We've seen the introduction of six-month payment holidays, a great short term reprieve but what happens when they end? The financial outlook doesn't look like it will drastically improve in the short to medium term.**

Struggling borrowers may be able to offset some of the pain through mortgage term extensions, but what will happen during this extension, interest will still accrue so should this time be used to help sell?

**Interest only options again provide breathing space, but are they kicking the can further down the road?**

We can't assume the situation will improve in six months or a year. By extending the mortgage term, customers will ultimately pay more than they could or should. With rising bills, there will be customer detriment. This is also impacting savings and the ability to plan.

As stress tests are based on current affordability, they could harm consumers in the long term. People could be credit-worthy now but unable to access the best rates due to inflation. Though stress test rules have been relaxed recently, this hasn't been recognised by all lenders; many still choose to adhere to this in line with their credit risk appetite.

There's also the massive risk of negative equity in the housing market. And it's not just first-time buyers who are affected. Equity release loans among the over-60s rose 28 per cent from £4.1bn in 2021 to £5.2bn last year according to the Financial Times[8]. **The Bank of Mum and Dad is no longer a dependable option for first time buyers.**

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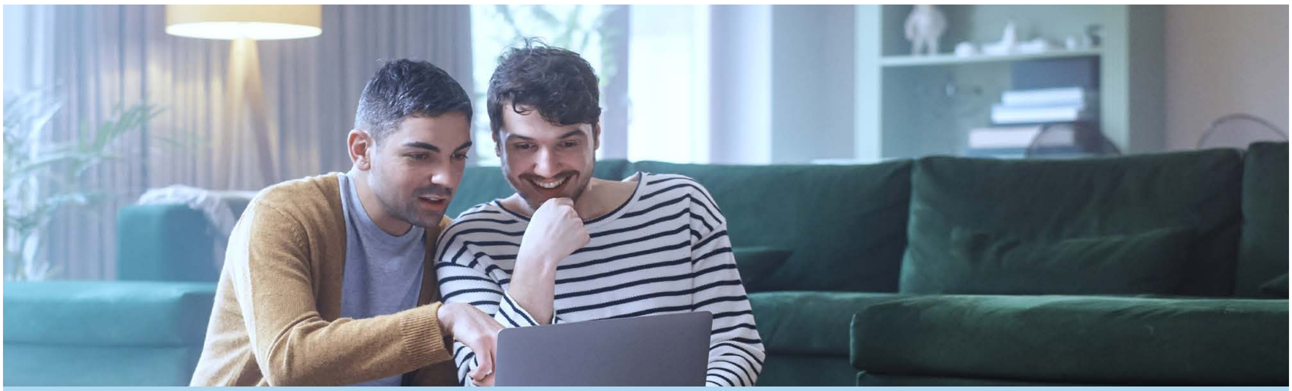

# A novel approach

Unfortunately, there's no quick fix. We welcome Government, Regulator and Trade Body interventions to date. In some cases, the methodology applied, like raising interest rates has been used before successfully.

## But we're in very different times.

The cost-of-living crisis and complex economic pressures are set to continue for some time. Doing the same thing will get the same results. We need something more inclusive and long term sustainable.

It's clear that the UK needs to develop better affordability assessments and stress test against market instability.

This can be achieved by utilising a wide range of data sources, APIS and economic modelling.

We must look at collaborative efforts between banks, credit unions, and specialist lenders to provide more accessible refinancing options.

**It's also time to explore innovative financial products and services.**

## It's time to consider a new approach and novel ideas like these:

### Extended mortgage guarantee schemes

These guarantees can be government-backed, like Homes England's 'Help to Buy' scheme or provided by private entities. These help to mitigate risk for lenders, making them more willing to offer mortgages to borrowers with smaller deposits or less-than-perfect credit scores.

### Prioritise housing

For six years the government has had a target to build 300,000 new homes a year – a target they've never met. We now need more wholescale changes with both housing stock and availability. The next government needs to make some difficult decisions, to put housing right at the centre.

## Longer term mortgage deals become more accessible

Offering mortgage terms of over 30 or 40 years, like in the US. This longer term mortgage is perfect for young lenders to help them on the property market and throughout the lifetime of the mortgage. HSBC is one lender that has recently increased its maximum mortgage length from 35 to 40 years for all customers. Kensington Mortgages also offer 40-year mortgage terms. We hope this move encourages more lenders to offer extended mortgage terms.

## Fund non-bank platforms

As a result of the crisis banks have become risk-averse, making it harder for borrowers without savings and a high deposit to get a mortgage. New challengers and non-bank players are stepping up to fill the gaps. These include peer to peer lending, insurance companies or pension funds. Research from Wall Street Journal[10] shows that in the US 68% of mortgages were originated by non-banks in 2020.

To successfully implement innovative mortgage approaches, the UK must consider local market dynamics, new and existing regulations, consumer protections, and long-term sustainability. Learning from international examples while tailoring solutions to the UK's unique circumstances could contribute to a more diverse and inclusive mortgage market.

## The technology enablers

Harnessing technology can significantly enhance the way lenders support mortgage borrowers with future applications. Making the process fair, accurate, transparent, and traceable. Open banking has been a game changer in financial services and particularly so for borrowers and lenders. It provides real time affordability assessments with Open Banking APIs making sure current and future affordability is based on accurate real time data.

## Reduced deposit requirements and return to a Loan to Value (LTV) of 95%

According to Statistica. The median loan-to-value ratio in the United Kingdom for sales from 2016 to 2022 was approximately 69%[9]. Homebuyers had to find an astronomical 29% deposit, pricing first time buyers out of the market. We need to support people trying to get on the ladder with a much more achievable and affordable deposit value.

This is especially true as interest rates hikes and inflation rises combined with the cost of living crises has pushed up rents further, reducing the ability to save. More competitive LTV offerings are now hitting the market, which is great for first time buyers who can scrape together the deposit, often with the help of the 'bank of mum and dad' but now the cost of the mortgage itself has become unaffordable.

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# The path to liberation

## As we've seen, the issues effecting mortgage prisoners and borrowers are multiple and complex.

Mortgage prisoners are an acute symptom of a flawed system. The cost of living crisis, a national housing shortage and an ageing population bring further challenges.

The industry must stand up and work together to support mortgage prisoners and future borrowers. There needs to be continued consultation and collaboration between government bodies, regulatory agencies, financial institutions, lenders, fintech and advocacy groups. Lenders must innovate and look to new ways of supporting customers.

The drivers for change:

- Government incentives to support the creation of affordable homes, robust but fair regulation as well as a review of current economic policy and tax strategies
- A radical rethink of the conventional way of doing things. Consider novel approaches that have proved successful in other countries to develop a more sustainable, inclusive and diverse UK mortgage market offering
- A consistent and fair approach amongst lenders that's forward looking and not based on historical market conditions. One which doesn't penalise consumers due to external factors beyond their control
- An appraisal of current technology stacks and legacy systems. Harnessing technology to support customers at every stage of the application process, through the lifetime of a mortgage and to product switch or remortgage.

Target Group's revolutionary mortgage origination solution is one way in which we're helping today's lenders support tomorrow's mortgage borrowers. Mortgage Hub is a loan origination system that uses a state-of-the-art integrated decision engine, combining automated valuation models, open banking, and character recognition technology.

**It's the mortgage solution fit for the 21st century and it's revolutionising the application process for borrowers, lenders and brokers.**

**See it for yourself here.**

**Get in touch today to begin the conversation.**

## Sources

For more detailed information click on the links below.


1 Mortgage Prisoner Review | FCA
2 Mortgage Prisoners (ukmortgageprisoners.com)
3 I'm a mortgage prisoner, what can I do? | MoneySavingExpert
4 UK homeowners face huge rise in payments when fixed-rate mortgages expire | Mortgages | The Guardian
5 Mortgage Market Review (parliament.uk)
6 House prices grew 20% during pandemic | FTAdviser
7 Policy statement PS19/27.pdf (fca.org.uk)
8 Mortgage Charter | GOV.UK (www.gov.uk)
9 How are financial pressures affecting people in Great Britain? | Office for National Statistics (ons.gov.uk)
10 Equity release sales among over-60s jump by 28 per cent | Financial Times (ft.com)
11 Mortgage median loan-to-value (LTV) ratio 2022 | Statista
12 Nonbank Lenders Are Dominating the Mortgage Market | WSJ

### Katie Pender, Managing Director

Katie is responsible for applying her experience and Target's technical, operational and digital capabilities to drive disruption and innovation in the mortgage market, focusing primarily on enhancing customer experience. She has a wealth of mortgage market and outsoucing experience, often focusing on establishing new entrants in the mortgage market.

### Rosalyn Byrne, Marketing Manager

A Marketing professional for over 20 years. Rosalyn's executed go to market plans and delivered digital transformation for national and global businesses across media, retail, life sciences and financial services. An active member of the Chartered Institute of Marketing, she enjoys keeping ahead of the latest innovations and trends.

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Our team of experts will work with you to understand your complexities, unique customer needs, and key strategic goals. Only then will we start to explore the right solutions to help you unlock your potential.

**Get in touch today to begin the conversation.**