Variable mortgages make UK market more volatile, study shows

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Credit: Nottingham Trent University

Britain's property market is "highly volatile" because almost three quarters of homeowners are on riskier variable or short-term fixed rate mortgages, research by Nottingham Trent University shows.

A market behaviour study by Dr Alla Koblyakova, of the School of Architecture, Design and the Built Environment, has proven a relationship between mortgage choice and UK house prices.

It shows that lending trends towards the variable or short-term fixed rate mortgage contracts amplifies instability and raises house prices. According to the study, for every 0.75 per cent change in the UK market share of variable or short-term fixed rate mortgages, house prices go up or down correspondingly by one per cent.

The study raises concerns that the country's large volume of variable or short-term fixed rate mortgage debt – which puts borrowers at increased risk of financial shocks – is a major driver for instability in the market, and in turn the UK economy.

"This study provides empirical evidence that the prevalence of variable-rate or short-term fixed rate mortgage debt amplifies fluctuations in house prices in the UK," said Dr Koblyakova, who recently presented the study at the American Real Estate and Urban Economics Association conference in Alicante, Spain.

"The findings suggest that the structural features of the mortgage funding system, such as higher profit margins for lenders who provide variable rate contracts, is a major driver of this.

"The concern is that this leaves the UK, which holds 74 per cent of its mortgage debt in variable or short-term fixed rate contracts, extremely vulnerable to financial shocks, such as changes in monetary policy, house prices fluctuations and cuts in people's personal incomes."

The study – based on a sample of more than 2,000 mortgage holders between 2001 and 2014 – was taken from a range of sources including the Bank of England Data Archive, Nationwide House Price Index, European Mortgage Federation and Council of Mortgage Lenders research.

It shows that lenders are incentivised towards selling variable or short-term fixed rate contracts as they are more profitable and less risky for lenders because they protect them against financial shocks, such as increases to the base rate. This risk is instead left with the borrower.

The research also shows that lenders are more inclined to offer larger loan to value ratios under variable rate contracts, which can leave financially restrained borrowers with no option but to accept a variable contract in order to achieve the required mortgage size.

Dr Koblyakova added: "The upturn of this is that the most vulnerable borrowers are put at the highest risk. And the more people can borrow, the more demand for property increases, which in turn drives prices up.

"But the data also shows that if there was more securitisation – the practice of investors buying pools of debt as secured assets – then lenders become more inclined to offer better long-term fixed rate contracts, which can have a stabilising effect on the market.

"Following the global financial crisis, there is little evidence of securitisation being practiced in the UK today. But if practiced properly it could help control house prices, make them less volatile and protect the most vulnerable borrowers from future financial shocks."

Provided by Nottingham Trent University

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