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Britain: Mortgage drought as economy faces plunge into recession

Chris Marsden
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Britain's banks and building societies are clamping down on new mortgages against a background of rising home repossessions.

First Direct was the first to withdraw its mortgage service to new borrowers, but the Co-Op Bank has withdrawn its own two-year mortgage deals offering a lower rate of interest after "unprecedented" demand. It gave only five hours' notice that it was closing to new business.

The American investment bank Lehman Brothers, which trades as Southern Pacific and Preferred Mortgages, announced it was withdrawing from the British mortgage market altogether. The bank faces billions in sub-prime losses.

The Derbyshire building society had withdrawn its two-year fixed-rate deal at 4.99 percent, which had become the cheapest in the market. The Cumberland building society took the step of restricting its two-year 5.28 percent fixed-rate loan to people in its local area and the Bank of Ireland had withdrawn "virtually everything."

The withdrawal of services by First Direct and the Co-Op was due to what was described as "unprecedented demand," as other mortgage providers have hiked up interest charges for new and existing customers.

The Royal Bank of Scotland raised its variable-rate offset mortgage from 6.2 percent to 6.45 percent, and the Kent Reliance building society hiked its standard variable rate to 7.59 percent. Nationwide has increased some tracker loans by more than half a percent. It will, in addition, add a premium to its mortgage rates for those who need to borrow more than 75 percent of a home's value. Direct Line has scrapped all deals except for a two-year fixed rate and has upped its interest charges from 5.95 percent to 6.69 percent, adding £2,202 a year to the cost of a £200,000 loan.

The most potentially serious move was made by Britain's biggest mortgage provider, the Halifax, which announced it will increase its mortgage rates for those without a 25 percent deposit—affecting nearly a third of potential new customers. The move also affects the Royal Bank of Scotland and Intelligent Finance.

Nearly one-and-a-half million homebuyers were already facing steep increases in payments when their existing cheap-rate deals of around 4.5 to 5.5 percent run out this year. More than 3,800 people are coming off cheap fixed-rate mortgage deals every day.

According to information group Moneyfacts.co.uk, the number of mortgage products available has fallen by nearly 40 percent in the past month to 4,794—a decline from 7,726 at the beginning of March. More than 90 mortgage products a day were scrapped last week. The British Bankers' Association said that the number of mortgages approved for people buying a house in February fell by a third compared with February of last year.

No provider now offers the 100 percent mortgages previously available.

The *Times* reports that even borrowers with big deposits, high incomes and good credit records are being turned away, noting that Nationwide refused a mortgage request from a long-standing customer with 50 percent equity in his £1.4 million home, a six-figure income and a clean credit record. Ian Cordwell was rejected because he was a self-employed consultant, after leaving his job as managing director at a major insurer last year. Nationwide's lender for the self-employed, The Mortgage Works, has pulled out of the market.

Cheltenham & Gloucester, part of Lloyds TSB, has instructed brokers that borrowers who work in the City and whose income depends on bonuses are not to be trusted. If they have bonuses of more than £100,000, they should be referred to underwriters and must provide their bonus history for the past two years and details of any anticipated bonuses.

Increases in mortgage rates have wiped out the value of two interest rate cuts by the Bank of England in December and February.

The Bank of England revealed that new home loans slumped to a near 13-year low in February—73,000 were granted, compared with 120,000 in February of last year, a decline of 40 percent. Even so, the scale of the crisis is set to intensify as the credit-fuelled spending boom grinds to a halt and goes into sharp reverse.

The Bank's figures showed that consumer credit had its sharpest rise in five years to almost £227 billion. Unsecured debt, not mortgages, rose by £2.35 billion in February to its highest level since October 2002. This was due to a £2 billion surge in borrowing through loans and overdrafts, the biggest rise since figures were first collected in April 1993. Outstanding debt on credit cards has increased by £350 million.

The situation is compounded by the growing number of lenders who face negative equity. The 2.5 percent house prices fall in March was the biggest monthly decline since September 1992.

Estimates vary, but all predictions are for further substantial falls for the next two years. Liberal Democrat Treasury spokesman Vince Cable warned that 3 million households could fall into negative equity within a year and that there were signs that

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repossessions were approaching the levels of the 1990s recession.

"There are currently three million families—three million—who have loan-to-value ratios of properties in excess of 90 percent, the Council for Mortgage Lenders confirms that," he said. "If the numbers I have been describing, a 10 percent fall over a year, are to materialise, all of those families, by definition, will find themselves in negative equity within a year, and many are now doing so."

Although the actual number of repossessions was far below that experienced in the early 1990s, orders filed with courts—which is the first stage of repossession—were at a "comparable level to that of the last slump." The Council of Mortgage Lenders' latest figures show that repossessions reached 27,100 in 2007.

Howard Archer, chief UK and European economist at Global Insight, said he "currently expects house prices to fall by 5 percent in both 2008 and 2009," but "the current escalation of the credit crunch means that there is an increased risk that a significantly sharper housing market correction could occur."

A further warning of a sharp rise in repossessions was made by Ron Sandler, the executive chairman of Northern Rock, the bank whose collapse and subsequent nationalisation by the government was the first manifestation of the threat posed by the sub-prime mortgage crisis that began in the United States.

"House prices are declining in certain areas, and they may continue to do so," Sandler told Radio Four. "And certainly the prospects for growth in this economy are not as strong as they once were. In that environment one should expect that repossessions figures—not just for Northern Rock, but for all banks—will rise."

Sandler has said he wants to drive customers away to halve Northern Rock's business. It plans to shed a third of its workforce by 2011, about 2,000 jobs.

Northern Rock's annual report makes clear just how overexposed the banks are and the scale of the losses they could face. The run on the bank led to a massive outflow of £12.2 billion in retail deposits over the year, compared to inflows of £2.5 billion in 2006, and took out £24 billion in Government loans.

The annual report discloses that Adam Applegarth, who stepped down as chief executive in December of last year, is entitled to a £760,000 payoff and could still receive £63,333 a month until November 16 of this year under his severance deal. In addition, £75,000 of his mortgage will continue to be charged at the concessionary staff interest rate. In 2006, Applegarth's total pay package was £ 1.4 million, including a £660,000 bonus. He lives in a £2.5 million home outside Newcastle and has a pension fund worth at least £2.2 million from which he can start drawing at 55.

The mortgage crisis to a significant degree reflects a loss of financial confidence throughout the banking system, which massive interventions by the Federal Reserve and other central banks internationally have failed to stem. Libor, the rate at which banks lend to each other, and the Bank of England base rate used to track each other fairly closely. Now, however, despite two cuts in the Bank of England base rate to 5.25 percent, Libor has shot up to 6 percent. Those customers with money to deposit can command a higher rate of return than in the past.

The credit crunch is also hitting the corporate sector. Citigroup has cut more than half the 25 staff in its leveraged finance business, handling lending to companies with high debt, and Deutsche Bank and JP Morgan have cut 40 percent of their leveraged finance staff. Imperial Energy, a UK oil company, was last week forced to scrap plans for a debt financing because the rates demanded were too high. It was forced to resort to a US$600 million rights issue, at one point driving its shares down by 25 percent.

The billionaire financier George Soros has predicted that the City of London faces a severe recession, which will drag the UK economy down with it. He attributed this to overvalued houses, personal debt of more than £1.4 trillion and a rise in unemployment,

Soros warned not to expect a rebound in the near future, calling the crisis a "historic event like the Great Depression" that would bring an end to 25 years of free-market thinking.

"I think we have come to the end of the road," he said. "To say that it won't affect the real economy is untenable, because it affected it on the upside, so it will affect it on the downside. Recession in the US is inevitable. There will be implications for the globalised economy and the UK happens to be as vulnerable as the US, but in different ways. The finance industry is much more important to the UK because London is a financial centre and the industry is going through a painful process of deleveraging. The housing market in the UK has at least not seen the building boom that we have seen in the US and the supply of new homes has not gone up, but on the other hand, the indebtedness of UK households is actually even greater relative to income than in the US."

See Also:
UK government nationalises Northern Rock
[22 February 2008]

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