UK FINANCE

HOUSEHOLD FINANCE REVIEW - Q2 2023

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This review explores trends in household spending, saving and borrowing through the second quarter of 2023. As cost-of-living and rate pressures continue to dominate the headlines, we look in more detail here at how households are managing their spending and borrowing in the face of these pressures.

Q2 2023 HIGHLIGHTS

- Household confidence continued to recover towards levels seen before last autumn's mini-budget, and spending remained robust, with no sign that consumers are drawing back on consumption at this stage.
- The significant contraction in house purchase lending that started in Q1 continued in Q2, as cost-of-living pressures and higher interest rates have further raised the bar for affordability, limiting the ability of households to access mortgage credit.
- The rapid increase seen in borrowing over a longer term as a means of stretching affordability looks to have reached its limit and is now falling away as the market cools.
- External remortgage activity was also weak, with comparative strength in internal refinancing where affordability tests are not required, suggesting cost pressures may also now be driving more retention business. However, borrowers now refinancing at the end of a fixed-rate deal are still on rates well below those at which their ongoing affordability was previously stress-tested.
- With cost and rate pressures continuing, households are now drawing down on their savings to meet higher expenses. In aggregate there are still substantial excess household sector savings built up through the period of restricted spending during the pandemic.
- As cost and rate pressures continued, mortgage arrears rose for the third consecutive quarter, in line with expectations. However, the total level of arrears remains very low by historic standards.
- Lenders continue to work with their customers who have difficulty making their repayments by providing tailored forbearance that best meets each customer's circumstances. While the government's Mortgage Charter is proving a popular "self-serve" option for customers, the significant increase in longer term borrowing seen up to now limits its effectiveness for newer, first-time buyers.
- Possessions numbers fell slightly and remain at historically very low levels, as lenders continue to work through the backlog of pre-pandemic cases to help those who cannot recover their positions exit their mortgages with as much equity as possible.

UK ECONOMIC CONTEXT AND OUTLOOK

There was some better news on the economy in the second quarter with GDP expanding by 0.2 per cent, up from growth of 0.1 per cent in the previous quarter. This remains a sluggish picture and still leaves the level of GDP below that immediately prior to the pandemic. It is, however, good news in that the recent GDP data are further confirmation that the UK looks like it will avoid a technical recession this year.

Across the quarter as a whole household spending was the major contributor to growth, expanding by 0.7 per cent in the three months to June. This was the strongest reading since Q1 2022 – before households were hit with sharp rises in energy costs stemming from the invasion of Ukraine.

Looking at the profile of growth across the quarter, there is a somewhat bumpy monthly profile. The additional bank holiday in May contributed to GDP declining on the month, but there was a solid rebound in June, which saw GDP rise by 0.5 per cent. Activity in June was further buoyed by a spell of good weather boosting retail sales, hospitality and construction activity – unlikely to be sustained through a rather soggy July. Ongoing industrial action, notably in the National Health Service (NHS) in the most recent quarter, continued to have an impact on the monthly data. Overall, the main takeaway is that there are a few bright spots in the UK economy, but the underlying picture is still relatively weak.

In the second quarter, there were finally some signs that inflationary pressures are starting to ease. CPI hit single-digits in May, for the first time since August last year, falling further to 7.9 per cent in June – broadly in line with the Bank of England's expectations. Food price inflation, while still in double-digits, is heading in the right direction, and transport costs are now falling with petrol prices, in particular, down on a year ago.

Looking to the third quarter, the lower energy price cap which commenced in July led to another material drop on the headline rate of CPI. However, the job on taming inflation may not yet be done. Core inflation (excluding food and energy prices) is proving sticky, and services inflation has been stuck above seven per cent since May.

While the trajectory of headline inflation in recent months is encouraging, not least for consumers, it will not necessarily be a smooth glide path back to the Monetary Policy Committee's (MPC's) two per cent in the coming years. Not least because of continued growth in wages. In the three months to June regular pay across the economy was 7.8 per cent higher than the same period a year ago – the fastest rate of growth since the series began in 2001. Including bonuses, pay growth stood at a hefty 8.2 per cent (though this was influenced by the NHS settlement in June).

Continuing wage pressure is also still being reported by businesses in regular surveys, such as the services purchasing managers' index, including in the early part of Q3. Recruitment challenges, business staff retention strategies as well as the recent increases in public sector pay remain the main drivers of higher pay settlements, with recruitment and retention challenges likely to persist should the labour market remain tight. Recent data, however, point to some loosening, with a continuing decline in the inactive population (excluding students and the long-term sick), the thirteenth consecutive decline in vacancies and a rise in overall unemployment. We should see these factors start to bear down on wage pressure in the second half of the year.

While the end of the squeeze on real incomes is now in sight, bringing CPI inflation back to target is not expected until 2025. The Bank of England, in response raised Bank Rate in August by a further quarter point to 5.25 per cent. For the six members who voted for the increase, risks to inflation continue to stem from a tight labour market and uncomfortably high wage growth, although there was an acknowledgement that monetary tightening over the past year and a half was weighing on economic activity. Forecasters expect we are near the peak for interest rates, with perhaps a further rise at the MPC's September meeting – this is somewhat lower than we reported in our Q1 2023 Household Finance Review.

Most forecasters expect subdued growth to be a feature of the UK economy in the second half of the year, with GDP for 2023 as a whole coming in at around 0.4 per cent. At the start of the third quarter business and consumer confidence was still fragile, with a similar trend seen in surveys across Europe. While cost of living pressures are easing, we are unlikely to see much strength in consumer spending. In addition, global trade and business investment are not set to step up and pull the economy onto a stronger growth path in the near term.

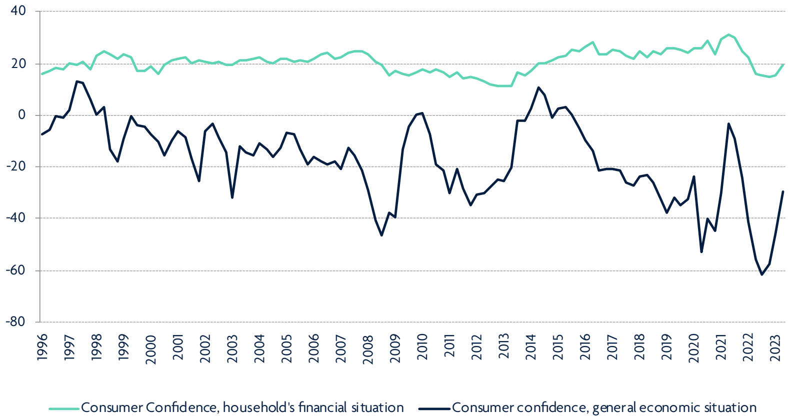
HOUSEHOLD CONFIDENCE REGAINED MORE GROUND FROM AUTUMN ALL-TIME LOW BUT REMAINS FRAGILE

Despite the ongoing pressures from the cost-of-living and, for borrowers, the sustained sequence of Bank Rate increases, consumer confidence continued to recover in the second quarter of 2023, having plummeted to an historic low in the turmoil following the September mini-budget (**Chart 1**).

It is likely that the lower energy prices, widely expected but announced later in the quarter, lifted at least some of the cost-based worries weighing on consumers. Although these prices remain significantly higher than those seen before 2022, they are also much lower than their peak levels, and this will have made a material difference for many.

However, given the rapidly changing economic environment and the even more rapid news cycle relating to cost of living and associated issues, these confidence indicators remain volatile. Overall inflation remains high and is taking longer to come down than previously expected, with the potential for further Bank Rate increases. So, while confidence was on the up in Q2, household budgets are still under significant pressure. In this continuing environment, the more positive trend in confidence remains fragile and subject to negative shocks. Indeed, July readings were less upbeat, and it is unclear where consumer mood will be heading next.

Chart 1: Consumer confidence



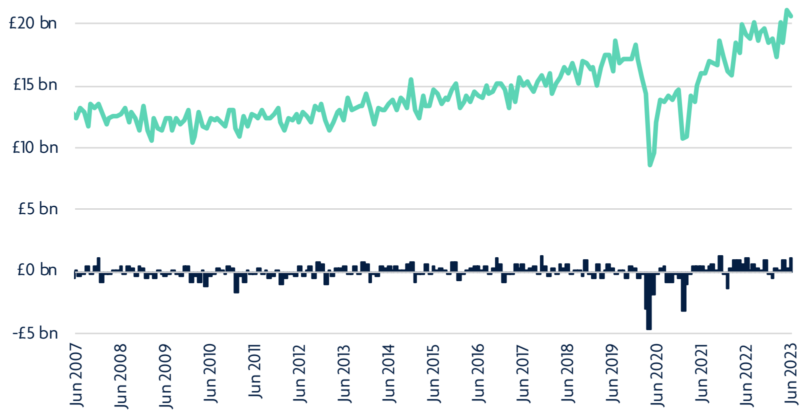
SOURCE: GfK

CARD SPENDING CONTINUES TO HOLD UP

In Q1 we observed unexpected resilience in consumer spending via cards, with particularly strong activity in the travel sector. Spending patterns typically show something of a drop off with the beginning of each year as households readjust after the elevated spending levels through the festive season. A possible reason for the strength this year was increased bargain-hunting in the January sales as cost-pressured households looked to maximise their disposable income in the face of higher price levels, particularly for more expensive items such as foreign holidays. Given this, a compensating drop-off in spending in the following months might have been expected, with activity brought forward to take advantage of the sales.

However, in line with the more positive consumer sentiment seen in Q2, consumer spending via credit and debit cards picked up through the quarter (**Chart 2**).

Chart 2: Card spending in month, £m



SOURCE: UK FINANCE

In part, this reflects ongoing price pressures driving up the average spend per transaction, which has been on an upward trajectory since the end of 2021, when inflationary pressure began to build. However, even stripping this out there does appear to be some underlying strength in both the willingness and ability of consumers to continue to spend. Data for the year to May indicate that spending on services continues to outstrip retail sales values, with strong year-on-year growth notable across travel and hotels.

It is likely that the resilience in consumer spending, in the face of significant pressure on household finances, is currently supported by the still-elevated levels of savings which the household sector had built up through the pandemic.

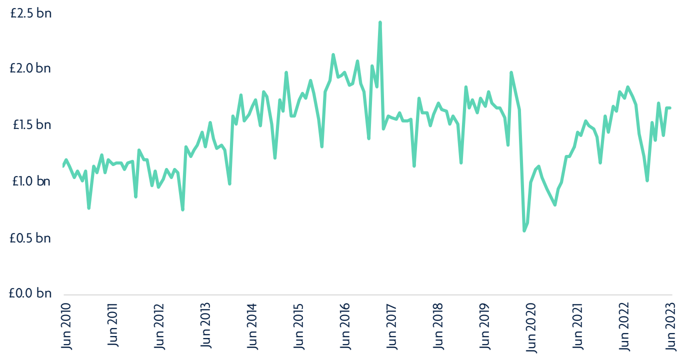
Like consumer confidence, wider events affecting cost of living and household finances have the potential to affect this. For now, however, the household sector in aggregate appears both willing and able to spend largely as normal, with households still able to draw upon their savings to plug any gaps between income and outgoings.

STRENGTH IN PERSONAL LOAN BORROWING MIRRORS CARD SPENDING

In line with the trends for card spending, borrowing for personal loans also showed moderate but continued strength into the second quarter of the year (**Chart 3**).

Personal loan borrowing, while heavily seasonal and volatile from month to month, appears to be running at around the trend levels seen since around 2016, and is largely unaffected by the increase in pricing (totalling around 215 basis points seen since Bank Rate began to rise from December 2021.

Chart 3: Amounts of new personal loans from banks



SOURCE: UK FINANCE

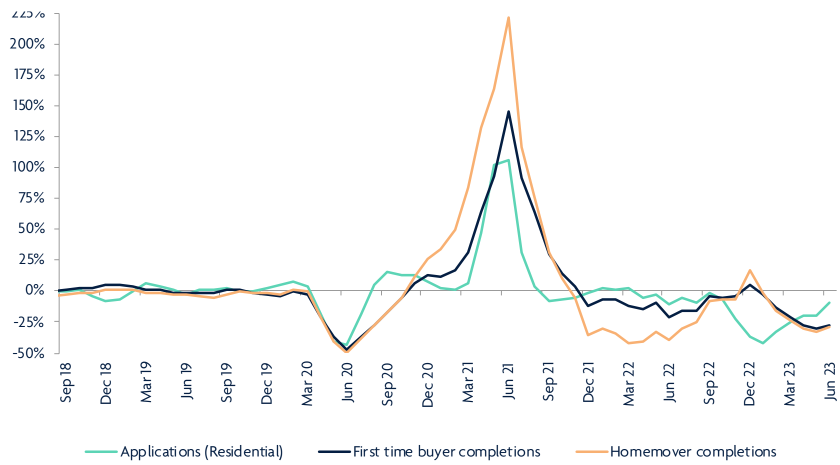
CONTRACTION IN PURCHASE LENDING CONTINUED, BUT SIGNS OF A LEVELLING OFF TO COME

Unlike the relative strength in consumer spending and personal loans, the recovery in consumer confidence has not translated to the same for mortgage borrowing.

The sharp downward trajectory seen in borrowing for house purchase as the year began continued in Q2, with overall activity down nearly a third compared with the second quarter of 2022 (**Chart 4**).

Throughout the first half of this year, activity levels have remained very low by comparison with recent years. This weakness, for both home movers and FTBs, stems from the significantly greater affordability challenges currently faced by borrowers. House prices are now either broadly static or in modest decline, depending on which index is used.

Chart 4: Mortgage applications and completions, 3-month moving average, year-on-year change



SOURCE: UK FINANCE

However, although wage inflation is now higher than that seen in recent years, prices relative to incomes remain near historic highs. Added to this, higher market interest rates for new mortgages, combined with higher monthly outgoings from high inflation, have significantly raised the bar for prospective borrowers to pass Financial Conduct Authority (FCA)-mandated affordability tests to buy the house they want.

With these affordability pressures unlikely to ease rapidly, house purchase lending is likely to remain constrained over the near term. Looking ahead, mortgage applications in Q2 have recovered a little from Q1 but remain down on a year ago, indicating Q3 completions will see a further contraction in activity.

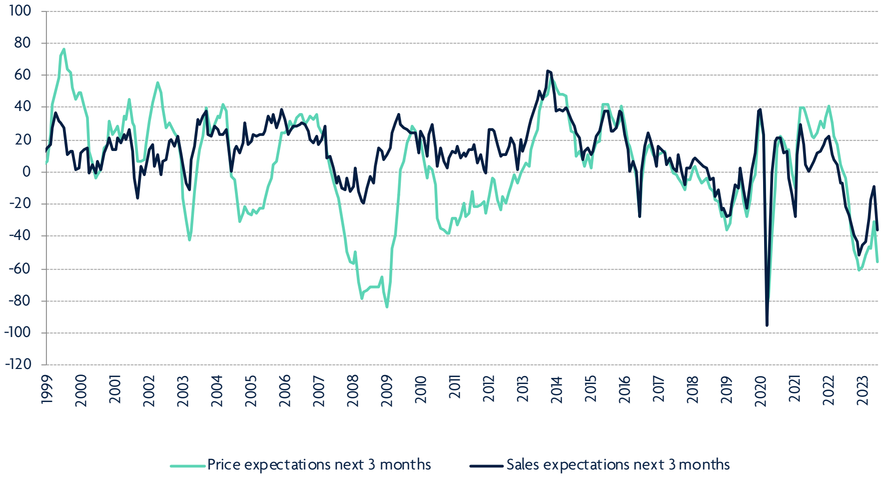
EXTERNAL FORWARD INDICATORS ALSO POINT TO WEAKNESS TO COME

In addition to the negative year-on-year readings from our applications data and lender price indices, Royal Institute of Chartered Surveyors (RICS) survey data give another, more forward-looking indicator of activity.

Following what looked like a recovery in surveyors' expectations as Q2 began, these readings then turned sharply downwards again as the quarter progressed, approaching the lows seen just after the mini-budget in autumn 2022 (**Chart 5**).

Taken together, the indicators suggest that the weakness in demand for mortgages credit will continue into Q3 at least.

Chart 5: Surveyors' expectations of housing market activity



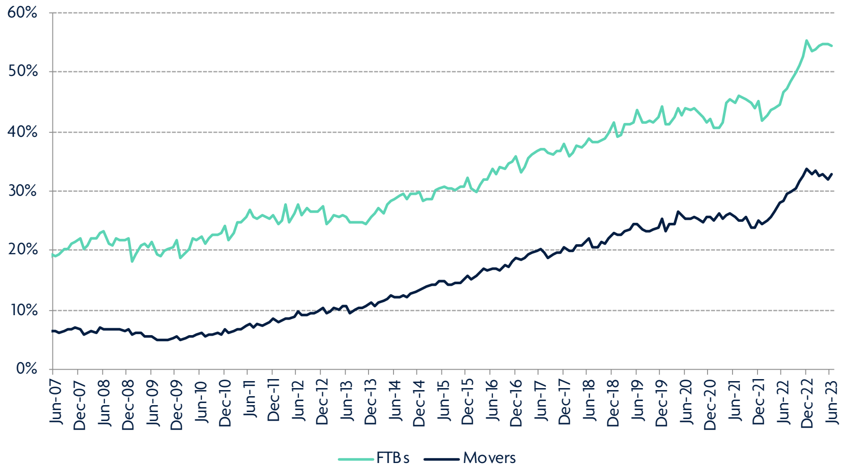
SOURCE: UK FINANCE

AFFORDABILITY STRETCH, BY EXTENDING TERM LOOKS TO HAVE RUN ITS COURSE AS THE MARKET COOLS

Throughout 2022, amidst high house prices, inflation, and rising interest rates all bearing down on mortgage affordability, we saw a rapid increase in the proportion of mortgage customers borrowing over a longer term. By the end of 2022, well over half of FTBs and one third of home movers were borrowing over terms of over 30 years (**Chart 6**).

However, in the first quarter of 2023 we saw the rise in longer term borrowing level off, tentatively suggesting that using this as a means of stretching affordability might have reached its limit, as higher interest rates and inflation had tightened the affordability calculation beyond the level at which a longer term could bring it back in line with underwriting criteria.

Chart 6: Proportion of new house purchase mortgages taken out with over 30-year term



SOURCE: RICS

This levelling off continued in the second quarter for First Time Buyers (FTBs) and, for home movers, longer term borrowing started to fall away, further supporting this view. At the same time, we have seen typical income multiples and, to a lesser extent, average LTVs start to fall back, signs that, increasingly, the market is being squeezed towards those with higher incomes and/or larger deposits.

As a means of lowering initial monthly payments and so improving the affordability calculation, longer term borrowing is both permitted under FCA responsible lending rules and falls within most firms' lending policies. If the mortgage runs its full term this does mean the customer ends up paying more overall than they would over a shorter term, although the majority of FTBs redeem their mortgage well before this, usually when they move house.

However, as we set out later in this Review, the increasingly longer terms taken out by recent borrowers may limit the help that changes to the terms of the mortgage might give (for example, term extensions), should these customers experience financial difficulty in the current adverse environment. Instead, lenders would need to turn to more formal forbearance.

CONSUMER SPENDING AND LENDING: SUMMARY

Even amidst ongoing widespread concerns about the cost of living, consumer sentiment has proved surprisingly resilient so far in 2023, and this has been reflected in robust card spending and personal loan borrowing. However, these cost and rate pressures have been seen much more acutely in the housing market, where these pressures are bearing down on mortgage affordability for prospective homebuyers. In line with our forecasts, this has contributed to a softer housing market in 2023, with fewer active buyers.

With these affordability pressures set to persist we expect a continuation of these subdued activity levels as we move through the summer and into the autumn.

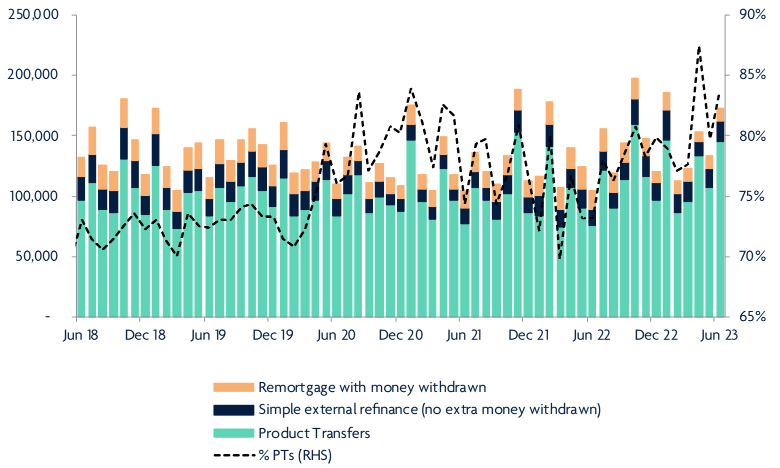
EXTERNAL REMORTGAGING WEAK AS AFFORDABILITY CONSTRAINTS DRIVE MORE TOWARDS PRODUCT TRANSFERS....

As at December 2022, there were an estimated 1.5 million residential mortgages set to come to the end of their fixed rates through 2023. This laid the ground for expectations of a strong refinancing market this year.

Although external remortgage numbers were weak in the first quarter of the year, this stemmed from a pronounced drop off in remortgaging where money is withdrawn, while simple pound-for-pound external remortgaging showed year-on-year growth. In fact, this simple external refinancing grew by slightly more than internal Product Transfer (PT) business. This suggested that the affordability pressures which were constraining borrowing for house purchase were not, at that stage, impeding the prospects for customers looking to refinance their expiring fixed rate deals on the open market.

However, in Q2 we did see a year-on-year contraction in simple pound-for-pound refinancing and growth in PT business, with PTs approaching a record nine in ten refinancing transactions in April (**Chart 7**).

Chart 7: Number of residential remortgages and internal product transfers



SOURCE: UK FINANCE

PT volumes are subject to month-to-month fluctuations, depending on the maturity schedule of individual lenders. So, a spike in one month, however pronounced, cannot be taken as reflective of a shift in consumer behaviour. However, notwithstanding this volatility, refinancing business overall looks have been shifting further towards the PT market for around 12 months, broadly in line with when cost-of-living and rate pressures began to build.

Overall, although many customers are still choosing to refinance externally, the growing strength in PTs (which are not subject to affordability tests) may indicate that affordability is acting as a greater constraint on borrowers' options when they look to refinance from existing fixed rates onto what are likely to be significantly higher market rates now.

While the continuing strong numbers of borrowers reaching the end of their fixed rate deals now will support strong refinancing activity through the second half of the year, the shift towards internal retention business, should this persist, will bear down on external remortgaging volumes and, therefore, on gross lending values.

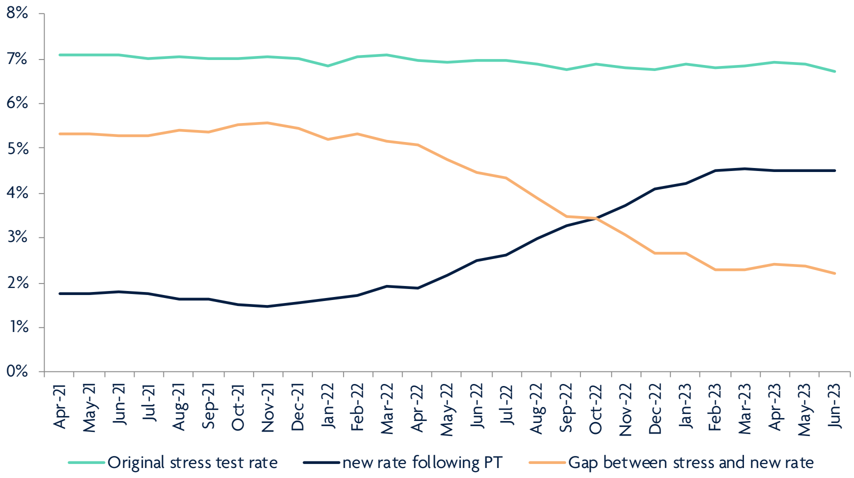
...BUT CUSTOMERS REFINANCING INTERNALLY ARE STILL WELL BELOW THEIR PREVIOUS STRESSED AFFORDABILITY RATE

The current, materially higher, market rates , combined with the high number of mortgage accounts scheduled to come to the end their fixed rates this year, has led to some public speculation that this represents a material risk to the UK mortgage market, in terms of ongoing affordability. And, as noted above, the shift towards internal PT markets, where affordability tests are not required, may indicate that refinancing customers are finding external remortgage options more limited.

This increase in monthly repayment amounts will be more noticeable for those customers coming off two-year fixes , having previously borrowed in 2021 when mortgage rates were at historic lows.

However, analysis of our loan level data shows that, although borrowers who have refinanced their loans this year are paying materially higher rates than their previous deal, these rates are still comfortably below the stressed rate at which their lender previously assessed their affordability. On average, borrowers refinancing internally this year are still paying over two per cent less than the stressed rate that their lender established was affordable at the time they took out the original loan (**Chart 8**).

Chart 8: Previous stress test rate vs follow-on PT rate, maturing fixed rate mortgage deals



SOURCE: UK FINANCE

Although cost of living pressures will also have further eroded these customers' affordability, this indicates that customers should retain a good, if significantly reduced, degree of wiggle room in their budgets, post-refinancing.

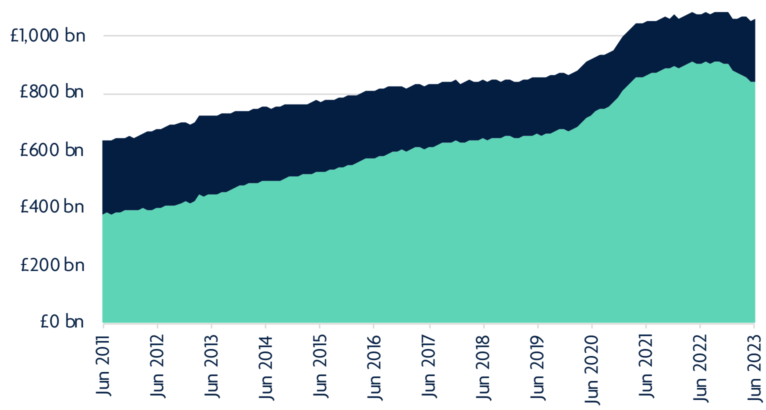
This is evidence that, even amid the ongoing significant pressures on household finances, the underwriting standards operated by the mortgage industry and enshrined in FCA rules since 2014 are doing precisely the job they were designed for, ensuring customers' finances are resilient against even the significant payment shock many are now seeing.

DECUMULATION OF SAVINGS CONTINUES AS HOUSEHOLDS USE RAINY DAY MONEY TO COVER HIGHER OUTGOINGS

In the first quarter of the year we saw - for the first time in at least a decade - a sustained, if relatively modest, decumulation of household deposits held with retail banks.

This continued through the second quarter, with the level of deposits around two per cent lower at the end of June than the position a year previously. While still a modest decline it does represent an acceleration on the one per cent drop seen in the first quarter (**Chart 9**).

Chart 9: Personal deposit account balances



SOURCE: UK FINANCE

In part, this running down of savings may represent households rearranging their finances to best take advantage of potential returns and, in the same vein, minimise the cost-of-living impacts on their finances.

Within the overall decline in aggregate deposit levels, the amounts held in instant access accounts decreased by seven per cent compared with Q2 2022, while the amounts in notice accounts, where rates upwards of five per cent can now be found by customers who shop around, saw annual growth of 23 per cent.

In addition, we also saw a degree of increased lump-sum repayment of mortgage debt in the quarter. In a rising rate environment this is rational financial management on the part of households, with those who are able to use excess savings, including those built up over the early months of the pandemic, to pay down increasingly expensive mortgage debt.

However, the additional sums being paid down - £13 billion since the start of the year are considerably less than the aggregate £28 billion contraction in deposits over the same period. So, while there is likely an element of prudent financial management in a rising rate environment, cost-of-living pressures look to be the key driver of households running down their savings in recent months, to support much higher monthly outgoings.

Despite the sustained run down of savings for six months, total deposit levels are still considerably above those seen prior to the pandemic. Within this, individual households will have different levels of savings and, while cost pressures persist, more will exhaust these reserves and need to either cut back on expenditure or else find other ways to cover their bills. For now, however, the household sector in aggregate still enjoys a significant, valuable cushion of rainy-day funds on which it can now draw to help cope with these additional cost pressures.

HOUSEHOLD REFINANCING AND SAVINGS: SUMMARY

While higher mortgage rates mean that customers refinancing their loans this year face significantly higher payments, these remain well below the stressed levels that their lenders had previously verified were affordable. However, in the face of continuing cost and rate pressures, we are now seeing a sustained decumulation of savings to cover increased monthly outgoings. For now, these excess savings, as well as the affordability tests for mortgages taken out previously, mean that many households are able to maintain their spending and borrowing largely as normal.

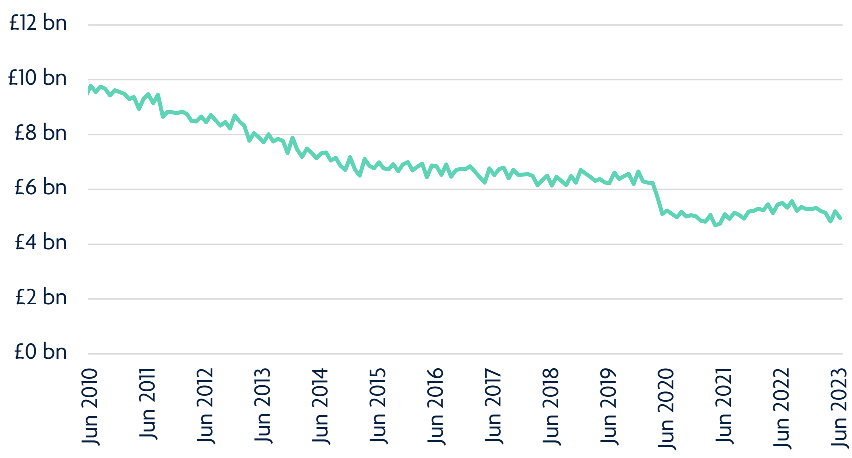
OVERDRAFT LEVELS STILL BROADLY STABLE

Although we are seeing a running down of deposit levels as households draw on their savings to plug the gap between income and higher monthly costs, this is still not, as yet, reflected in any noticeable rise in overdraft utilisation (**Chart 10**).

While the cost-of-living pressures felt by households are not likely to ease fully this year, the level of excess savings still held by the sector in aggregate will help them meet additional cost and payment burdens and mitigate the extent of any build-up of relatively expensive unsecured debt.

However, the longer the cost-of-living challenges persist, more and more households are likely to run through these savings, and we may then see overdraft levels begin to tick up.

Chart 10: Household sector overdraft debt outstanding at end of period



SOURCE: UK FINANCE

GROWTH IN CREDIT CARD DEBT STABILISED IN Q2

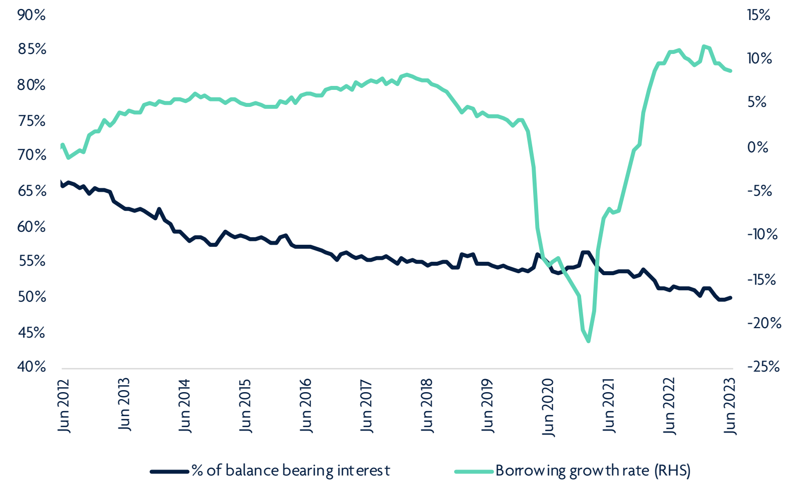
The elevated growth in outstanding credit card balances, seen since the pandemic-related spending restrictions came to an end in 2021, continued in the second quarter of 2023, but the rate of growth appears to have now levelled off (**Chart 11**).

With the aggregate level of card debt still some 11 per cent below its pre-pandemic peak and average spend driven upwards through persistent inflation, these strong growth figures are expected and are not, in themselves, indicative of consumers relying more on revolving unsecured debt to cover higher outgoings.

Further supporting this, even as balances continue to show this strong growth, the proportion of overall debt that is interest-bearing continued to trend down in Q1, giving no sign that more households are unable to pay off their balances each month or, indeed, that there has been a material shift in repayment behaviour.

Like overdraft debt, there is no sign as yet that cost-of-living pressure is feeding through into the unsecured space, while those accumulated savings providing a buffer for the household sector in aggregate.

Chart 11: Credit card balances outstanding



SOURCE: UK FINANCE

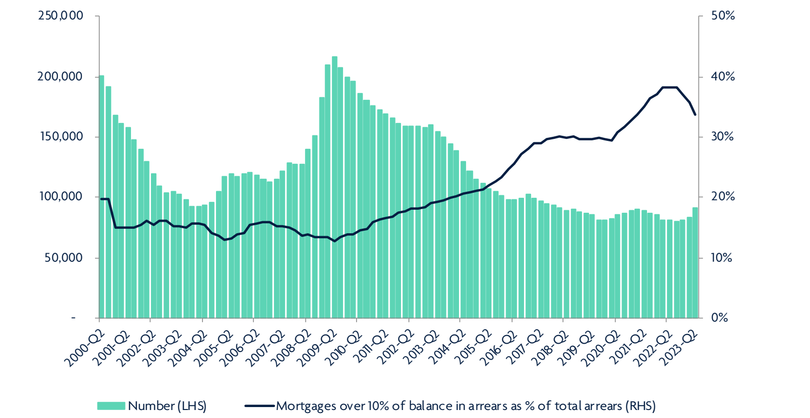
External figures for other personal sector credit products, for which we do not have visibility from our own data, point to a decline in demand. Data from the Finance and Leasing Association (FLA) indicate a slowdown in car finance – for both used and new vehicles, as well as a fall away in other consumer finance products. However, the unsecured borrowing seen in recent years will add to the overall existing debt burden for households, with recent lender accounts citing greater provisioning for unsecured debt losses indicating the greater risks in this sector amidst ongoing pressures on household finances.

ARREARS CONTINUED TO RISE THROUGH Q2, BUT LEVELS REMAIN VERY LOW

Following a period of falling arrears (since the start of 2021), arrears showed a small, but expected increase in Q4 2022, followed by a larger, but still modest, increase of 2,530 arrears cases, bringing the total to 83,760 mortgages in arrears representing over 2.5 per cent of the outstanding balance. In addition to this rise in headline arrears figures, we also saw a larger increase in early arrears (representing between 1.5 and 2.5 per cent of balance) in Q1.

Very early arrears, as well as those that are low in pound terms, may arise for reasons that are not related to customer stress – for example failed direct debits or misalignment of salary in and mortgage payments out of an account. The vast majority of these are resolved very quickly, most commonly within a couple of weeks, and do not generally represent a cause for concern. However, those that have reached 1.5 per cent of the outstanding balance, while still below our headline reporting threshold, have a greater likelihood of worsening. As such, the increase in these early cases pointed to the likelihood of a similarly larger increase in headline cases in Q2.

Chart 12: 1st charge homeowner and buy-to-let mortgages in arrears[1]



SOURCE: UK FINANCE

Notes:

1. Arrears measured as those representing more than 2.5 per cent of outstanding mortgage balances.

Headline arrears in Q2 followed expectations – rising by 6,920 cases (8.3 per cent) - to reach 90,680 mortgages with arrears representing over 2.5 per cent of balance. While levels are still very low by historic standards, this does represent the largest quarterly increase since 2009. (**Chart 12**)

Within the total, numbers rose in each band, from the lightest through to the heaviest (where arrears represent over ten per cent of the outstanding balance). However, the proportion of heavier cases continued to fall, as lenders continue to work through the backlog of mostly pre-pandemic longterm arrears cases where there is no prospect of recovering the customer's position, and these cases proceed to possession (and so move out of the arrears figures).

As we have set out in previous reviews, the combined pressure from cost-of-living and higher rates impact on mortgage affordability, not just for those on variable rates but also on those on fixed rate deals set to mature, when they look for a new deal. However, as we have shown above, the rates now paid by borrowers refinancing their expiring fixed rate loans this year, while materially higher than their previous deal rates, are still considerably lower than those at which their previous loan was stress-tested.

Therefore, while higher rates and cost-of-living are putting borrowers under greater pressure, the evidence from our data suggests that mortgage costs for borrowers refinancing remain within the bounds of affordability that underpinned the original lending decisions, even in the adverse scenario that is currently playing out.

While some, at the margins, will be struggling to meet higher mortgage costs and wider increased outgoings, the vast majority will still have flex in their budgets to cope with these higher costs, albeit with a degree of belt tightening in many cases. In the absence of a significant increase in unemployment (which is not expected by external forecasters), we expect further increases in arrears to be relatively limited, compared with previous cycles. In line with our published forecasts, we expect that cost and rate pressures will see arrears continue to rise towards our forecast of 98,500 cases by the end of December 2023.

LONGER TERM BORROWING MAY LIMIT THE EFFECTIVENESS OF SOME TYPES OF FORBEARANCE

As we move through this period of greater pressure on household finances, including mortgage payments, lenders will continue to offer and deploy the full range forbearance options they have available to help their customers through difficulties they may encounter. We strongly encourage any customer worried about their finances to engage with their lender at the earliest opportunity to discuss their situation, and lenders will look to identify the option that best suits each customers' individual circumstances.

In addition to the forbearance options already offered by the industry for many years, the government has also launched its Mortgage Charter to recognise the additional pressure on mortgage holders from higher interest rates and provide borrowers who are worried about their payments with an additional degree of reassurance.

Lenders who have signed up to this voluntary Charter will provide a term extension or a temporary six-month switch to interest-only payments to all up-to-date mortgage customers who request it. These switches can be made on an execution-only basis, and the measures will not affect customers' credit files. Following the six months, customers who have taken a switch to interest-only will automatically revert to capital repayment terms, which may often result in a higher monthly payment than was the case before the temporary switch, as the deferred capital then needs to be paid off over the remaining period of the original term.

For those choosing a term extension, this will remain in place in perpetuity and the payments will remain at this lower level, unless the borrower chooses to revert to the original term within the first six months. However, as observed previously, borrowing over this longer term will mean the overall cost of borrowing is greater.

The measures available under the Mortgage Charter will provide an additional layer of support over and above the business-as-usual forbearance options offered by all lenders. However, the effectiveness - in terms of the benefit these options can provide – will vary from customer to customer, according to the specifics of their mortgage debt. And here, the rapid rise of longer-term borrowing seen over the course of 2022, is particularly relevant.

As we observed here (and in previous Reviews), borrowing over a longer term does raise a risk that, should that borrower run into payment difficulties down the line, this longer term does limit the extent to which further changes to the mortgage can help.

For example, were a FTB borrowing a typical £196,000 over 35 years to take a five-year term extension, this would result in a reduction of only around £46 per month in the initial total payments of £931, and a temporary interest-only switch would reduce payments by £191. For the same borrower borrowing over an initial 40-year term, the reductions would be lower still, £34 per month from a five-year term extension or £144 for a temporary interest-only switch. In contrast, a customer currently on SVR, who typically has only ten years to run, would see a substantially greater reduction in payments (Table 1).

It is important for customers to be aware that, as shown above, the measures available under the Mortgage Charter, while easily accessible and without credit file impact, may offer less significant benefit to some customers, particularly those who have a longer remaining term on their mortgage. For those who are at risk of financial difficulty or in arrears, lenders' forbearance toolkits will apply.

As we explored in our Q1 Review, customers in arrears are not a homogeneous group; they have different financial situations and different drivers of their payment issues, and so a tailored approach can usually offer the best solution to their payment difficulties. Customers unsure about what targeted help is best for them should talk to their lender to discuss the options available and identify the most appropriate one given their circumstances. These discussions do not affect a customer's credit file.

Table 1: illustrative benefits and overall cost to customer from temporary interest-only switch and term extension

	Mortgage characteristics as at April 2023			6 month switch to interest-only		Term extension of 5 years	
	Balance	Rate	Term remaining	Temporary reduction in monthly payments	Total additional cost of switch over remaining term	Reduction in monthly payments	Total additional cost of switch over remaining term
New FTB loan, April 2023 *(assume 5 year fixed rate, which remains the most popular product)*							
Borrowing over 30 years	£195,642	4.54%	30 years	£256	£1,253	£65	£32,371
Borrowing over 35 years	£195,642	4.54%	35 years	£191	£1,122	£46	£33,682
Borrowing over 40 years	£195,642	4.54%	40 years	£144	£999	£34	£34,901

SOURCE: UK FINANCE

It is important for customers to be aware that, as shown above, the measures available under the Mortgage Charter, while easily accessible and without credit file impact, may offer less significant benefit to some customers, particularly those who have a longer remaining term on their mortgage. For those who are at risk of financial difficulty or in arrears, lenders' forbearance toolkits will apply.

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POSSESSIONS BROADLY FLAT IN Q2 AND REMAIN WELL BELOW PRE-PANDEMIC NORMS

Mortgage possessions showed a small drop in Q2, with 1,120 cases, compared with 1,260 in the first quarter. The slight fall in activity is likely to be linked to logistic and capacity constraints in the court and eviction stages of the process, with a substantial backlog of cases still remaining.

Lenders continue to work through this backlog of mostly pre-pandemic cases of long term, unrecoverable arrears positions, but total possession numbers remain very low by historic comparisons and are still well below the activity levels seen immediately before the pandemic struck, which themselves were close to historic lows.

Notwithstanding the modest drop in Q2, we expect possession activity to show a gradual trend increase through the year, with activity still reflecting those cases that pre-date both the current cost-of-living squeeze and the pandemic before it.

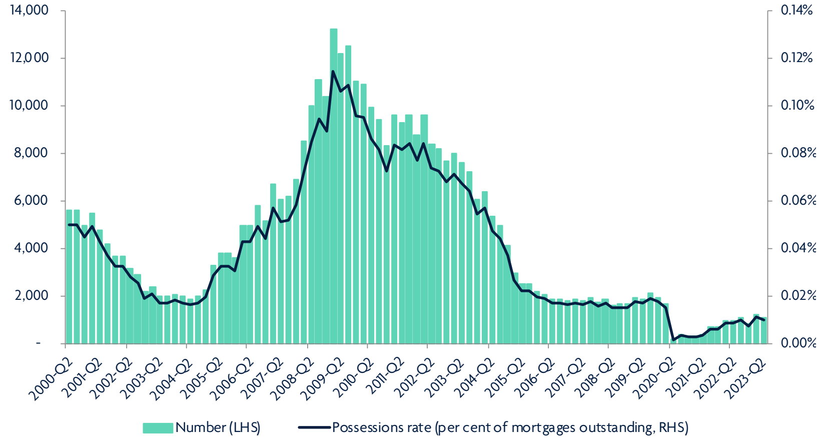
CLEARING THE BACKLOG MORE IMPORTANT AS RATES RISE

As we have explored in previous Reviews many customers in arrears, particularly in deeper arrears, have been behind on their mortgage for quite some time and are on variable rates mortgages which, until last year, were typically low.

In the current environment, higher interest rates contribute to a faster build-up of arrears. And, with price levels currently in modest decline, these two factors will erode customers' equity levels with each month that arrears persist.

Although all possessions are unwanted and always a last resort, it is important that customers do not remain in unrecoverable arrears positions longer than is absolutely necessary, and that if they reach this position are able to realise the maximum amount of equity on exiting their mortgage.

Chart 13: Number and proportion of 1st charge mortgages taken into possession in period



SOURCE: UK FINANCE

HOUSEHOLD DEBT: SUMMARY

The excess savings built up over the early months of the pandemic in 2020 has provided households with a buffer against the current high-inflation, high interest rate environment. This has, thus far, prevented any build-up of expensive unsecured debt as households draw on these savings to cover higher household bills.

However, the cumulative increase in Bank Rate, combined with wider cost-of-living pressures, is placing upwards pressure on mortgage payments, with the increases in arrears seen since late 2022 expected to continue through this year as these pressures persist. However, a continuing strong labour market and extensive lender forbearance will mitigate these increases, with arrears peaking at still relatively low levels by historic standards.

As always, the industry stands ready to help its customers when they experience financial difficulties, and we strongly urge anyone worried about their situation to talk to their lender at the earliest opportunity.