

An Affordability Act

An exposition and embellishment of ideas developed by Edward Ingram.

Banks and others giving people mortgage loans generally need to be sure that the borrowers are able to repay them. Repossession may be assumed to be bad for everybody, and only an irresponsible bank makes unaffordable loans. And it is not just the borrower and the bank who are affected: for example, the global financial crash of 2008 was largely caused by excessive “sub-prime” lending.

Unfortunately, there is a downside to the necessary financial prudence. Strict application of an affordability criterion at a time when house prices have risen much faster than wages means that a large proportion of the UK population cannot get a mortgage on the cheapest houses in their area, even when they have an adequate deposit, and this despite the fact that they also cannot afford the rent they have to pay instead.

And there are also serious potential problems for those who can obtain a mortgage, who are generally have little choice but to push to the limit of what they can afford. This hurts greatly at first, but less after a few years and a few pay rises. However, this tends to make everybody extremely vulnerable when interest rates change. Consider a very common form of mortgage which has level repayments over a fixed term, but with a variable interest rate. When the interest rate increases there can be a very big jump in the required payments. For example, if for 4th year of 25-year mortgage interest rises from 6% to 8% then payments increase by 19%.

This is bad for the borrower, for the bank and for the nation.

- It is bad for the borrower because it tends to put major strain on domestic finances, possibly forcing choices between feeding the family, heating the home, and keeping up with mortgage payments. It can make the mortgage unaffordable, and possibly even render the family homeless.
- It is bad for the bank because it is likely to increase costs of chasing arrears, increase bad debts, and increase repossessions, as well as impairing the bank’s reputation.
- It is bad for the nation primarily because interest changes happen all at the same time, which causes potentially major harm to the economy by making a significant and sudden reduction in the amount of money available for buying things. It is also likely to cause increased social security costs from housing benefit for those who can find somewhere to rent, homelessness of those who cannot, and mental health problems for everybody.

In fact all those problems are unnecessary. They are merely the result of that particularly rigid form of mortgage. If instead of making the 19% leap in payments the borrower were allowed to undertake to increase payments every year by just 1.9% then the mortgage would still be paid of on time, with none of the pain and instability. Nobody would lose from such an arrangement. Spreading the escalation of payments removes the pain for the user, removes the risk and inconvenience for the bank, and removes the shock to the economy when large adjustments are made nationwide.

Indeed, this is so much in the national interest that it would be highly desirable to make it mandatory that such an arrangement always be available. What is required is legislation stipulating that when there is an interest rate rise on a repayment mortgage the borrower is never forced to increase his repayments by a percentage greater than one which if applied each year thereafter would get the mortgage paid on time.

Perhaps call it The Affordability Act?