

HM Treasury Press Notice

9 December 2003

THE MILES REVIEW OF UK MORTGAGE MARKET: INTERIM REPORT PUBLISHED

Professor David Miles today published his [interim report](#) analysing why long-term fixed-rate mortgages currently account for only a small proportion of the UK mortgage market.

While many borrowers could benefit from longer-term fixed-rate mortgages few choose these products at the moment. Mortgages in the UK are overwhelmingly either at variable rates or at rates fixed for around two years. The report points to three key factors that account for the low take up of longer-term fixed-rate products:

1. Borrowers tend to attach much greater weight to the level of initial monthly repayments than to the overall cost of borrowing over the life of the loan.
2. Many borrowers have a poor understanding of risk and therefore pay little attention to the insurance which longer-term fixed-rate mortgages can provide against unexpected interest rate rises.
3. The way in which many mortgage lenders compete for new business results in cross-subsidisation from existing borrowers paying standard variable rates (SVR) to new borrowers taking out discounted variable and short-term fixed-rate mortgages. This means that longer-term fixed-rate mortgages appear expensive when compared with discounted mortgages.

The development of a larger market in longer-term fixed-rate mortgages also depends on the efficiency with which mortgage lenders are able to raise funds to finance them, which in turn depends on a number of factors. Some of these factors would probably prove temporary if greater demand emerged. For example constraints due to insufficient liquidity or the inability of lenders to assess the pre-payment risk associated with fixed-rate products would ease as a market developed and lenders' experience of pre-payments grew. Others constraints, such as capital requirements, accounting rules and legislative constraints on building societies, might require a policy response to enable the market to develop properly. In the light of further consultation on these funding issues specific recommendations will follow in the Final Report.

The report also presents evidence that borrowers' tendency to attach too great a weight to the level of initial mortgage repayments can contribute to macroeconomic instability and can make monetary policy more difficult to operate. Such macroeconomic problems would be much reduced if households in the UK were encouraged to take a more forward-looking approach to borrowing and to choosing between mortgages. This is clearly desirable in its own right, whether or not the UK adopts the euro.

On publication of his report Professor Miles said:

"In recent decades there has been little long-term fixed-rate mortgage lending in the UK. This report analyses why that is so. For many households, particularly those borrowing a great deal and those whose incomes are uncertain, there are significant advantages of fixing the level of repayments for several years. Yet few of such borrowers take out longer-term fixed-rate mortgages.

Borrowers need to be helped to understand risk better and to make more forward-looking decisions and lenders enabled to fund loans and handle risk in the most cost effective way. I look forward to consulting further with all interested parties before putting forward recommendations next year."

Professor Miles will publish his Final Report, with recommendations, around the time of next year's Budget.

Notes to Editors

1. In his Budget statement on April 9th 2003 the Chancellor announced that David Miles would lead a review of the UK mortgage market. The terms of reference for the review are as follows:

- Undertake analysis of supply and demand side factors limiting the development of the longer-term fixed-rate mortgage market in the UK to establish why the share of longer-term fixed-rate mortgages is so low compared to the United States and many other EU countries;
- Consult with key stakeholders to establish views and inform analysis;
- Examine whether there has been any market failure that has held back the market for long-term fixed-rate mortgages and consider associated opportunities, risks and potential costs; and
- Deliver an interim report by autumn and a comprehensive report and recommendations to the Chancellor by Budget 2004.

2. David Miles is Professor of Finance at Imperial College, University of London. He has long specialised in the economics of financial markets, pensions and housing.

3. The Review has been consulting widely over the Summer – a list of organisations and individuals consulted so far is annexed to the report – and will continue to consult over the coming months. Further written submissions should be received by 23rd January 2004.

Submissions should be sent by email to:

miles.consultation@hm-treasury.gov.uk

or by post to:

The Miles Review Team

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4. The Interim Report is available on the Internet at www.hm-treasury.gov.uk/milesreview.

5. Press enquiries: 020 7270 5238

6. Non-media enquiries: 020 7270 4558