Higher interest rates mean the end of the party for property

As owners are forced to pay double or triple the interest on their mortgage, many will sell up.

By Emma Haslett

Illustration by Gregory Baldwin/Ikon Images

In the years since the financial crisis, buying a first home has felt like a herculean task. With interest rates at rock bottom, first-time buyers have received almost no reward for their savings, and once they do build up a deposit, actually purchasing a home has involved pitching themselves against fierce competition, often from would-be landlords and other cash buyers.

As they scrimped and saved, denying themselves slice after slice of avocado toast, those waiting to climb the first rung of the housing ladder watched as demand pushed prices out of their reach: in the year to August, house prices increased 13.6 per cent; in the past decade they have increase by more than 50 per cent. It is hardly surprising that this has become a generational issue. While first-time buyers struggled, homeowners watched the homes they bought in the years of lower house-price to earnings ratios rising in value. Many used their growing equity to buy another property and became landlords to people who could not afford to join the market themselves.

It isn't older generations' fault that house prices have risen. The buying frenzy since the last financial crisis has been fuelled by a combination of ever-cheaper borrowing – in March this year Halifax offered the cheapest mortgage the UK had seen, a two-year fixed deal at 0.83 per cent interest – and a government that was prepared to twist itself into fiscal pretzels to prevent house prices from falling, ever. House prices were out of control, and the government was encouraging it: during the height of the buying frenzy after the government temporarily abolished stamp duty one investor said buyers were so keen they bought homes without even looking at them.

All that has come to a grinding halt. With the Bank of England determined to control spiralling inflation through a series of interest rate rises (today it announced its eighth consecutive rise, hiking rates by 0.75 percentage points to 3 per cent, the highest since 2008), the price of a mortgage has rocketed. And now that the Prime Minister has insisted on austerity at all costs, those contortions that kept the housing market aloft – Help to Buy, the stamp duty holiday and so on – may well be finished. As the economy tanks, economists are expecting house prices to fall between 10 and 15 per cent. Is this the end of Britain's property party?

Although interest rates have been creeping up for months, the mortgage market began to feel the pain in earnest after the mini-Budget at the end of September. With the markets in turmoil following the announcement of huge tax cuts, economists speculated that the Bank of England would be forced to raise interest rates to 6 per cent by next year. Mortgage providers took action, pulling some of the lowest-rate mortgage products off the market and raising rates for others above 6.5 per cent.

NEW STATESMAN

Subscribe to The Crash

View all newsletters >

An essential weekly read on the challenges facing the global economy.

Sign up here

By the time the turmoil began to calm hundreds of products had been removed from the market – almost 300 went in a single day – while some borrowers with agreements in principle reported that their lenders had pulled out of their deals. The biggest casualties were high loan-to-value mortgages – the sorts of mortgages used by first-time buyers, who usually have a smaller deposit. Meanwhile, average mortgage rates quickly rose above 6 per cent.

Content from our partners

Print's role in driving the environmental agenda

In partnership with Kodak

Patients and doctors can work together for better health

Liz Neal and Oliver Law

How Abu Dhabi's Community Hub will boost the next generation of media talent

Alona Ferber

Rules introduced in 2014 required lenders to ensure borrowers could afford up to a 5 per cent rise in interest rates. The reality is now that many of those faced with remortgaging may struggle to afford increased payments. And there *are* many – after the buying frenzy of 2020 as many as 1.8 million fixed-rate mortgages will come to an end next year, according to the Resolution Foundation.

[See also: It's time to stop kidding ourselves that the Bank of England can control inflation]

Brokers are already seeing the effects. Paul Welch, the founder of largemortgageloans.com, says some of his clients' mortgage costs are "tripling". "I expect a lot of people will sell and downsize because their mortgages will not be affordable," he says.

Richard Campo, founder of the mortgage broker Rose Capital Partners, is advising clients to remortgage early. "We wrote to them and said, look, we think you should pay the exit penalty and come out, because if rates do go up 2 or 3 per cent, you're paying a 1 per cent exit fee, but you save 2 per cent for the next five years, potentially, so it's a no-brainer." Other clients have switched to interest-only mortgages. "If the base rate stays below 5 per cent, it's going to work out cheaper than fixed," he says.

Allan Fuller, an estate agent in London, says one client, a midwife on an interest-only mortgage, is selling because she can no longer afford the repayments. "She said, 'Fuel bills are going to go up and with the cost of living and my mortgage, it's a triple whammy.' She's just not going to be able to cope with that."

The buy-to-let market, which is dominated by interest-only mortgages, will be hit hard. Campo says that for many of his landlord clients, who are about to be the subject of tough new rules on insulation and conditions from the government, rising interest rates have been the last straw. For buyers lower down the housing ladder, that may mean more homes come onto the market. For first-time buyers, though, it's probably a bad thing because the number of rental properties will drop. "It's going to have a huge impact on the 11 million people who rent in this country," says Campo. "Rents are going to go up."

There are reasons to be cautiously optimistic. James Smith, an economist at ING, says the housing market is more protected than it was during the previous financial crisis: "The share of mortgages that are on very high debt-to-income ratios is much lower than it was in the financial crisis."

And Lawrence Bowles, a residential researcher at Savills, points out that "if we did see house prices fall by 10 per cent, that will be taking them back to where they were in January this year" – so most households will avoid falling into negative equity.

But there is also a sense that those hit the hardest – those whose mortgages will become the most expensive, and whose ability to save will be hampered even further as rents rise – are the people who have struggled the most: first-time buyers. "Those days of rock-bottom interest rates are over," says Smith. "I don't think we're going to see a return to those rates over a three- or four-year horizon." Instead average mortgage rates will settle around 4 or 5 per cent.

Global economic factors – such as rising energy prices and the after-effects of the pandemic – have caused this. Today, however, the Bank of England warned that the UK faces the longest recession since records began, partially because factors specific to Britain – Brexit and the aftermath of the mini-Budget, which the KPMG economist Yael Selfin says has added "between 1.1 and 1.25 percentage points" to interest rates – have added to the turmoil that will make climbing that first rung on the housing ladder even harder. "We've gone out of our way to shoot ourselves in the foot," says Campo.

[See also: Why has the Bank of England raised interest rates when a recession is inevitable?]

Topics in this article: Bank of England, House prices, Housing, interest rates, mortgages