

Home-ownership at the crossroads?

- There are early signs that home-ownership in the UK is changing and that this might have long-term consequences for the housing market and wider economy.
- The total number of home-owners has broadly stagnated since 2005. Meanwhile, strong growth in Buy to Let activity has disguised a fall in the number of owner-occupiers buying with a mortgage over recent years.
- Housing issues have become a core area of Government policy, but in many respects the housing market is increasingly dominated by the structural mismatch between supply and demand. Measures to address these imbalances are necessarily longer-term in nature.
- Innovation by lenders has broadened the range of households that can take out mortgage products and the options to help keep people in their homes if they experience financial difficulties. Although lenders are increasingly basing underwriting decisions on assessments of individual affordability, the need for prudence means that affordability pressures for many households have intensified over time.
- Such pressures are particularly acute for young adults, resulting in many choosing to rent privately rather than to buy and a growing share of first-time buyers relying on parents or other relatives to help out financially.
- But house moves may be becoming more difficult for existing home-owners, with less trading up activity and increasing signs that the housing market is becoming more polarised and fragmented, and functioning less well than in the past.
- The housing market continues to be underpinned by strong fundamentals, but a number of trends will challenge the future shape and functioning of home-ownership in the UK.

Introduction

The recent survey evidence (SEH, 2007), suggesting that the total number of English households in home-ownership has fallen since 2005, reinforces the case for reflecting on how the tenure has changed over the years and where it might be going. Although the total number of home-owners has shown only a modest decline of 25,000 from 14.65 million to 14.62 million (and one well within the margins of error of the survey), the fact is it also shows that the number of mortgaged households has been falling since 2002 (from a peak of 8.47 million to 8.23 million, a fall of some 230,000 households).

What these data begin to signal is that home-ownership as a tenure may be undergoing important changes. With the constant distraction of media attention devoted to house prices and home-ownership and television series on buying or renovating homes, it is possible we have

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overlooked some rather fundamental longer-term changes which are working their way through the UK.

The purpose of this article is to provide a reflective overview of where we are today, how we got here and, perhaps more importantly, possible futures for UK home-ownership. The last is a matter of great significance, not just for home buyers, owners and lenders, but also for the economy and the wider health of society. As the title suggests, an underlying hypothesis is that the UK housing market is evolving quite rapidly, and that this raises a number of questions about the long term shape of home-ownership. The article charts the rising level of government activity around home-ownership, reflecting growing political pressure and underlying concerns.

What we can also see over time is the way lenders have engaged with evolving market trends, with, for example, considerable efforts being made to support and sustain first-time buyers in the face of intensifying affordability pressures. Lenders have had to balance such activity with the need to exercise caution in the face of market uncertainties and a stronger regulatory environment.

Underwriting and credit assessment have become more sophisticated, with more lenders switching from simple income multiples to affordability models which look more closely at debt servicing capacity (CML, 2006). This has allowed income multiples to be progressively extended. In terms of products, we now see more lenders offering 100% loans thus easing the deposit constraint and interest only loans which help ease the initial debt service burden for those who have to stretch to gain access to local markets. Guarantor arrangements and group mortgages have also come onto the market, along with intergenerational loans. Finally, given the rise of self employment and more chequered credit histories, we have seen a substantial expansion of the near prime and sub prime markets as lenders seek to assist the full spectrum of would-be buyers.

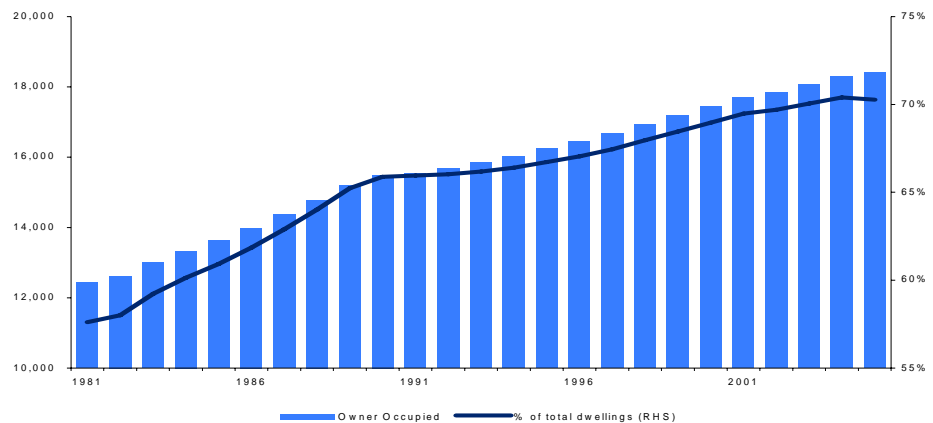
As all of this might suggest, lending policies have continually evolved to support and sustain the growth of home-ownership. Lenders have built a better understanding of different market segments and the associated risks and structured products to address these.

Taken together with the Capital Requirements Directive (and its emphasis on measuring and managing risk) and mortgage regulation now in place, these are substantial new features to the market which provide an important backdrop to the remainder of this article.

The context

The UK has witnessed a dramatic change in tenure patterns since 1918, when nearly 80% of households rented from private landlords. Home-ownership has grown from 23% in 1918 to 71% in 2003 before settling back to 71% in 2006.

Chart 1: Home-ownership in the UK, 1981-2005



Source: DCLG

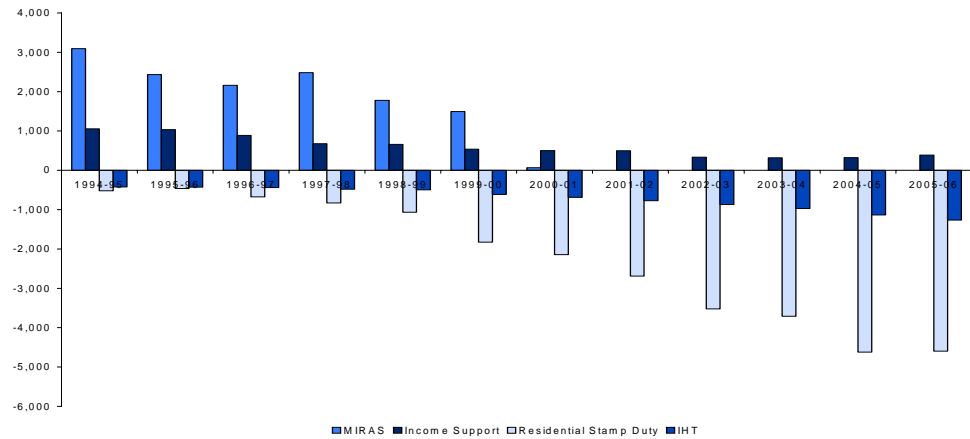
Historically, it was the Conservative party in government that championed home-ownership across the UK. This was the party that introduced the Right to Buy for council tenants in 1980, a policy which had added around 2.3 million homes to the home-ownership total in Great Britain by the end of 2004 and pushed home-ownership levels up by over 10 percentage points. Chart 1 captures the sharp rise in the growth rate of home-ownership in the 1980s before it fell away in the early 1990s recession and then settled at a new lower rate. There are significant national and regional variations to this pattern, most notably Scotland where the rate of home-ownership continues to rise quite sharply.

Yet it was also the Conservative Government that cut back income support for mortgage interest (ISMI), began the withdrawal of mortgage interest tax relief and presided over the worst housing market recession on record during the early 1990s.

A relatively lukewarm support for home-ownership continued into the early years of the Labour administration. Mortgage interest tax relief was completely abolished from April 2000 and Labour opted for a partnership agreement with industry to encourage the wider take-up of mortgage payment protection insurance rather than restore earlier cuts in ISMI. It even cut back on its own low-cost home-ownership programme. Chart 2 plots the reduction in financial support for home-ownership from the mid 1990s as measured by mortgage interest tax relief, ISMI, Stamp Duty and Inheritance tax. Since the turn of the century, the sector has become a net

contributor in tax terms, though this does ignore the value of the capital gains exemption for the principal residence (see Hills 2007 for another view).

Chart 2: Total tax/benefit treatment of owner-occupied sector



Source: UK Housing Review 2006/2007

In more recent years, as house price increases have strongly outpaced earnings growth and affordability pressures have intensified (Cunningham, 2005), we have seen significant policy developments and the Labour government has moved strongly to assert its home-ownership credentials. Alongside a concern that households who had previously expected to enter home-ownership were now unable to do so were two other issues. First, there was a recognition that plans to strengthen public services were being undermined by lack of choice/opportunity in the housing market creating difficulties for recruitment and retention. Second, the government's plans to ensure widespread opportunities to acquire assets in general and homes in particular as a way of giving choice and freedom to households were being put at risk.

A brief chronology makes the point.

In 2000, the government signalled its awareness of mounting housing pressures with its white paper, *Quality and Choice: A Decent Home for All; The Way Forward for Housing*. Relevant to this article, the focus was on sustainable home-ownership, reform of house buying and selling, area-based renewal and home improvement, but it did also include the Starter Home Initiative.

In February 2003, the Deputy Prime Minister (DPM) set up a Low Cost Home Ownership Task Force (this became the Home Ownership Task Force) which reported in November 2003, recommending a range of improvements to the LCHO programme. A consultation paper on LCHO followed in April 2005, and in September of that year the government set out its proposals for reforming the sector. These included rationalising the product range and the

arrangements for managing the programme (setting up 'Zone Agent' housing associations to supervise the programmer in each area) and creating further opportunities to help social housing tenants acquire a stake in their homes.

Meanwhile, work on assessing the potential impacts for the UK of joining the European Monetary Union awakened the Treasury to the significance of housing and the housing market (indeed the UK's heavy reliance on variable rate mortgages was used as one of the reasons against joining). This then led to the commissioning of the Miles report in 2003 (his report *UK Mortgage Market: Taking a longer term view* was published in 2004). Subsequently, the Treasury has been closely involved with many housing initiatives, for example setting a target for the growth of home-ownership and encouraging shared equity.

In April 2003 the Chancellor appointed Kate Barker to undertake a review of housing supply. Her final report came out in March 2004, with the government's response being published in December 2005 as part of its Pre-Budget statement. The government committed to increasing housing supply in general and shared equity and social housing in particular bringing overall annual supply up to 210,000 per annum. Significantly it committed itself to moving towards 'the government's aspiration of 75% home-ownership'.

This was seen as a realistic aspiration though it was recognised that much had to be done with housebuilders and the planning system to achieve this. Major new investment is underway in the planning profession but unsurprisingly it has taken some time to develop a policy framework around one of Kate Barker's core proposals - planning gain supplement (PGS), effectively a new tax levied on developers, through which the costs of infrastructure provision would be met (the consultation on this closed at the end of February 2007).

In January 2005 the DPM published *Homes for All*, his five year plan for tackling housing shortages. This was followed by two joint ODPM/HMT papers, in May '*Extending Home Ownership*', which focussed on adding one million more home-owners by 2010 and in July *Housing Policy: an overview statement*. In March 2006 the Chancellor announced the establishment of the Shared Equity Task Force to look at ways of increasing access to home-ownership. Its report was published in December 2006, and in March 2007 the government announced a 'Shared Equity Competition' through which the private sector could offer up ways of extending access to home-ownership.

As all this suggests, the Labour government has undertaken a major and rapid refocus in housing policy towards home-ownership. It is well summed up in the foreword by the Chancellor and the DPM in the Government's response to the Barker Review (HM Treasury/ODPM, 2005, page 1);

"We will extend home ownership towards 75 per cent. We will deliver new and better homes, to support growth and prosperity in every English region. And we will continue to build on our record of success in building new affordable homes, bringing quality and choice to those who rent. The choice is clear: meet the needs of future generations, or deny them the opportunities we enjoy. Extend the benefits of home ownership towards 75 per cent of households, or accept that unaffordable housing will constrain our social and economic ambitions. Support affordable housing, or see growing inequalities and disadvantage."

The significance of this shift has not been lost on many. Shelter questioned the shift towards home-ownership (Grannum, 2006), arguing that it was a risky strategy and one which needed careful management as well as stressing the case for what it felt should be a more balanced cross-tenure approach to addressing housing issues. The government too is not unaware of the risks. In February 2007, and with little publicity, a 100 page research report *Social Mobility and Homeownership: a Risk Assessment* was issued by Communities and Local Government. Though not a policy document, this spelt out the implications of the government's aspirations - 1.5 million new home-owners to achieve 75% - and the need to draw in more financially marginal and vulnerable households with a consequent shift in the risk profile of the home-ownership base.

Emergence of can't buy and won't buy

Although housing aspirations fluctuate over time, broadly speaking reflecting the state of the housing market, the widespread preference for home-ownership has persisted over a long period of time (see Smith, 2004b). Pannell (2007) provides the most recent evidence. The January 2007 BMRB survey shows that home-ownership aspirations, after a period of fragility, have now recovered strongly, with some 78% of households indicating it is their preferred tenure in two years' time. Of particular significance is the recovery within the under 25 age group, where 50% now suggest this is their preference, up from 37% in 2003 (though well below the 79% in 1989). As Pannell rightly notes this preference sits somewhat uncomfortably with the fact that ownership rates for the under 25s have been falling.

Table 1, showing the aggregate trend in housing tenure among young adults, highlights the dramatic fall-off in home-ownership rates for those under 30 years old over the past twenty years.

Table 1: Trends in housing tenure among young adults in England, %

Year	Age 20-24			Age 25-29			Age 30-34		
	Owner occupied	Social rented	Private rented	Owner occupied	Social rented	Private rented	Owner occupied	Social rented	Private rented
1984	35	33	33	60	24	16	66	24	10
1988	41	28	30	64	23	13	72	21	7
1991	38	27	35	63	21	16	72	20	8
1993/94	34	31	35	59	21	19	68	20	12
1995/96	na	na	na	56	23	22	70	18	13
1996/97	28	28	44	54	23	23	65	19	16
1998/99	25	32	43	52	23	24	66	19	15
1999/00	27	28	45	54	20	26	66	18	15
2000/01	26	30	44	53	20	27	67	19	14
2001/02	23	32	45	52	19	29	65	19	16
2003	24	27	49	51	19	30	66	17	17
2004	20	29	51	50	19	31	64	18	18

Source: Survey of English Housing

Notes: na = not available

Andrews (2006) provides insights into why this has happened. He points to factors such as credit constraints (the lack of a deposit) and student debt slowing the transition to home-ownership, the substantial costs of transactions in the context of significant job mobility of younger households, as well as a shift in the income distribution where younger households faced a relative decline in incomes. The upshot is non-graduate and single person graduate households face particular difficulties entering the housing market.

As Smith et al (2005) argue, the long term consequences of these changes in entry to home-ownership are potentially enormous and require further research. First time buyers (FTBs) have been crucial in absorbing properties from last time and existing sellers, so helping to maintain the liquidity of the housing market. FTBs have in the past made up nearly 50% of annual transactions, whereas now are about 30% of the market. This attracts much comment but it is important to recognise that because home-ownership has been growing over time the volume of moves by existing home-owners increases and the proportion of transactions by first-time buyers almost inevitably declines. But, we should note that the actual number of FTBs has fallen, from a peak of 613,000 loans in 1986 to 369,000 in 2005, a 40% reduction over 20 years.

With an ageing population it is no surprise to note that the number of 16-34 year old persons has also been in decline through the 1990s albeit it is now recovering. This reduction has obviously contributed to the falls discussed above but as Holmans (in Smith et al, 2005) notes, it is the behavioural factors that outweigh demographic trends. Tatch (2006) reminds us that some

transactions reported as FTBs are in fact returners to the market (it is estimated such households make up about one fifth of stated FTBs). Given that they are typically older and wealthier their presence has a distorting effect on the statistics. Tatch also highlights the increasingly important role of financial assistance from parents and other relatives in helping those under 30 onto the housing ladder.

What all this suggests is that there may now be significant groups of households - including many young, single people, those on lower incomes and those without generous parental support - that face great difficulty in achieving or to all intents and purposes are excluded from home-ownership. Wilcox (2005) analyses the capacity of working households aged 20 to 39 to purchase at the lower end of the market. In 40 local authorities, 40% of younger working households could afford to pay more than a social sector rent but could not buy at the lowest decile point of local house prices. If such exclusion persists over a number of years, we run the risk that the home-ownership rate might begin to fall significantly as it has in other countries (see Holmans, 2000; Whitehead and Scanlon, 2004 and Stephens, 2006).

Mitigating Circumstance and Wider Implications

These changes are being mitigated in a variety of ways. There has been a degree of substitution in terms of market activity. Declining numbers of FTBs have been masked by the growth in the purchase of second homes and by the surging Buy to Let market (Thomas, 2006).

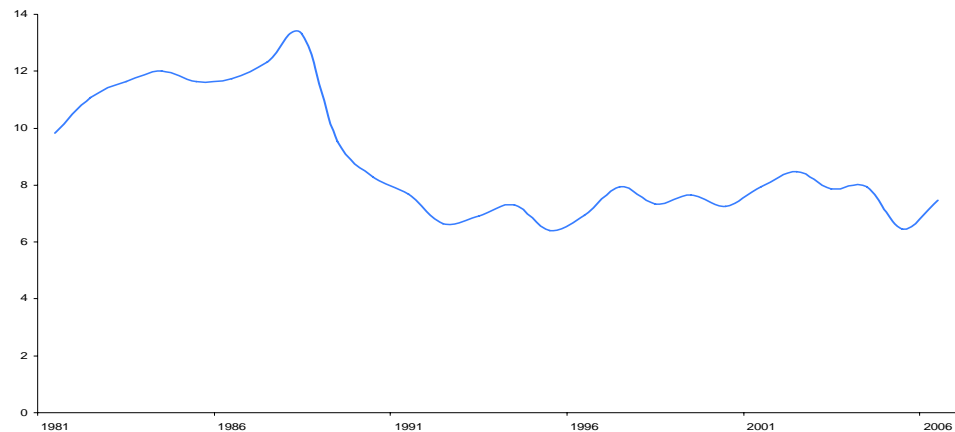
The market has therefore continued to grow, with high levels of market activity in terms of mortgage volumes (record gross and net lending), a recovery in transactions (1.25 million in 2006, up from 1 million in 2005), and resurgent house prices albeit showing signs of stabilising.

The government's pledge to increase home-ownership by one million households over five years and the creation of a range of new programmes designed to ease access to the market reflects the seriousness with which the government is treating this. It recognises that there is a growing problem in terms of access to home-ownership. However, there is now increasing anecdotal evidence to suggest that the problem is now more widespread than simply FTBs.

Given that wages have lagged significantly behind house prices for the best part of a decade, that prices in preferred locations near good schools and amenities have experienced even more rapid price inflation, and that changes in Stamp Duty mean that material transaction costs are now biting on ever larger parts of the market, there is a suggestion that existing home-owners too are finding it increasingly difficult to trade up and improve their housing circumstances. In other words, the housing ladder is not working as well as it once did. Donnell (2007) shows that turnover in the housing stock has been declining, down from an average of 9.5% per annum in

the 1980s to 6.5% in the period 1995 to 2005, with substantially less trading up to higher value properties.

Chart 3: Turnover as percentage of owner-occupied stock, England & Wales



Source: HM Revenue & Customs, HM Land Registry and DCLG

This suggests that households may have to remain in property that is no longer suitable for their needs or aspirations. Although some will adapt and improve their existing home to mitigate this, the indirect effect will be to block the market for those 'below' them on the housing ladder.

The attractiveness of the UK, and London in particular, as an international destination creates additional challenges. The upper end of the market is being powerfully driven by the UK's role as an international centre for finance and trade, while at the lower end large migrant inflows have kept wage inflation down but exacerbated demographic pressures on housing demand.

These are in part speculative comments, but they do point to a number of ways in which the housing market may be becoming more polarised and fragmented. We certainly need to research and understand such developments more fully, and possibly to respond to them rather more effectively. It also may be thought to pose questions about the government's real ability to meet the targets it has set itself - roughly one million more home-owners by 2011 and a further additional 1.5 million home-owners to achieve its 75% home-ownership target by 2015.

The question then is reconciling the economic and policy environments, the trends discussed earlier and likely market evolution. Policy is moving broadly in the right direction to assist continued growth. Supply has increased and over the medium to long term it promises to have a modest bearing on house price inflation. For the short term, however, the setting of interest rates will have by far the greatest impact. Government initiatives to assist households enter the market

are increasing, albeit there may still be questions about scale and who they are targeted at, consumer appetite and the willingness of the private sector to take over the equity lending currently provided by government (Public Accounts Committee, 2007).

The future of the housing market and home-ownership

There is a close link between the two as the heading suggests. A number of commentators have recently been offering more sanguine views on the future of the housing market (see for example Miles, 2006). And most forecasters have edged down their forecasts of house price increases and edged up their forecasts of arrears and possessions. The debate on whether the UK has experienced a house price bubble that will burst or whether the experience of recent years reflects a continuing adjustment to a lower inflation and interest rate environment continues (Cameron et al, 2006, and King 2007). At the time of writing, the evidence still favours advocates of a 'soft' landing although the longer double digit percentage house price growth persists the greater the risk that there is a sharper downward adjustment. Although the demand–supply fundamentals remain positive in terms of rapidly increasing number of households and slowly increasing supply of homes, the ultimate test is whether sufficiently large numbers of households can continue to enter the market and sustain their position in the face of pressures arising from interest rate rises, council and utility bill increases and other costs.

If there are uncertainties about the future of the housing market the same is also true in relation to home-ownership. Earlier in this article we suggested that the market would continue to grow in both percentage and number terms. However, there are a number of threats to that position. First, although the numbers of FTBs has begun to increase again, they are historically low (partly because of demographic change but also because of market circumstances). Second, entry is being substantially underpinned by a number of factors including help from existing owners, typically parents, whose own capacity to assist has been enhanced by sustained house price growth and the capacity to borrow against the value of their home. If market conditions deteriorate, this capacity might be reduced and with it their ability or willingness to assist the next cohort of FTBs.

What can or should be done?

All the evidence continues to point to worsening affordability for FTBs and others, although this is mitigated in part by the continuing erosion of lenders' margins, prudent relaxation of lending criteria and continuing product innovation. Higher short-term interest rates have caused mortgage costs to pick up sharply. The vast majority of households will cope readily with this, but the number struggling at the margins will continue to grow and this is likely to include some households coming off two or three year fixed rate deals who face a significant payment shock reflecting the new higher prevailing rates compared to when they took their loan out.

Fortunately, strong house price growth and the relatively benign economic backdrop mean that in many cases lenders have a wide array of forbearance tools at their disposal to help borrowers facing short-term difficulties.

The government has recently set up a National Housing and Planning Advice Unit whose job it will be to monitor affordability and supply across England and if necessary to press for changes in regional spatial strategies. But the real impact of such a Unit and the interventions it might make are likely to be over the medium to long term, and it is unlikely to provide a mechanism for managing any short term difficulties.

With the Government's Spending Review report due in October and expected to include a segment devoted to housing supply we are well aware the government is 'on the case' with respect to the medium term. However, what this article has sought to do and what needs to happen more widely is to begin to think about the challenges facing the market and home-ownership targets for 2015. There is a degree of complacency around the simple demand/supply imbalance as being the mechanism that will prevent any significant downturn. What we have tried to argue here is that although the policy direction is now clear, the challenges to the market, to policy and to home-ownership levels are very significant.

As indicated at the outset, lenders have been active in developing new products and processes to support a changing housing market and given current competitive pressures this is likely to continue. The future market will evolve within the context of a regulated regime which puts a considerable premium on responsible lending and treating customers fairly – both of which are sufficiently loosely defined to encourage lenders to err on the side of caution, along with the CRD regime where risk is assessed and paid for through capital weightings.

It also puts a greater premium of sorting out the issue of how best to sustain the housing market in the event of difficulties. The current Competition Commission inquiry into payment protection insurance in general has cast a shadow over the efforts by government and industry to create a functioning public/private safety net for home-owners. While it is accepted this was only ever partial the reality is that the inquiry has produced unhelpful media coverage even though the OFT agrees that the situation in terms of mortgage payment protection insurance is rather better than the mainstream market.

We might also ask whether despite the considerably enhanced level of activity, government has fully appreciated the risks, the need for more joined up thinking across policies (including fiscal measures) and the case for clearer thinking about the balance between tenures and the linkages between them. In addition, as the PAC itself made clear, there is now a pressing need to resolve the future of the intermediate ownership market. Currently demand exceeds supply and if the

government wants to take forward its home-ownership agenda to reach 75% it will have to ensure single people can access the market (CLG, 2007) and create more flexibility to allow households to move from renting to ownership (and vice versa).

The aim of this article is to stimulate a long overdue debate about the future shape of home-ownership. Though the housing market remains relatively well underpinned in terms of price levels, a number of tensions are emerging that do pose long term questions. We need now to move to answer them.

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