Bubbling up again

Oonagh McDonald analyses the US housing market and warns that there are worrying signs of problems over mortgage debt resurfacing

The US housing market underwent an enormous boom in the run-up to the financial crisis that it helped trigger.[1] That may now be repeating itself.

The housing bubble topped out in late 2006 and 2007 when an unprecedented number of subprime and near subprime mortgages began to default. The severe losses associated with these defaults undermined Bear Stearns and led to the failure of Lehman Brothers and other banks, and, ultimately, to the financial crisis.

Since then, nationally, house prices have crept back up to spring 2005 levels. In the main cities, as measured by the Case-Shiller index, they are 15 per cent to 17 per cent off the summer 2006 figures. However, house price growth slowed down in 2014 and is only expected to increase at the same level in 2015 or at a much slower pace, between 2.5 per cent and 4.5 per cent.

Even so, around 1.2 million houses have already been lifted out of negative equity, or 89 per cent of all mortgaged properties. This still leaves 5.4 million, or 10.8 per cent of all mortgaged properties, underwater. Some of these are in a greater predicament than others. Of the 49.9 million residential properties with a mortgage, some 10 million, or 20 per cent, have less than 20 per cent equity and, of those, 1.4 million have less than 5 per cent equity. Such borrowers have much more difficulty refinancing, selling or buying a new home. For the lower paid, too, affordability also remains a problem. The National Association of Realtors Affordability Index continued to fall from 196.5 in 2012 to 164.4 in 2014.[2]

At the same time, housing is a political hot potato: affordable housing, foreclosure prevention, increasing home ownership and boosting the economy are all high on the agenda, particularly with the US presidential election looming. Home ownership fell to 64 per cent from the 69 per cent attained in 2004 (Q4) and 2005 (Q1), and below the 65 per cent level seen at the start of Clinton's home ownership campaign.

Banks have to be 'flexible' and 'innovative' with their underwriting standards

Because of political pressures, the same complex pattern of laws, goals and policies that led to the 2008 crisis are all in place. The 1992 Federal Housing Enterprises Financial Safety and Soundness Act, for example, requires Fannie and Freddie,[3] when they acquire mortgages from lenders, to assist lenders in providing mortgages in areas where there are many low-income and minority families through "appropriate and prudent underwriting standards".

The act gave the Housing and Urban Development Department (Hud) the power to set and increase quotas for such loans to be acquired by the government-sponsored enterprises (GSEs). The Community Reinvestment Act (CRA) of 1977 was amended in 1995 so that lenders were no longer encouraged to lend to those on low incomes and minorities, but it requires lenders to show publicly that they have made the required loans and to find ways of making such loans even if they did not meet their lending standards. Banks and other lenders had to be "flexible" or "innovative" with their underwriting standards. All of this legislation remains in place. The only change is that the Federal Housing Finance Agency (FHFA) now sets the goals, not Hud.

The CRA has recently been energetically enforced by the civil rights division of the Department of Justice with the aim of pushing banks into lending to minority borrowers on "flexible" underwriting terms. Thomas Perez, secretary of labour, condemned "lending discrimination" as "discrimination with a smile, and it tears communities apart. The corrosive power of fine print is every bit as destructive as the cross burned in the neighbourhood".[4]

The DoJ's actions against banks were based on the "disparate impact" theory of underwriting criteria because their application of neutral policies disparately affects minorities. However, the DoJ should seek to prove intent to discriminate, as required by the relevant legislation, the Fair Housing Act and the Equal Credit Opportunities Act. The cases also hinged on statistical analyses, rather than scrutiny of a bank's lending policies. When challenged, the banks, fearing adverse publicity, settled out of court, so providing millions of dollars in fines to the DoJ. The Supreme Court is considering an appeal and may soon rule against the use of the "disparate impact" theory.

The FHFA

The FHFA, established under the 2008 Housing and Economic Recovery Act (Hera) is, as the conservator and regulator of Fannie Mae and Freddie Mac, responsible for their overall management

1. See US Bureau of Economic Analysis, *Final Sales to Domestic Purchasers*, retrieved from Federal Reserve Economic Data, Federal Reserve Bank of St. Louis. Available at www.research.stlouisfed.org/fred2/series/FSDP/, 15 April, 2015.
2. This index measures whether a typical family earns enough to qualify for a typical mortgage for a typical house. At an index value of 100, a family with the median income has exactly enough earnings to qualify for a mortgage on a median-priced home. An index above 100 means that a family earning the median income can more than qualify for a mortgage.
3. The government-sponsored enterprises (GSEs) in US housing are: the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal Home Loan Bank System (FHLBank System), which consists of 12 Federal Home Loan Banks (FHLBanks). Fannie Mae and Freddie Mac were founded in 1938 and 1970 respectively to buy, hold and sell FHA-insured loans in the secondary market. See: www.fhfaoig.gov/LearnMore/History
4. Remarks at the Rainbow Push Coalition-Annual Wall Street Conference, 14 January, 2010.

and has the overriding requirement of ensuring that they act in a "safe and sound" manner.

Its purpose is to stabilise both institutions, restore their financial soundness, maintain normal business operations and conserve their assets and property. It also establishes the "affordable housing goals", but these are, at least in theory, secondary to "safety and soundness".

The acting director until January 2014 was Edward DeMarco, a highly experienced civil servant, who steered the enterprises through the loss-making years until they returned to profitability in 2012 for the first time since 2006. In 2012, Fannie recorded a profit of $17.2bn and Freddie $11.2bn. Up until 2012, to support Fannie and Freddie – and by extension the US housing market – the Treasury bought their senior preferred stock. The senior preferred stock agreement required the enterprises to make quarterly dividend payments at an annual rate of 10 per cent to the Treasury, which the Treasury had to lend to them so that they could pay the dividend.[5]

All changed as soon as the enterprises became profitable. The 2012 agreement meant that the Treasury would take the entire positive net worth of Fannie and Freddie each quarter, leaving a buffer of $3bn for each one from January 2013. The buffer would be reduced to zero over the following five years, standing at $1.8bn in 2015. The agreement also required a reduction in Fannie and Freddie's portfolios by 15 per cent a year until they reached $250bn each by 2018.[6]

DeMarco commented that the "faster reduction of the retained mortgage portfolio will further reduce the risk exposure and simplify the operations of Fannie Mae and Freddie Mac...These changes provide certainty to Fannie Mae and Freddie Mac and market participants as they continue to perform their critical mission of providing liquidity and stability to the country's housing market."[7] That was true when DeMarco was in control of the FHFA, but is less likely under his successor's directorship.

5. The Federal Housing Finance Agency Office of the Inspector General (2013), *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements*, noted: "In order to support stability and liquidity in the mortgage market during the 2008 housing crisis, in September 2008, the US Department of the Treasury committed to provide funds—up to a cap—to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) when needed to ensure that their liabilities do not exceed their assets. It did this through senior preferred stock purchase agreements (PSPAs). As of December 31, 2012, the Treasury had provided $187.5bn to the enterprises. The PSPAs initially required the enterprises to pay dividends on the Treasury's investments at an annual rate of 10 per cent, totalling about $19bn a year by 2012, an amount greater than the highest combined annual profit that the enterprises ever earned. As of December 31, 2012, the enterprises had paid $55bn in dividends, and they frequently had to draw additional funds from the Treasury in order to pay the dividends, further increasing the Treasury's investment."

For 2014, DeMarco set Fannie and Freddie the goal that 30 per cent of the overall single-family purchase loans they buy should be loans made to those on low and very low incomes and those in under-served areas. It is proposed that this target should stand at least until the end of 2017. As in the past, purchasing loans from lenders obliged to lend to such groups to meet CRA requirements, means that the loans are much more likely to have to be made on the basis of low deposits, lower credit scores and higher debt-to-income ratios.

In its report on its annual housing activities for 2014, for example, Fannie Mae makes it clear that the mortgages it purchased may be based on lower credit scores, up to 97 per cent loan-to-value (LTV) ratios, low mortgage insurance and that, for some kinds of mortgages, the lenders are allowed to use unemployment benefit as a "source of income, whether or not they are seasonal and without meeting continuity of income requirement".

Small wonder that Fannie found that loans made in 2013 to low and moderate-income families were 168 per cent more likely to become 90 days' delinquent and 174 per cent more likely to default than loans made to families with incomes above the median level.[8] The nature of the loans bought is vital as Fannie and Freddie dominate the mortgage-backed securities market, issuing 97 per cent to 99 per cent of all mortgage-based securities. The US housing market is, however, highly politicised. Just how politicised could be seen in 2014 when there was not only a fall in the enterprises' profits but also a change of director.

President Barack Obama ensured that a former Democratic congressman and member of the House financial services committee, Melvin Watt, was appointed director of the FHFA,

6. FHFA Office of the Inspector General: *Analysis of the 2012 Amendments to the Senior Preferred Stock Purchase Agreements* 20 March, 2013.
7.DeMarco E, acting director, FHFA (2012), 'Changes to Fannie Mae and Freddie Mac preferred stock purchase agreements'. Press release, 17 August.
8. Fannie Mae. 2014 Annual Housing Activities Report and Annual Mortgage Report, March 13, 2015.

despite strong opposition. Indeed, Senate rules had to be changed so that his nomination was approved, since he had publicly stated that he "didn't know a damn thing about derivatives" nor did he know "what was in Tier 1 capital. I guess I just don't have enough knowledge in this area to understand".

For the first year he did tread cautiously, apart from announcing a postponement of increases in the guarantee fees paid to Fannie and Freddie for the loans they bought. DeMarco had introduced fee price increases to allow the private sector more scope to compete with the government-sponsored enterprises (GSEs). After a lengthy period of consultation, the FHFA is still considering what to do. Market participants expect a slight reduction in the fees, but no decision has yet been announced.

These fees are charged to cover credit risk on the loans the enterprises guarantee and should, in theory, ensure that risk is priced without too much assumption of a government backstop – ie without a major distortion. However, a desire to make US voters feel that they are in an economic upswing may well have trumped prudence. Certainly, Obama announced at the same time that the Federal Housing Administration (FHA)[9] will lower annual mortgage insurance premiums "to make mortgages more affordable and accessible".

In what looks increasingly like a race to the bottom in lending standards, the FHFA has also moved to make it easier to get a mortgage. In December 2014, the FHFA announced that the GSEs would buy loans that had only a 3 per cent down payment, provided that they had certain risk-mitigation elements, such as stronger credit histories, lower debt-to-income ratios and full documentation. This met with considerable opposition in the Housing finance committee, at least from Republicans such as chairman Jeb Hensarling. He said: "You're once again putting people into homes they cannot afford."

Fannie Mae relaunched the 30-year, 97 per cent loan-to-value mortgage, which was suspended in 2013, to meet the demands of the FHFA that it take market share from the FHA. This is a repeat of its introduction in 1994 to meet the requirements of its then regulator, Hud, which still oversees the FHA. Access to low-cost capital and minimal capital requirements allows for such "competition" to continue for a long time. However, low-risk borrowers are charged more to subsidise the costs of providing mortgages to high-risk consumers.

'I don't know a damn thing about derivatives, nor what was in Tier 1 capital'

Cross-subsidisation in single-family guarantee fees charged by Fannie and Freddie was "evident across product-types, credit score and LTV categories", with the "greatest subsidies" going to the "highest risk mortgages".[10] All this is happening despite Congress's mandate that the FHFA should adjust the prices of mortgages and guarantee fees to reflect the actual risk of loss – that is, eliminating dangerous and distorting pricing by the two GSEs. DeMarco worked hard to achieve these objectives but Watt is not attempting to comply with the mandate.

'You are once again putting people into houses that they cannot afford'

The reason why charging properly for risk is not something the FHFA's director is likely to embrace soon is rooted in the fundamental problem he faces: extreme pressure from housing, community, labour, civil rights and consumer groups all arguing that principal reduction is a key element in addressing the housing crisis, "essential to right the balance for struggling homeowners and stabilising hard-hit consumers".

A 2014 letter from "Americans for Financial Reform", for example, argues that for those facing foreclosure, "the ability to reduce the principal owed on mortgages" is "the most effective way to avoid foreclosure".[11] To allow this reduction in principal for the 365,000 underwater loans backed by Fannie and Freddie would cost about $18bn.

Watt is still considering the issue, having cut the enterprises' income by reducing the guarantee fees at a time when their income overall is reduced. He has also instructed Fannie and Freddie to pay 4.2 cents on each dollar of the unpaid principal value of their new business purchases to be allocated into the Housing Trust Fund (HTF), which helps support the construction of affordable housing, and to the Capital Magnet Fund, which provides grants to community development projects and non-profits for affordable housing projects.

Both were established in Hera in 2008 and DeMarco had suspended payments into the funds. HTF will be one of more than 30 affordable housing programmes, an unnecessary addition, according to the Government Accountability Office. The Capital Magnet Fund is supervised by the Treasury, but the grants it provides arguably ignore statutory obligations to taxpayers to "preserve and conserve" Fannie and Freddie's assets.

There have been official words of warning. The Inspector General for the FHFA produced a report in March this year, arguing that the "continued profitability of Fannie and Freddie is not assured".[12] It pulls together all the implications of the current agreements with the Treasury with an analysis of the sources of their income. Both Fannie and Freddie have to reduce their portfolios over the next few years from the current $438bn for

9. The FHA was established in 1934 and incorporated into Hud in 1965. It provides insurance for mortgages backed by the government. The buyer pays for the insurance as part of the monthly mortgage payments, and the proceeds are set aside in a separate account, and the insurance is considered to be self-financing. It is designed to protect the lender from losses incurred if the borrower defaults on the loan. For the borrower, the required down payment is as low as 3 per cent and there is greater flexibility in calculating household income and payment ratios.

10. Fannie Mae and Freddie Mac (2012), *Single Family Guarantee Fees* p 7.

11. 'Americans for Financial Reform joins more than 200 other groups in urging FHFA Director Mel Watt to reverse Fannie-Freddie policy on principal reduction' (6 Nov, 2014). Creating MBS involves using the assets, and interest payments, of diverse and hard-to-value mortgages to back what should be easy-to-value bonds. These bonds had their own sorry tale to tell in the financial crisis – proving to be much less secure than investors were led to believe. For many years following the crisis, the Fed was the only large taker for MBS. For an introduction to the development of the MBS market, and of the savings and loans crisis, see Michael Lewis (1989), *Liar's Poker.*

12. Inspector General for the FHFA (2015), *The Continued Profitability of Fannie Mae and Freddie Mac is Not Assured*. White Paper Report.

Fannie and $414bn for Freddie to $250bn each.

This not only cuts risk, however, it also cuts what was their largest historical source of income. Core earnings from their business, single and multi-family guarantees and investments were 40 per cent of their income in 2013 and 55 per cent in 2014, with the rest coming from non-recurring events such as settlements of legal actions and tax-related items. "Non-recurring events" hit a record of 60 per cent of earnings, or $79bn, in 2013.

To add to that, Fannie and Freddie's capital cushion has to be reduced to zero by 2018. Stress tests in April 2014 suggested that, in a worst-case scenario, they would need between $84.4bn and $190bn of additional capital, depending on the treatment of deferred tax assets through the end of the stress test period in the fourth quarter of 2015. (The worst-case scenario assumes that house prices would be down by 25 per cent over nine quarters – deeper than the 2007 and 2008 plunge.)

Clearly, Watt's decisions so far have made it more difficult for Fannie and Freddie to remain profitable.

Further difficulties for the enterprises may arise, if and when, the Federal Reserve, as the single largest purchaser of their mortgage-backed securities (MBS) exits from its MBS programme this year. Between 2008 and 2010, the Treasury and the Fed bought trillions of dollars of MBS guaranteed by the GSEs and Ginnie Mae, a federal agency that guarantees securities backed by mortgages insured by the FHA, the Department of Veterans Affairs and other federal agencies.

In 2011, the Fed announced a second round of purchases funded by reinvesting principal payments from its holdings of GSE and Ginnie Mac securities in GSE and Ginnie Mae MBS. In September 2012, the Fed said it would buy more agency MBS at a rate of $40bn a month and continue to reinvest principal payments in GSE and Ginnie MBS.

The Fed is gradually reducing its commitment to buying the GSEs' MBS. Together with Ginnie Mae, it has issued trillions of dollars of MBS since 2006, and, with the collapse of the private label securities market, have issued between 96 per cent and 99 per cent of all MBS.

In 2014, it issued 97 per cent of all MBS in the US, totalling $1.02tn. It is difficult to see who would take over the Fed's dominant position as the purchaser of MBS. Even with the explicit government guarantee of the mortgages issued by Ginnie Mae, these are big boots to fill.

That said, there are plans to tackle the challenge. The counsellor to the housing secretary stated that the FHFA is "laying the groundwork for the future housing finance system based on private capital...Despite having only minimal retained capital levels at the GSEs, investors continue to have confidence in their securities due to the backstop the PSPAs provide each company. The substantial remaining capital support left under the PSPAs gives market participants the confidence to buy GSE securities on a day-in-day-out basis. This is despite the fact that the GSEs remain in conservatorship and have minimal capital levels".

> Reforming the system of housing finance will be a priority after the election

Just how minimal? Only $1.8bn in 2015. Investors assume that the Fed will, should anything go wrong, pump capital into Fannie and Freddie. At the same time, the Treasury sweeps all of their earnings into its coffers. The FHFA's director is, in effect, reducing their earnings and is likely to increase their risks.

The bottom line is that the administration has no intention of recapitalising Fannie and Freddie. The reduction of the capital buffer to zero by 2018 is meant to underscore that. But, as the buffer falls, it becomes increasingly likely that, if there are losses for Fannie and Freddie, another infusion from the Treasury would be required. Watt's actions have perhaps made losses more likely.

The administration believes that the Treasury backstop will give mortgage investors enough confidence in Fannie and Freddie without having to rebuild their capital base. It is unlikely that there will be any bi-partisan agreement on the reform or abolition of Fannie and Freddie before the 2016 presidential election. Reforming the system of housing finance will be an urgent task for the next administration.

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Relaxed about relaxing

Richard Northedge discusses the UK housing market and sees no need for alarm yet as the generous lending ratios that preceded the financial crisis return

Global commentators like to begin the timeline of the financial crisis with Lehman Brothers' collapse in September 2008, but UK observers start the clock a full 12 months earlier, with the run on Northern Rock. The former building society had given home loans of five times borrowers' incomes and 110 per cent of their property's value, financing its rapid growth with the residential mortgage-backed securities whose refinancing eventually brought down Lehman. But before the US investment bank tumbled, other UK housing lenders – Alliance & Leicester and Bradford & Bingley, followed by the mighty Halifax – had also been rescued by rivals or bailed out by the government.

As dominoes toppled worldwide, the UK experience was an early lesson in financial risk. Yet, even before the last crisis has been fully cleaned up, British lenders are again relaxing their mortgage terms. Having tightened their lending policies as the crisis unfolded, banks are now easing them, increasing loan-to-value and loan-to-income ratios while squeezing their net lending margins. Loans are on offer at less than 1.1 per cent. But lenders have the financial and legislative backing of government and regulators. Easy borrowing was diagnosed as the problem in 2007: now it is being prescribed as the solution. The question is whether it could be storing up problems for the future.

Politicians acknowledge housing's importance to the UK economy. Most households are owner-occupiers; most non-owners would like to buy. Property ownership gives people confidence that translates into consumption, employment and growth as well as reducing their dependence on the state. Falling values and negative-equity upset owners but can erode banks' capital catastrophically.

A "healthy" or rising property market is, therefore, in everyone's interest – even those yet to buy, assuming that they can hope to get on the housing ladder, because they would not want to buy an asset falling in value and see their savings disappear. Housing's political importance was demonstrated by the string of policies and promises announced by all parties before the general election.

The banks' reaction to the developing financial crisis was traditional and rational. They belatedly imposed tougher lending standards, raised rates and cut lending because resources were restricted by the reduced liquidity. Banks that had relied on the originate-and-distribute model to renew their funding had to curtail lending severely once the securitisation market closed. With the horse bolted, banks shut the stable door, applying credit-scoring, checking income claims and demanding greater deposits to build in a buffer to absorb the falling values. Loans were priced to reflect risk, with higher rates for higher loan-to-value ratios.

There is a circularity in this, however: the responses to the problem typically make it worse. The reduced supply of loans means fewer purchases, which depresses prices, further deterring buyers. Property prices started to fall in September 2007 as queues of customers formed at Northern Rock branches. Home sales, nearly 1.5m that year, more than halved in the next year, with annual gross mortgage lending collapsing from £363bn to £135bn over three years.

Easy borrowing was seen as a problem, now it is touted as a solution

As the vicious circle revolves, the accompanying economic recession makes potential purchasers wary and unable to pay so much; rising unemployment increases arrears and repossessions, exacerbating the fall in values. Even if demand for loans and supply contract in tandem, thin transaction volumes cause the market to stagnate.

It is a vortex that the UK housing market had descended into in previous downturns. Yet, this time some aspects of previous spirals were absent. After criticism of heavy-handed repossessions in the 1990s, lenders agreed to act more compassionately. They may also have been inspired by an urge to avoid write-downs, which would have increased their own capital charges. Repossession peaked at just 37,900 in 2009 compared with 75,500 in 1991. And instead of interest rates rising, this time they fell. Bank rate had risen to 5.75 per cent in July 2007: the first quarter point cut came in December with the rate plunging to just 0.5 per cent by March 2009.

An important entrant to UK shadow banking was the Bank of Mum & Dad

Even if lower interest rates were not aimed specifically at supporting the housing market, and therefore property lenders, they had that effect. Other measures that helped revive the market followed. Quantitative easing, intended to encourage investors to take their money out of the shelter of government bonds and put it into productive, but riskier, businesses by lowering borrowing costs, started in 2009. The Funding for Lending Scheme, launched in August 2012, gave banks even cheaper finance for lending to homebuyers and small business. Although mortgage lending was excluded from January 2014, building societies still outnumbered other FLS borrowers for outstanding drawings at the start of this year.

However, low interest costs alone have not been enough to attract buyers into the market. When 90 per cent mortgages and high income multiples were common, monthly repayments were the main limitation on borrowing: after cautious lenders retreated to giving 60 per cent loans, the constraint became buyers finding the 40 per cent equity.

Before 2007, an important entrant to UK shadow banking – the Bank of Mum & Dad – had helped bridge the gap between loan and price for first-time buyers, pushing prices yet higher by doing so. It was an easy way for parents to increase their exposure to the rising tax-free property market – an arrangement that suited both them and their children.

After 2007, as banks tightened their lending criteria, that funding gap widened, despite prices falling. But, in a falling market, parents became less inclined to provide risky secondary mortgages – equity loans – even if the recession did not also curtail their ability to help. So, having cut interest costs and increased the supply of bank funds, the government now produced measures to address the housing market's equity gap.

Help to Buy was launched in 2013 to allow purchases of properties priced below £600,000 with a deposit of just 5 per cent. Initially it covered newly-built homes, topping up a conventional 75 per cent mortgage with a 20 per cent equity loan that is payment-free for five years while the principal increases with the house value. Six months later, Help to Buy was extended to all homes, with loans from a group of major lenders where the government guarantees the slice above 75 per cent, subject to a 4.5 loan-to-income ratio.

The government scheme was criticised when launched. There were fears taxpayers would be lumbered with expensive guarantees if house prices continued falling. The Bank of England worried Help to Buy would destabilise the housing market; the IMF was concerned it was driving up London property prices; the

Office of Budget Responsibility doubted it would boost construction. Initially, only five lenders backed the scheme.

In fact, Help to Buy caught, or caused, a turn in the housing market. Prices outside the West Midlands, East Anglia, the north, Scotland and Wales started rising again in 2013, following a southern recovery. Yet, take-up has been weakest in London (20 per cent) despite – or perhaps because of – the capital's prices rising fastest. The BoE's financial policy committee now concedes Help to Buy is not driving up prices. However, while a fifth of buyers of new homes used the scheme in its first year, builders have not increased output significantly: completions fell from 198,000 in 2007 to 106,000 three years later but recovered to just 114,000 in 2014.

The experience has, however, encouraged mortgage companies to relax their lending conditions at the same time as other factors made them reassess the risks of high-value and high-income ratio loans. The return of property price inflation ensures high loan-to-value ratios steadily fall to safer levels – although the risk-related premium interest rate continues. The realisation that bank rates will remain low for longer allows lenders to cut fixed-rate terms and reduces the risk of non-payment. Rapidly falling unemployment also diminishes that danger.

Repossessions peaked at 13,000 in the first quarter of 2009 – far below peaks in past recessions – and are now down to 4,000. The number of mortgages in arrears halved over those six years to just over 100,000.

Meanwhile, some regulatory factors encouraged banks to focus on mortgage lending. Home loan rates are low, but so is the capital backing required. Revised Basel regulations cut the risk-weighting for residential loan-to-values below 80 per cent from 50 per cent to 35 per cent: now a review could cut that further. Separately, the BoE and ECB are supporting the revival of securitisation markets.

Mortgage lenders, therefore, can justify relaxing their terms on the basis that they are not unduly increasing risk. Yet, demand has failed to match the improved supply despite the relaxation and despite cheaper borrowing, state schemes to reduce the equity gap, and stamp duty changes that reduce most purchasers' up-front costs. Would-be first-time buyers who stayed out of the market when values were falling and lacked confidence or finance to buy when prices were low now complain that rising prices prevent them buying – particularly in the south-east. Even though homebuying is now more affordable in many other parts of the UK, sales have picked up only slowly: mortgages approvals of around 60,000 a month this year (including buy-to-let loans) are down 18 per cent on early 2014.

> Help to Buy caught, or caused, a turn in the housing market

Lenders, therefore, have launched a mortgage war to attract reluctant borrowers. Loan-to-value ratios have risen and rates have fallen. Average mortgage rates have halved since 2009. Two-year fixed-term mortgages at less than 2 per cent are common, with 1.18 per cent available on 65 per cent loans. Five-year fixes at 1.09 per cent for borrowers with 60 per cent equity are on offer. A 75 per cent two-year fix costs another 50 basis points with an extra 100 for 95 per cent loans. However, no-equity deals are still off limits. The spread between rates on low and high loan-to-value ratios has narrowed slightly since Help to Buy started, says the BoE, but the premium still protects lenders against a severe housing-market downturn.

> With demand still slack, the mortgage war may have to escalate further

Although high-ratio loans are available, they remain a small and possibly diminishing proportion of banks' lending. Mortgages exceeding four-times income comprised 9.7 per cent of gross advances in the last three months of 2014 – much lower than in previous quarters or previous years. Mortgages exceeding 90 per cent of value were 3.8 per cent. That is double 2011's level, but high loan-to-value loans accounted for 25 per cent of new mortgages in 2007, and even more in the 1980s and 1990s. Many of the lenders specialising in high-ratio loans did not survive the financial crisis.

Not all changes in the lending environment have favoured relaxation of loan terms. Low wage inflation reduces one protection against arrears and interest rates must eventually increase. A concerned Prudential Regulation Authority has imposed a 15 per cent cap on how many mortgages lenders can give at more than 4.5 times the borrower's income. The Mortgage Market Review has, since April 2014, required lenders to apply much stricter scrutiny of borrowers' incomes and outgoings, too. Meanwhile, bank stress tests get tougher and pre-election threats of a mansion tax, rent controls, inheritance-tax concessions on family homes and Help to Buy Isas are reminders that housing remains a political football.

The PRA and the BoE's financial policy committee continue to monitor mortgage lending closely but seem not unduly concerned. GDP growth is a comfort, even if productivity and wages remain anaemic, but London prices seem to have flattened or are falling and, as with the upswing in the housing market, trends tend to spread outward from the capital. At the same time, lending policies, however, are set nationwide: they reflect price levels rather than direction or momentum. The contrast between property inflation and the deflation seen in the wider economy is a paradox yet to be resolved.

But although the generous lending ratios that preceded the financial crisis have returned, this time they are being offered more discriminatingly, protected by stringent selection processes, sophisticated risk matrices, government guarantees and a growing economy. And nationally, house prices are still not quite back to their 2007 peak. So, with demand still slack, the mortgage war may have to escalate further. The warning sirens are not sounding yet.

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