Mortgage equity withdrawal and consumption

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Mortgage equity withdrawal is borrowing that is secured on the housing stock but not invested in it, so it represents additional funds available for reinvestment or to finance consumption spending. Mortgage equity withdrawal was an important source of finance in the 1980s. But it fell back sharply in the 1990s, and remained negative for much of the decade. This article discusses the motivation for and the effects of mortgage equity withdrawal, using evidence from a recent consumer survey carried out for the Bank of England and the Council of Mortgage Lenders.

Introduction

The article on pages 91–99 looks at how changes in wealth affected consumption and the saving ratio in the second half of the 1990s. One of the factors accounting for the fall in the saving ratio was mortgage equity withdrawal. This article discusses mortgage equity withdrawal in more detail.

The first section outlines how the Bank calculates aggregate mortgage equity withdrawal, and explains the relationship between this aggregate measure and other macroeconomic variables. The second section outlines the results of a microeconomic study of the various ways in which households can withdraw equity. The third section reports the results of a recent MORI survey, which investigates how equity is withdrawn, what it is spent on and why this method of finance was used.(1)

An aggregate measure of mortgage equity withdrawal

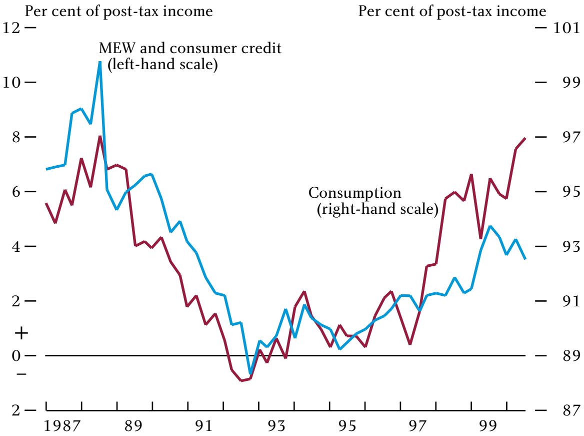
Mortgage equity withdrawal (MEW) occurs when lending secured on housing increases by more than investment in the housing stock. Investment in the housing stock, including buying new dwellings and spending on improvements, will tend to increase housing wealth. If investment is fully funded by an increase in debt, then net housing equity is unchanged for given house prices. If the increase in debt is greater than investment, funds are available for non-housing purchases and housing equity is withdrawn.

The Bank's measure of MEW is the difference between net lending secured on dwellings (plus grants for housing) and households' gross investment in housing.(2) Investment comprises new houses, home improvements, transfers of houses between sectors, and house moving costs, such as stamp duty and legal fees.(3) So MEW measures mortgage lending that is available for consumption or for investment in financial assets (or to pay off debt).

Relationships with MEW at the aggregate level

MEW is closely related to consumption, and the relationship is closer when consumer credit is added (see Chart 1). But this may partly reflect an accounting identity. By definition, consumption is funded by income, unsecured borrowing, MEW or disposal of

Chart 1
MEW and consumption

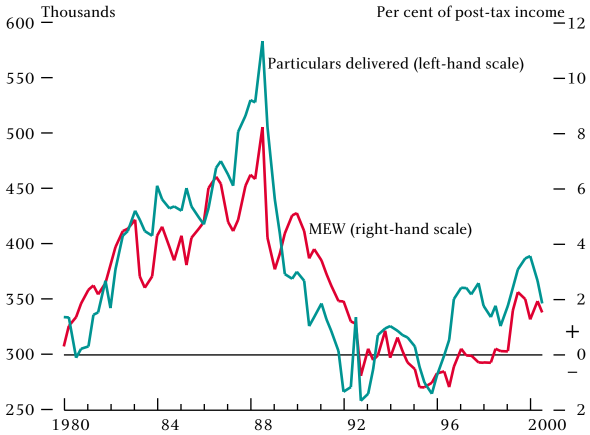


(1) A joint report on this survey will be published by the Bank and the Council of Mortgage Lenders later this year.
(2) See www.bankofengland.co.uk/mew.htm for a full description and codes for the series, and a link to the latest data.
(3) Although these fees do not add to the value of the housing stock, they are measured as investment, so reduce the funds available for consumption.

assets. Typically it is changes in borrowing, rather than changes in gross saving, that are associated with changes in the ratios of consumption and saving to income.(1) So an increase in borrowing may be an early indicator of consumption growth.

Recent *Inflation Reports* have discussed the close link between MEW and housing market transactions.(2) But when transactions picked up in 1997, MEW remained subdued (see Chart 2). This perhaps partly reflects the financial and psychological impact of housing market conditions in the early 1990s, when prices fell sharply and led to a sustained period of negative equity for some homeowners, and partly the availability of finance from other sources, such as demutualisation windfalls. The link between MEW and housing transactions was re-established clearly in 1999.

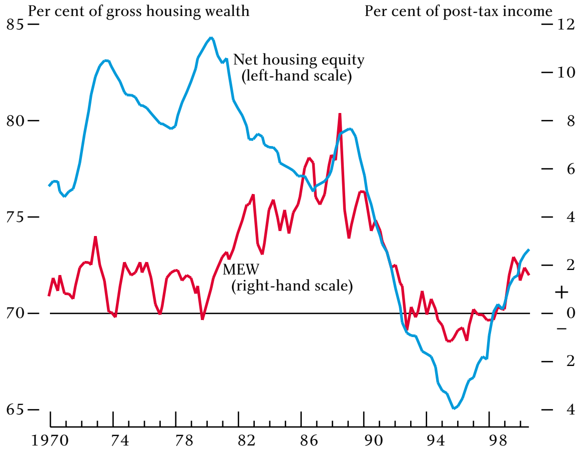
Chart 2
MEW and transactions



Another influence on MEW is the level of house prices, and particularly the level of net equity. To withdraw equity, households need to have positive net worth in their home. For the household sector as a whole, net housing equity has averaged around 75% of gross housing wealth since 1970, but has been quite variable over time—mainly reflecting changes in house prices.(3)

Net housing equity and MEW were, however, unrelated until around 1985 (see Chart 3). This may reflect an increase in the ability of households to withdraw equity following liberalisation of the financial sector in the 1980s. So MEW is now related to house price changes and to housing market activity.

Chart 3
MEW and housing equity



A microeconomic measure of MEW

As an alternative to the Bank's aggregate measure, MEW can be calculated as the sum of various types of gross withdrawals of equity from housing, net of gross injections. The resulting net equity withdrawal figure should, in theory, be the same as the Bank's aggregate measure. The flows represent the ways in which individual households are taking money out of, and putting non-secured funds into, property. These are set out in Table A.

Table A
Ways of withdrawing and injecting equity

Withdrawals	
Last-time sales	A seller does not buy a new property, so the proceeds of the sale are released from the housing market.
Trading down	A seller moves to a cheaper property but reduces the mortgage by less, to leave a cash sum.
Over-mortgaging	A moving owner-occupier increases their mortgage by more than the difference between the old and new house prices.
Remortgaging	A borrower takes a new mortgage and increases their debt without moving properties or improving the property to the same extent.
Further advances and second mortgages	A borrower raises a further advance on an existing mortgage or takes a second mortgage without improving the property to the same extent.
Injections	
First-time purchases	The deposit paid by first-time buyers.
Under-mortgaging	A mover changes their mortgage by less than the difference between the old and new house prices.
Under-remortgaging	A borrower takes a new mortgage and reduces their debt without moving properties or improving the property.
Repayments of mortgage debt	Regular repayments of principal and the redemption of mortgages, except on sale or remortgaging.
Home improvements	Home improvements paid for with non-secured funds.

An example

A simple example illustrates how the micro and aggregate measures compare. Suppose someone inherits

(1) See Chart 4, on page 92 of this *Bulletin*.
(2) See, for example, the November 1999 *Inflation Report*, page 6.
(3) For many individual households gearing is likely to be much higher. A sector-wide measure cannot be used to analyse the incidence of negative equity, for example.

a property and sells it for £100,000 to a first-time buyer, who pays a 10% cash deposit and borrows the rest. On the micro measure, the seller withdraws £100,000 and the buyer injects £10,000—so net MEW is £90,000. On the aggregate measure, there has been no investment in housing but net lending has risen by £90,000, so MEW again is £90,000.

Flows of gross withdrawals and injections

Alan Holmans of Cambridge University, in a joint Bank of England/Council of Mortgage Lenders (CML) project, has estimated the flows of withdrawals and injections from various data sources.(1) His preliminary figures show that last-time sales are the largest component of gross withdrawals, although over-mortgaging and remortgaging are important factors in the pick-up in MEW. Repayments of debt are the most important injection—although these mainly consist of many small injections by a large number of households (eg the capital amortisation element of repayment mortgages).

Evidence from a consumer survey

The Bank and the CML, as part of their joint project, commissioned MORI to carry out a survey of people who had been in a position to withdraw equity (because they had recently moved, remortgaged or taken a further advance).(2) The sample consisted of 918 respondents, of whom 301 had moved, 502 had remortgaged and 200 had taken a further advance, between June 1998 and September 2000.(3)

How equity is withdrawn

35% of movers withdrew equity and 39% injected it.(4) In money terms, net equity withdrawal by movers was small (see Table B). But 5% of movers were first-time buyers who will tend to inject some equity in the form of a cash deposit. Excluding these, net withdrawals were more than twice as large. For remortgagers, 13% injected equity, with 37% keeping the size of the loan unchanged; the remaining 50% withdrew equity. Average net withdrawals by remortgagers were £11,000 and by those taking a further advance £22,000, the greater amount reflecting the lack of offsetting injections.

The relatively low value of net withdrawals for movers may look surprising, given the close correlation between the aggregate measure of MEW and housing market transactions. But it excludes an important source of gross withdrawals—last-time sales—which will also be linked to transactions and lead to high levels of net equity withdrawal (there are no injections for last-time sales). Around half of gross equity withdrawal over the 1990s has been by last-time sellers. In addition, the remortgage and further advance figures are particularly boosted by withdrawal for home improvements—see below—which does not affect the aggregate measure.

What equity is used for

64% of those withdrawing said that they spent some of their withdrawn equity within the first six months. 20% used the money to pay off previously acquired debts so would not have increased their consumption. Only 9% saved the money for any length of time.

Those who said that they spent some of the money within the first six months were also asked what things they spent money on. The majority (76%) mentioned home improvements, although these are not in the Bank's definition of MEW.(5) 22% mentioned purchases

Table B
Average withdrawals and injections

Figures in £s

June 1998 to September 2000

	Gross withdrawals	Gross injections	Net withdrawals
Moved	21,400	23,800	1,100
Excluding first-time buyers	*21,400*	*23,000*	*2,600*
Remortgaged	27,000	17,900	11,100
Took further advance	22,000	n/a	22,000

n/a = not applicable.

Note: Average size of gross withdrawals by those withdrawing, average size of gross injections by those injecting and average net withdrawal by all respondents (excluding 'don't knows').

Table C
Use of withdrawn equity for those who said that they spent the money(a)

Per cent

June 1998 to September 2000

	Moved	Remortgaged	Took further advance	Total
Home improvements	70	75	80	76
New goods for the property	34	25	13	22
Car	13	6	6	7
Other goods	11	5	3	5
Holiday	7	5	3	5
General expenditure	11	12	7	10
Other	30	13	12	15

(a) Respondents could list multiple items.

(1) Holmans (2001), *Housing and mortgage equity withdrawal and their components flows*, forthcoming.
(2) The survey does not provide evidence on last-time sales or the effects of making injections, except at the time of a house move or remortgage. Further advances include second mortgages.
(3) The survey was carried out between Friday 29 September and Monday 23 October 2000.
(4) The remainder either kept their net equity constant or did not know whether they had withdrawn or injected.
(5) Home improvements are included in household investment and are netted off the measure of MEW.

for the home, and 7% said they bought a car or other vehicle (see Table C). Of the respondents who had moved, fewer mentioned that home improvements were the most expensive item on which they spent money.

Why equity withdrawal was used

It is not possible to tell from the aggregate data whether increases in house prices trigger spending that would not otherwise have happened (in which case MEW provides a channel by which the wealth effect of house price rises affects spending), or whether equity withdrawal is simply a cheap way of funding desired spending (in which case, MEW arises from substitution towards borrowing with relatively lower interest rates on secured lending). So the survey also asked what encouraged the respondent to raise cash this way, and what respondents would have done had they not withdrawn the equity.

32% of responses cited a rise in the value of their house as a factor for using equity withdrawal, with more of those remortgaging with the same lender giving this reason (see Table D).(1) But 31% of responses said that it was a cheap way to finance desired borrowing. Significantly fewer movers, 10%, said that the price of the loan was important, though 19% saw withdrawing equity when moving as a good opportunity to raise capital, suggesting lower transactions costs play a role.

Table D
Why finance was raised through equity withdrawal(a)

Per cent

June 1998 to September 2000

	Movers	Remortgagers	Further advance	Total
House prices	25	35	33	32
Cheap loan	10	31	42	31
Best way to borrow	19	5	7	8
Advice	9	31	26	25
Advertising	1	8	8	7
Awareness	13	31	33	28
Other	37	3	12	13
Don't know	13	9	3	7

(a) Respondents could list multiple reasons.

In a separate question, those who had remortgaged were asked for their motivation for changing their mortgage. 42% said that they wanted a better interest rate or deal and 31% said that they wanted to raise money for a specific purpose (ie they remortgaged in order to withdraw equity).

Further, 63% of decisions made would have been different if equity could not have been withdrawn. Other responses indicated that alternative sources of finance, such as taking an alternative loan or reducing savings, would have been used to fund activities.

So the evidence is mixed. House price rises appear to trigger MEW for some borrowers, but many households say that they wanted to spend anyway and used equity withdrawal as a relatively cheap way to fund this spending. And even for those households who do not see house price rises as a trigger, the amount they are able to withdraw will be affected by past rises in house prices.

Conclusions

Mortgage equity withdrawal picked up in 1999 and has remained high since. According to Alan Holmans' estimates, over-mortgaging and remortgaging are important factors in this rise. Evidence from the MORI consumer survey suggests that MEW will have helped to fund consumption over the past two years. It is also likely that at least some of this spending would not have occurred if housing market variables had been weak, or if lending restrictions had prevented households from withdrawing equity.

(1) Respondents were allowed to give more than one answer.