How the impact of higher interest rates will reduce property prices

Submitted by: Key Loans & Mortgages Limited t/a KIS Finance
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Higher interest rates make it harder to buy property, which in turn will lead to reduced demand and lower house prices, analysis by KIS Finance (https://www.kisbridgingloans.co.uk/) has found.

Anyone currently looking for a mortgage will have been unpleasantly surprised by the massive increase in the cost of borrowing over the last few months.

Whilst the Bank of England base rate rose from 0.1% in November last year to its current level of 2.25%, the cost of mortgage products has risen far more sharply, as lenders try to price for the current unpredictability of the market and uncertainty over how far rates will continue to rise. The result has been a massive impact on both the residential and buy to let housing markets, at a time when everyone is facing the pressure of the rising costs of fuel and other everyday goods.

If you have a fixed rate from a year ago, life is going to be so much easier than if you are now coming off a fixed rate and looking for a new one.

Average fixed mortgage rates rise by nearly 4%

Customers now looking for a fixed rate residential mortgage are finding that the market has changed beyond recognition in the last couple of months. With lenders withdrawing numerous products, the ones that remain are set at considerably higher rates, pushing many potential first-time buyers (once again) out of the market. Those whose current fixed term products are coming to an end face the worry of soaring monthly repayments, alongside other rising costs.

What do these increases mean for an average buyer?

At KIS Finance we have reviewed the impact of the recent rate increases for a typical customer.

Simon purchased a property in October 2021 for £220,000 and needed a mortgage of £198,000. He wanted to fix the rate for 5 years in order to protect himself from unexpected rate increases. At this time a mortgage was arranged for Simon at a rate of 2.5%, with a monthly cost of £745.05 over a 32 years term.

However, if Simon purchased the same property, with the same terms today, the rate would be 6.14%, resulting in monthly payments of £1,185. With an additional cost of £440 a month not easily absorbed, the impact would be considerable and likely to push many homeowners into debt.

Property prices likely to fall as a result

As the cost of borrowing soars, we're likely to see a contraction in the housing market, with the number of first-time buyers and people looking to move up, falling. House prices are also predicted to fall as customer demand declines due to the increased cost of obtaining a mortgage. As people review the amount they can borrow, we are likely to see a downward pressure on house prices that hasn't been seen since the 2008 and the credit crunch.

Some are predicting that prices could fall by as much as 5% in 2023, with a further 5% fall in 2024, as a result of the current mortgage rates rises. Those who have taken out high loan to value mortgages over recent years, may face the potential risk of negative equity in their properties, if prices were to fall sharply.

Pressures on Buy to Let Market may lead to rent increases

As rising interest rates impact on buy-to-lets, we reviewed the potential knock-on effects that this could have on the rental market.

Sarah was a basic rate taxpayer who purchased a Buy to Let property for £152,000 in October 2021 with a monthly rental income of £650. She needed a mortgage of £114,000 and the mortgage was approved with a 5-year fixed rate of 2.19%.

At that time the rental income was stress tested at 4.5%. This means that she needed a minimum rental income from the property of £513 per month to cover the loan. (E.g. £114,000 x 4.5% /12 x 120%).

However, if Sarah wanted to purchase the same property today, the current rate would be 5.39% and the maximum loan based on this rental income would be £70,671 with the same lender. The reason for the reduced loan amount is that the lender has increased their stress test calculator to 8.49%, which means that the rental income would now need to be £968 per month to cover the required loan.

With lenders increasing the stress test multiples, the resulting impact on rents will hit the housing market at the worst time, as general costs of living soar. If tenants can't afford to pay the increased rents, then there will be a drop off in people renting and a decrease in the demand from landlords to buy properties to rent out. This in turn will lead to falling property prices.

Equity Release Market coming under pressure

The rise in interest rates has also had a significant impact on the equity release market, with rates increasing sharply over the last few months.

The cost-of-living crisis has meant that some homeowners have turned to equity release as a way of providing an additional income. Others with interest only mortgages have used equity release to raise the funds to repay the loan. However, increasing interest rates have made this a less attractive option for many.
Pat approached KIS Finance in May 2021 as she was coming to the end of her interest only mortgage and needed to raise funds to repay the loan. The maximum loan available based on her age and property value of £190,000 at that time was £80,560, which was enough to clear her interest only mortgage of £75,000. The interest rate was 6.64% and if she chose to have the interest added continually for the next 15 years, Pat would owe £217,535 at the end of the term.

However, faced with the same scenario now, the maximum loan available to Pat would be £73,150 at the rate of 8.37%. On this basis, after 15 years, Pat would now owe £255,609. For those who have been relying on equity release to clear an interest only mortgage they may well face the worrying prospect of not being able to raise sufficient funds to do so.

Bridging Finance rates buck the trend

Whilst mainstream mortgage rates have been soaring, it has been a very different story with bridging finance. Bridging rates have been overall falling for the past 12 years due to the increased levels of competition in the market, with rates falling as low as 0.41% a month in the first quarter of 2022, down from 0.45% in the last quarter of 2021.

In part this is due to the fact that many bridging lenders have what are referred to as “non-utilisation costs” which means that they are charged for funds that they have arranged, even if they are not using them. Therefore, it makes sense for them to lend the money out, even if it is at a lower rate. Bridging margins were already high, meaning that lenders could afford to absorb some increased costs, but increasing competition has been gradually reducing margins.

However, those in the sector are predicting that even bridging rates may start to rise, as lenders feel the squeeze caused by the bank of England’s consecutive interest rate rises over the last year. Some lenders have started to increase their rates for the first time in 12 years, and we are seeing increases of 0.1% to 0.2% per month, but more noticeably the fear of reduced property values has seen the maximum loan to values drop from 75% to 70%.

The impact on the wider economy

Holly Andrews, MD at KIS Finance (https://www.kisbridgingloans.co.uk/) comments on the findings:

“With interest rates likely to continue to climb over the coming months, housing costs are set to account for an increasing proportion of household incomes. Whether it is increasing mortgage payments or rising rents, disposable income will be hard hit by these rising costs.

Alongside the increasing costs of other essentials, such as energy and food, we are likely to see a significant reduction in non-essential spending. As people cut back on eating out, gym memberships and non-essential shopping, the overall economy will start to feel the squeeze as the focus for the coming months for many will be economic survival.”

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Full report:
https://www.kisbridgingloans.co.uk/finance-news/how-the-impact-of-higher-interest-rates-will-reduce-property-prices/

About KIS Finance:
KIS Finance are an independent finance broker specialising in bridging finance, development finance, commercial mortgages, equity release, and secured loans. Their team of advisors have considerable experience across multiple different areas of the finance sector, as well as insurance and compliance.

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