Determinants of distress in the UK owner-occupier and buy-to-let mortgage markets

Vladimir Lazarov\textsuperscript{1} and Marc Hinterschweiger\textsuperscript{2}

Abstract

The mortgage market has played a central role in the global financial crisis. One particularly pressing question surrounds the conditions under which mortgage borrowers enter default. This paper develops a dataset from residential mortgage loans which UK banks and building societies have pre-positioned with the Bank of England for use as collateral in exchange for central bank funding. The dataset is used to investigate differences in borrower distress in the buy–to-let (BTL) and owner-occupier (OO) mortgage markets. We explore the determinants of borrower distress (arrears and default) in the BTL and OO mortgage markets as a function of borrower and loan-level stock/flow characteristics over the loans’ lifetime as well as macrofinancial variables. We find systematic differences between the buy-to-let and owner-occupier markets. We are able to differentiate the probability of default between the BTL and OO markets controlling for borrower income and a range of loan characteristics and macro variables. Our main result shows that, adjusting for affordability, the loan-to-value ratio is reliably more important for defaults in the OO market than for defaults in the BTL market, contradicting McCann’s (2014) prediction.

Key words: Distress, default, arrears, mortgage lending, loan level, micro data, United Kingdom.

\textsuperscript{1} Bank of England
\textsuperscript{2} Bank of England