Affordability – more than just a housing problem

NHPAU

Building Awareness For The Future

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Foreword

'House prices plunge'; 'Property market crashes 25%'; 'Homes back to 2004 prices'.

With headlines like those it is easy to believe that the problems of high house prices, which were the subject of so much debate before the credit crunch and the recession, are now long gone. But they are not.

A report, written by the Centre for Housing Policy at the University of York on behalf of the National Housing and Planning Advice Unit – an independent body that advises the government and the regions on the affordability of homes in England – shows that the problem we call 'affordability' has simply changed shape.

The demographics requiring ambitious house-building targets before the recession remain but the credit crunch has sharply reduced the level of new building.

Obstacles deterring first-time buyers from purchasing, like the requirement of large deposits, still exist despite falling prices and mean often that only the wealthiest can proceed.

The proportion of income required to cover mortgage costs has risen in the long term and is no longer eroded by inflation, putting more at risk of repossession if unemployment worsens.

The problems caused by not being able to get on the housing ladder will exist for some even when the economy is strong.

The consequence is that the current financial crisis may well worsen, rather than resolve, the long term problems caused by rising property prices and affordability.

This report looks at how affordability issues affect individual households today and in future generations, and at the housing market and its influence on the wider economy. It also considers what the social consequences may be for those households unable to own their own homes because of high property prices.

The report found that:

- The UK housing market's twin characteristics of high prices and a long-term under-supply of new homes being built, encourage cycles of boom and bust;
- These cycles contribute to volatile consumer spending patterns – people spend more when homes are rising in value, and less when prices are falling, so taking the housing market's ebb and flow into the wider economy;
- High house prices lead to high labour costs and major problems in recruiting and retaining staff, especially in regions where house prices are highest;
- In turn, services to the public suffer badly when key staff move jobs (or even decline them to begin with) because homes are expensive to buy or rent;

- The numbers of first-time buyers are falling – but not just because of the credit crunch or demographic changes. Often they just cannot afford to buy;
- Those first-time buyers who do take the plunge increasingly rely on parental help with a deposit, meaning those with better-off families have an advantage;
- Those at the margins either do not buy, perpetuating inequality and disadvantage, or buy and then risk repossession and financial disaster;
- High prices also have by-products of overcrowding and poor physical and mental health for those priced out or who risk repossession;
- The tendency for inherited housing wealth to make larger numbers of people more financially independent is not always evident – quite often, it is the already well-off who inherit housing, making the gap with the 'have nots' wider.

Once the housing market stabilises and the recession ends, it is safe to assume that more and more households will want to live in their own homes.

But they will face an even greater shortage of new homes because of the downturn in the house-building industry since 2007. Low levels of delivery during the recession will lead to further undersupply of housing, at a time when the need for decent housing continues to increase. As a country we need a very significant increase in housing supply if we are to address the problems outlined in this report, as the likelihood is that prices will rise again and affordability will worsen if there is not a rapid boost in supply after the downturn recedes.

What will be the social and economic consequences of these affordability problems? That is what this report investigates.

NHPAU,
May 2009.

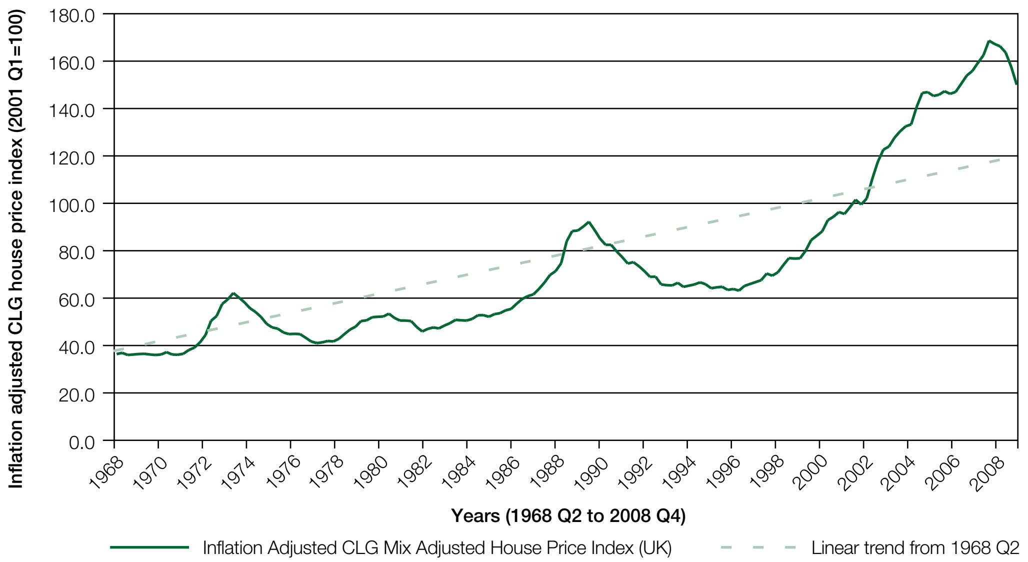
Boom and Bust:

How high house prices hit the whole country

The credit crunch, falling property prices and global recession may appear highly contemporary problems but in reality the UK housing market has been particularly vulnerable to boom and bust for at least the past 40 years.

There was a small boom in prices in the late 1960s followed by a larger one in the early 1970s; at the end of that decade there was another mini-boom followed by a more dramatic and longer-term increase in prices throughout much of the 1980s, see figure 1.

Figure 1: Booms and bust in the UK housing market (1968 Q2 to 2008 Q3)



Source: NHPAU analysis

The early 1990s saw a bust on an unprecedented scale as typical prices fell heavily – by as much as 35 per cent in some cases – and they did not regain their 1989 'highs' until just before the Millennium.

Even so the recovery from that bust then kept on going and turned into the longest rise in house prices since records began, from 1996 until late 2007.

According to the Department of Communities and Local Government the all-time high price for an average home in the UK was £219,256 in September 2007. This figure, even after adjustment for inflation, was over 60 per cent higher than in 2001 and four times that of the late 1960s.

But boom turned to bust yet again in late 2007 with the start of the credit crunch.

Respected industry commentators such as the Nationwide Building Society and the business consultancy Capital Economics say the eventual house price falls this time around may be as great as 35 per cent, although others forecast more modest figures.

Yet while the global credit crunch may be the cause of the current downturn, there are more UK-specific issues too.

For example, this apparently-inevitable cycle of prices going up and down sharply is a feature of housing markets where the supply of new homes consistently fails to meet demand, as has occurred in this country.

The problem manifests itself like this:

- A consistent under-supply of new properties compared to demand, leads to more people wanting too few homes – so prices inevitably rise sharply;
- Some homes are then bought not by 'genuine' purchasers to live in, but by speculators who anticipate prices will rise thanks to the shortage;
- To afford the high prices, 'real' buyers who need homes to live in will be more inclined to take on large mortgages or borrow from relatives;
- These highly-indebted buyers are then particularly vulnerable whenever there is an external shock to the market, like the credit crunch;
- So when the external shock comes along, some of these hard-pressed buyers fall into negative equity or have their homes repossessed.

International studies have shown that the UK is more vulnerable to this cycle of events than some other countries because even in times of acute housing shortage, the supply of homes does not increase by anything like enough to meet demand.

So does a sharp downturn in the housing market like the one we are now encountering affect the wider economy, too?

The answer appears to be a firm Yes from economists including Kate Barker (whose government-commissioned Review of the UK Housing Supply was released in 2004)[1] and David Miles (Morgan Stanley's chief UK economist and the author of a report for the government on UK mortgages[2]), who are also both members of the MPC.

They and others suggest housing markets exert some – perhaps significant – influence over wider national economic performance. The strength of such influence is under debate amongst academics but most agree that, in principle, house price rises lead to the 'feel' of greater affluence amongst home owners.

As a result they spend more either directly, by withdrawing the growing equity from their home, or by at least using the existence of growing equity to underpin their spending. The same theory works in reverse so when house prices fall, owners tend to rein in spending.

So although there is no umbilical cord linking the housing market with the national economy, house prices clearly have an effect on broader economic well-being. So having a housing market structured in a way that encourages volatility means the national economy is more susceptible to boom and bust, too.

This effect also trickles down, in different ways, to the UK regions too.

The Confederation of British Industry reported[3] in 2005 that 23 per cent of firms were having difficulties attracting staff to 'high cost' regions with London, the south east and eastern England in particular hit by large housing costs. To cover such costs, wages were higher but in turn this risked the competitiveness of firms in the region.

Reports by a range of economic planning consultancies in recent years[4] confirm this trend and show that a minority of businesses based in south east England may consequently relocate to areas where house prices (and therefore wages) will be lower. This could, in a few cases, even involve relocation overseas with India, Romania and France being cited as countries where this hurdle could be overcome.

Then there are the rural economies which suffer not only from high house prices but also, in some cases, from a relative shortage of homes to rent in both the private and social sectors.

The problems of the countryside have been apparent for many years. Back in 2004 Shelter, the housing and homelessness charity, found rural homes to be less affordable than urban ones in six out of eight English regions and claimed some 37 per cent of the rural population spent over a half of their income on housing.

More recent academic studies have shown the problems to be more deep-rooted still. Research amongst young people in rural areas around Stratford-upon-Avon[5] revealed that 83 per cent of those studied – including young couples who were both earning good incomes – could not afford to buy.

Numerous other surveys have demonstrated how young people have to leave their own rural areas to buy their first home or get work, and then often cannot afford to return. In their place, these communities become dormitory villages or retirement communities as families are replaced by commuters, retirees or wealthy-income households.

The knock-on effects are obvious. Fewer younger people lead to fewer facilities for them, so accentuating the need for the remaining young residents to leave; in turn, employers will also relocate, denying even the older rural inhabitants some of the jobs, shops, or leisure facilities they may wish. The Post Office has already announced the closure of 2,500 of its 14,000-strong branch network and the 2008 Taylor Review[6] identified problems caused by threats to the viability of schools caused by unaffordable local house prices and high numbers of second homes in some rural communities.

We will now look in more detail at how high house prices affect employers and the services they deliver to the public.

How High House Prices Affect Jobs and Services

Affordability problems caused by high house prices in many areas have inevitably created a combination of problems for employers.

Some find it hard to recruit staff because their area has a reputation for high house prices while others encounter problems retaining more experienced staff who move up the career ladder, want to buy their own place, but find they cannot afford to do so.

Some employers encounter both and their staff then engage in long commutes, increasing their own and imposing higher environmental cost.

There may be limited flexibility for private sector employers to address some of these issues but the public sector with its high proportion of relatively low-paid 'key workers' – typically those in education, local government and the emergency services – believes it has much less flexibility to counter the problem of expensive homes.

A survey by the Halifax Bank of Scotland in 2007[7] showed that average house prices in 70 per cent of towns across Britain were unaffordable to key workers, up from 65 per cent five years earlier. No fewer than 99 per cent of locations were deemed unaffordable to nurses, 97 per cent to fire-fighters, 77 per cent to teachers and 72 per cent to police officers – all these figures were steeply up from levels recorded in a similar survey five years earlier.

Perhaps worst of all, the entire 32 London boroughs and all 34 locations surveyed in the south west of England had average property prices that were unaffordable.

The Halifax's findings have been echoed in numerous surveys of public services' employment issues[8]. Although not all surveys use the same methodology (some, for example, look solely at key workers living alone so ignore those with partners in more highly-paid jobs) it is nevertheless clear that there are many problems linked directly or indirectly to poor housing affordability in almost every area of the UK:

- In Devon, the coastal and rural areas (where second home ownership can form a significant proportion of the housing stock) and the city of Exeter have particularly acute affordability problems;
- In St Albans, Hertfordshire, a key worker in their late-20s earning £19,000 to £25,000 a year would need a partner earning £30,000 to £36,000 to afford to buy a home;
- In Cambridge – where public sector workers generally earn above-average salaries for their trades and professions – a single person would nonetheless need to earn £39,285 to buy an average priced property. A couple would have to earn £47,790;
- In Surrey, pay rates for nurses, teachers and police officers are below the average income in the county and key workers require income multiples of over six to afford a home on their own.

These are simply examples and are by no means an exhaustive list. It is therefore unsurprising that public sector employers have problems regarding staff turnover and the delivery of services, with their roots in the high price of local ownership and renting.

Again, these problems are relatively similar in nature but are geographically widespread:

- In South East England, locations with attractive ‘youthful’ lifestyles can attract new recruits even if there are expensive homes to buy or rent. Some young people appear willing to pay highly for fashionable locations, but these costs then become a problem when staff get older and wish to settle permanently – they then move away, leaving employers short of experienced staff;
- In West Kent, some 40 per cent of all employers cited recruitment and retention difficulties linked to housing costs, especially for teachers and care workers;
- All London public services have higher staff turnover and vacancy rates than elsewhere. Police authorities try to recruit from outside the capital but find it hard to attract those with families because homes are expensive, while young teachers who share homes with friends or colleagues then leave London when they later want to have their own property, be it rented or purchased;
- Local authorities in Reading and Darlington – despite diverse salaries and house prices – have a common problem in offering positions to applicants who then decline the jobs because of a lack of affordable homes nearby;
- In Surrey, the health service has problems recruiting paediatric nurses, radiographers, occupational therapists, physiotherapists, paramedics and technicians. Other employers have problems recruiting police officers, social workers and probation officers. In some cases here, and in areas in the East of England, some key workers moved to jobs just inside Greater London, where they get London weighting to enhance salaries.

Although some surveys of private businesses recount similar problems, the private sector appears to be less badly affected – or, perhaps, feels more empowered to offer local solutions.

A report in 2003 by Roger Tym and Partners[9], an economic planning consultancy, shows that 28 per cent of private sector employers in south east England have problems with recruiting staff compared to 78 per cent in the public sector.

However, four in 10 of those private employers having recruitment difficulties cite high housing costs as being to blame. With some exceptions, there were generally fewer problems in areas with lower house prices than those with higher prices.

Some 10 per cent of businesses questioned in a survey of south east employers say they increased pay to try to offset high housing costs that may deter more professional employees, while others improved their benefits packages.

In a study in Cambridge[10] – where over 50 per cent of private employers said they recognised the need to make some gesture to offset high housing costs – some offered relocation packages including temporary lodgings, travel costs and even paying utility bills and providing furniture for new employees.

Employers with lower paid jobs to offer (typically these may be to bus drivers and shop assistants, for example) encountered one major problem commonly found in the public sector; that is, junior staff moving away when they became older and wanted their own home.

When employees do move away they tend to move relatively short distances, predominantly to areas with less expensive housing. This applies across both the public and private sectors.

Unsurprisingly this has contributed to a rise in commuting in recent years. Traffic increase is complex and few would claim it is mainly down to house prices, but there is some evidence in data from the Office for National Statistics and public bodies that travelling between low cost housing areas and more expensive employment locations has risen in line with property prices.

An inevitable consequence of this volatility in the labour market is that services, especially in the public sector, will suffer. But there are other consequences of high house prices, and now we will look in particular on the property market's effect on young and first-time buyers.

High House Prices and the Slow Demise of the First-time Buyer

Housing affordability is perhaps most obviously important to the first-time buyer.

First-timers are crucial to the housing market and, because of its inter-connection, to the wider economy because they introduce new funds and buy the homes that usually-older existing owner occupiers want to sell. This in turn allows those sellers to move up the housing ladder which allows the first-timers to step on to the first rung.

But as house prices have risen over past decades, and as mortgage financing has changed in the more recent past, so the profile of the first-time buyer has changed.

Not all of this can be described as simply ‘high house prices deter first-timers’ but the boom in property values has certainly changed the landscape.

For a start, it is increasingly the case that not all purchasers officially recorded as ‘first-time buyers’ have never actually owned a home.

Research in 2006[11], before the downturn, revealed that as many as 20 per cent of purchasers classified as ‘first-time buyers’ (because they were living with their parents or in rented accommodation prior to a purchase) were in fact returning to home ownership after taking time out as an owner-occupier, perhaps for financial or relationship reasons.

As a result, they differ from the classic definition of young, cash-strapped/student-debt burdened first-time buyers. Instead, most of these ‘returners’ are older and typically have larger deposits than genuine first-timers. This niche group constitutes only 5 per cent of those officially described as first-time buyers aged below 30 but rise to 30 per cent of those aged 30 to 40 and constitute no fewer than 60 per cent of those recorded as first-time buyers aged over 40.

Some in this group of ‘returners’ would, no doubt, have wished to continue in owner-occupation when their circumstances worsened; but instead, very likely because of high house prices, they opted to rent or live with friends or family.

Secondly, although conventional wisdom says the average age of the first-time buyer rises as typical house prices increase, recent evidence has suggested otherwise.

Data from the Council of Mortgage Lenders shows first-time buyers were typically aged 26 back in 1974; that average age varied from 26 to 29 at different points until the late 1990s. Then, as the most recent boom began, the average age hit 30 for the first time and even moved to 31. But in 2004, years before the credit crunch bought the boom to an end, the figure began falling and by 2007 it was down to 28 again.

Successive reports, notably the 2004 Barker Review, have identified that affordability problems have existed for many years, and certainly pre-date the credit crunch.

One reason, for example, that there were slightly fewer first-time buyers in the 1990s and 2000s than in the 1980s is simply because there were fewer young people around. The 1980s was the peak period for children of the ‘baby boom’ generation to hit their 20s and 30s and move into home ownership, so the totals since then have inevitably dropped.

It is only more recently that credit constraints and evolving attitudes to mortgages (by lenders as well as borrowers) have caused further changes in the profile of first-timers.

Studies[12] show that in 1984 the average first-time buyers used income multiples of 1.99 to obtain a mortgage – by 2004 that was 3.03. Whereas in the mid-1990s only 1 per cent of first-time buyer mortgages were based on income multiples of 4.0 or above, by 2005 this applied to no fewer than 20 per cent of them.

But this does not mean first-timers became more reckless; quite the reverse. In 1989, at the start of another large housing downturn, some 50 per cent of first-timers were on 100 per cent mortgages; by 2006 that had dropped to only 5 per cent.

So what caused the higher income multiples and larger mortgages? In part, these have been caused by high house prices but higher income multiples have also been a response to low and stable interest rates.

Prior to the credit crunch, which hit in August 2007, a wide range of lenders were willing to offer high loan to value ratios, albeit not necessarily on the best deals or terms. The decline in high percentage borrowing was mainly explained by the sheer level of high house prices and affordability problems.

Those relatively small numbers of first-time buyers in recent years who have relied on 100 per cent mortgages have typically been those who are least financially secure, with other debts and sometimes unpredictable income. They are most vulnerable in a credit crunch, recession, and growing unemployment. Only those from relatively well off backgrounds who could access family wealth could expect to enter such a market, especially in the south.

Once the credit crunch hit, 100 per cent mortgages rapidly disappeared. Much of the reason for the relative decline of these mortgage products is because mortgage lenders have demanded increasingly large deposits and this is credited as being another reason why first-time buyer numbers have fallen.

Long before the credit crunch, mortgages with high loan-to-value levels – that is, covering a high proportion of the property’s sale price – have been falling.

In the second half of the 1970s the typical mortgage for a first-time buyer rose from 84 per cent of a property’s sale price to just under 90 per cent. After a dip in the early 1980s it rose further to about 94 per cent by 1985 and stayed there until 1997.

By the Millennium the typical mortgage was 90 per cent where it remained, broadly consistently, until 2007. So 10 per cent deposits (equivalent to £20,000 on an average priced home in 2007) became a commonplace requirement as property values soared.

Unsurprisingly, raising that deposit became a major hurdle for many young people.

Anecdotal experience suggests many teenagers and people in their 20s do not see saving as a top priority, especially if it means cutting down on social activities.

Few solid pieces of research exist on how long it takes first-timers to save a deposit but National Savings says it takes 50 per cent longer to muster a property deposit now than it did in the mid-1990s. A study undertaken by the Council of Mortgage Lenders[13] says first-timers these days often raised their deposit from a mixture of genuine savings, old student loans, and one other source – the Bank of Mum and Dad.

Indeed, parental help for first-time buyers (in terms of advice as well as money) is increasingly seen as essential by young people and their parents and grandparents alike.

Data from mortgage lenders' surveys suggested that in 2008 parents gave at least some financial contribution to half of all first-time buyers by paying for a part or all of their deposit. The trend is now commonplace across the UK but with important regional and demographic differences:

- It is most common in Northern Ireland where 48 per cent of first-time purchases were 'parent-assisted' followed by 44 per cent in London, 40 per cent in East Anglia. The lowest were 33 per cent in Scotland and 32 per cent in northern England;
- Assisted buyers typically bought more expensive properties than unassisted buyers, and paid higher deposits;
- Average assisted deposits ranged from £12,900 in northern England to £57,000 in London – compare that with £5,350 and £12,500 in the same two locations from unassisted first-timers;
- Unassisted buyers typically had lower incomes than assisted buyers – £22,500 against £29,000 in Scotland and £40,350 against £54,500 in London.

So the better off were those made more financially secure by parental contributions.

We will examine in detail later how high house prices can accentuate inequality but from even these few figures it appears that continued family assistance may result in the housing market becoming more polarised, with the children whose parents are already home owners representing a greater proportion of all new purchases.

Although some assistance comes from grandparents, perhaps through bequests, much of the parental wealth funding this assistance comes, of course, from their own family homes which have risen in value consistently from 1997 to 2007.

But if the equity in those properties diminishes because of falling prices, or if parents cannot access the equity because of credit restrictions, then the wider housing market may suffer with fewer transactions.

This fall in the number of first-time buyers is not the only consequence of affordability problems. One other consequence is that enthusiasm for and participation in home ownership by people of all ages has tailed off – and that is what we look at next.

Affordability:

Is It Undermining Support for Home Ownership?

No one quite knows the answer to this, but has the high cost of home ownership temporarily slowed what some consider to be the inevitable rise of owner occupation in the UK? Or has it actually turned some of society against this form of tenure?

Clearly affordability has a big role to the recent downturn in home ownership. While there are many reasons why young people live at home and not independently, research in 2008 by the NHPAU[14] shows 35 per cent of those aged 25 to 29 remaining in the family home because they cannot afford to rent or buy.

Other surveys reinforce this trend, often showing higher numbers of young people still living with parents in those regions with the highest house prices, like London and south west England.

Even taking into account reductions in the number of young people as demographics have changed, NHPAU analysis suggests that as many as 1.2m 'new' households cannot be formed in England alone because high housing costs oblige young adults to stay at home or sharing.

This has led to a rise in the predicted average size of households in south east England – another high priced region – from 2.35 in 2004 to 2.45 in 2029.

One by-product of this situation is that if people want to form households, cannot afford to buy but insist on the freedom of living away from their family, they look to the private rented sector as a solution.

The Survey of English Housing (SEH) provides substantial evidence of this trend. Of all the new households it reported in 1999-2000[15], for example, 40 per cent began in private rented housing, 34 per cent in owner-occupation and 25 per cent in social rented property. By 2005-6 the proportions had changed to 48 per cent in private rented, 32 per cent in owner-occupation and 20 per cent in social rented property. These figures switched even more from ownership to private renting in new households with the youngest members.

So is this temporary or part of a permanent change of attitude towards ownership?

Some 84 per cent of under 25s say that in the long term they do still want to own their own home, but enthusiasm to take the plunge varies in line with a region's affordability – in London, for example, 70 per cent of under-25s say they want to own in two years' time whereas in the much more affordable north west of England the figure is 80 per cent.

However, many low-income young people, currently renting or still in the parental home, have responded to surveys by saying they anticipate being unable to own at any time in their lives. For some it is the sheer size of a deposit that forces them to that view, while for others the risks and responsibilities that come with ownership outweigh the perceived benefits.

In the SEH research those low-paid young people who did want to buy – many key workers, for example – did so because they felt property offered the only means by which they could amass significant wealth and provide for their old age.

Some others advocate eventual ownership because it helps them feel more financially secure and comfortable – but they admit that, while they are young, they can find those features in good quality private rented housing too.

Young people now stay at school longer and a majority are likely to go on to higher education. As a result they enter the job market later than before and form relationships and become parents later, too. Studies of young people's attitudes suggest they want to remain as flexible and responsibility-free as possible into their late 20s – and they see private rented accommodation allowing them to do that in a way that traditional owner-occupation would not.

There are also growing aspirations amongst younger people, and this is where the high cost of housing may be seen to deter prospective purchasing.

For those young people who do commit to buy, price forces them to choose only small properties. Property consultancy, DTZ, says[16] first-time buyers can only afford small flats which explains the proliferation of studios, often in city centres which have high levels of amenities and are where many young people work and socialise.

A lettings study by another property consultancy, CBRE/Hamptons[17], shows that many professionals who rent want the same 'traditional' qualities in rented accommodation that they would seek in a home they would buy – a safe neighbourhood, an easy commute to work, and close proximity to family and friends. Because they cannot afford to buy in areas with these characteristics, mainly because of the high deposits necessary, these people seek private rented accommodation as an alternative.

It is of no surprise, then, that the size of the private rented sector has increased from 9 per cent of all households in 1988 to 12 per cent in 2008; the proportion of under 30s that rent privately has increased from 33 per cent in 2001 to 43 per cent in 2007.

This tenure, as well as providing freedom and flexibility, allows tenants to save if they want to eventually buy – despite occasional surges in rents, their levels have only kept pace with average earnings and have fallen relative to house prices and the costs of ownership, so offering many tenants the chance to save while paying rent.

While ownership and private rented accommodation have been centre stage in these discussions on affordability and future housing trends, much less has been heard about the social rented sector.

By comparison, this sector has under-achieved.

Separate research by the NHPAU in 2008[18] shows that the net annual housing need for social housing rose from 93,000 in 2002 to 155,000 by 2006 while the number of new social lets in the same period fell significantly.

Demand for social housing, relative to its supply, is highest in London. But whereas some areas elsewhere in the UK used to have a balance of supply and demand for social housing, the high cost of owning and running one's own home across the country now means there is high demand for social housing everywhere – and it is simply not being met.

This has occurred at the same time as fewer people leave social housing and so create fewer opportunities for new tenants to move in. Over recent years, many social sector tenants would have moved on to their own bought homes, but once again high housing costs means social housing turnover is now much lower.

One likely consequence of this will be an increase in over-crowding as the reduced stock and turnover of the social sector obliges residents with expanding households to make do with what they have got. This phenomenon hits children, particularly.

A report by Shelter in 2004[19], using industry-norms like sleeping accommodation and room sizes to measure crowding, found that of those households in England which were officially overcrowded consisted of families with children.

Figures for different regions of England varied from 1.4 per cent of households to 6.0 per cent; over a third of these households were to be found in London, where nearly one child in three in the capital's social housing sector officially lives in overcrowded conditions. Those from black and ethnic minority backgrounds are six times more likely to live this way than those from other ethnic groups.

The private sector is not immune from this problem, although figures suggesting overcrowding in owner-occupied homes have fallen – hardly surprising, given that many of those likely to fall into this category may well have been forcibly removed from the ownership sector and are now obliged to rent privately or socially.

This report shows clear connections between poor housing conditions and general well-being, particularly between overcrowding and ill-health. These include:

- A report from the Office of the Deputy Prime Minister in 2004 highlighting that overcrowding had at least some influence on children's social and emotional development and their physical stature;
- A Shelter report in 2005 saying that overcrowding adversely affected the health of parents and children through feelings of lack of privacy, depression, anxiety, stress, insufficient room for children to play, high levels of argument and fighting, sleep disturbance and the inability to entertain friends;
- Complaints from overcrowded residents of all ages of worsening relationships, deteriorating educational achievement and medical problems.

It may be too simplistic to attribute all such problems to affordability issues which cause people to abandon – or be unable to even consider – home ownership. But as affordability difficulties surface, so such connections need to be explored.

Next we will consider the fall out from an increase in the level of repossessions.

The True Cost of Repossessions

Our temporary period of historically-low interest rates should not mask the fact that prior to the credit crunch, housing costs as a proportion of incomes had been rising even through a lengthy period when borrowing has been relatively inexpensive.

A series of studies illustrates the problem:

- The Expenditure and Food Survey shows that 40 per cent of those buying a property in 2004-5 were spending 30 per cent or more of their income on housing-related costs;
- Shelter's research shows that 9 per cent of households pay over half of their income on housing costs and 4.1 per cent of households pay over two thirds (a figure that rises to 12 per cent in London and 10 per cent even in apparently diverse areas like south east and north east England);
- Difficulties in meeting housing costs are felt disproportionately in lone parent, black and ethnic minority households, says Shelter. In its report, some 23 per cent of struggling home owners said they would rely on state benefits if they were unable to meet housing costs – perhaps unaware that for most of the time since 1995 (and at the time of the survey) benefits did not cover mortgage costs for the first nine months of a claim;
- CML data shows that repossessions rose from 2004 onwards, well before the credit crunch but from the time that Bank of England base rate increased to its 'recent high' of 5.75 per cent. While recent low base rates may have alleviated this problem, there is concern that households having to refinance may move to lenders' less favourable standard variable rates.

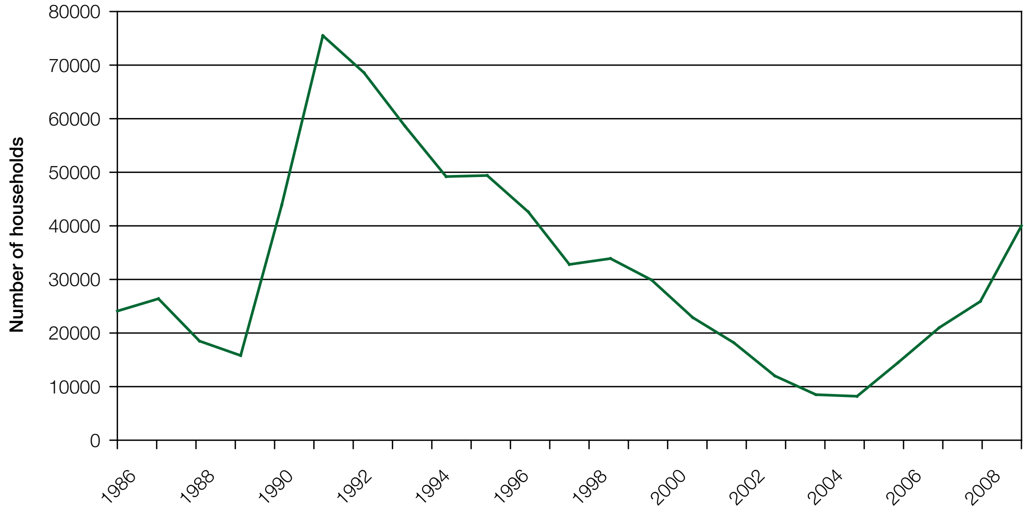
In the last major recession in the early 1990s, when Income Support for Mortgage Interest existed after just eight weeks to pay interest on mortgages held by Income Support claimants, some 300,000 households still lost their homes through repossessions and it was estimated only 25 per cent of those in arrears were eligible for ISMI.

ISMI, which was modified in the 1990s to take effect only after 39 weeks over a decade ago, has now been changed again to take effect just 13 weeks after an initial claim. This is just one of a number of government safety nets introduced this year.

In addition there is the Homeowner Mortgage Support Scheme, which provides government-guaranteed interest payment holidays and extensions to the mortgage term for those households with a partial or temporary loss of income. The government has put in place a Mortgage Rescue Scheme, where housing associations are allowed to buy an equity stake in some homes, with the owner's consent, to reduce their outgoings and assist in the repayment of the mortgage.

Repossessions rose to 46,700 according to FSA figures in 2008 and the CML expects them to reach 75,000 this year, though others suggest they will go higher. Figure 2 shows the number of households taken into repossession from 1886 to 2008, showing that since 2004 repossessions are once again on the rise.

Figure 2: Homes taken into possession 1986-2008



Source: CML AP4

Observations from the Citizens Advice service early in the credit crunch noted that those owners seeking advice on mortgage debt were predominantly the less well-off and included many who had borrowed from sub-prime lenders and had taken out additional secured loans against their property.

They say understanding of the debt problems was typically poor amongst these individuals, and the advice they had received from lenders had allegedly been inadequate.

The effects on those who do have their homes repossessed can be devastating. In addition to the financial and physical disruption, a series of surveys of individuals and families in this predicament have found long-lasting effects on self-esteem and relationships.

Humiliation, embarrassment, marital and relationship break-up, parenting difficulties, job loss, financial insecurity, fear of poverty, social isolation and a lack of independence and self-worth are commonly found for individuals; in the current crisis, broader issues such as the failing reputations of institutions and distrust of markets and wider economic activities may also be included.

For many, the aspiration of expanding home ownership in the UK from 70 per cent to 75 per cent or above was intended to move individuals and society in a wholly opposed direction to that encountered by those suffering repossession.

If affordability problems prevent that expansion of ownership, and possibly lead to its contraction because of repossessions, there must be concern that inequality of wealth and opportunity will widen between the home ownership 'haves' and 'have nots'.

We will explore this theme further when we look at inheritance and the transmission of housing wealth from one generation to another.

Home Ownership:

Spreading Wealth To Future Generations or Creating Haves and Have Nots?

Home ownership and inheritance are sometimes considered a kind of double-pronged tool to 'trickle down' housing wealth to successive generations. But evidence suggests it can just as easily accentuate inequalities, making the children of affluent owners still richer and the poorest even more disadvantaged.

Housing wealth is widely distributed throughout society, at least compared to stocks and shares or annuities and bonds, and housing wealth has increased in recent decades for every sector of society. So for example:

- The value of privately owned homes has risen from the equivalent of 100 per cent of the UK's Gross Domestic Product in 1980, to 185 per cent of GDP in 2007;
- In 1995, average net property assets for 25-34 year olds were only £9,000 but by 2005 this had risen over 10-fold to £95,000;
- In 1995, average net property assets for 45-54 year olds was £54,000 yet by 2005 this had more than tripled to £182,000.

This makes housing wealth appear a kind of universal benefit, at least to owners, and to some extent a 'leveller' of wealth as the proportionate gap between younger and older owners had narrowed over the years. But behind the averages, the house price booms of the 1990s and 2000s can be seen to have benefited some regions of the UK and some existing owners far more than others.

Consider these examples:

- In 1993 an average-priced home in Kensington, central London, would buy you two average-priced homes at low-priced Leven in Fife. But by 2003 a Kensington home would buy no fewer than 24 properties in Leven because of the large rises seen in central London;
- The wealthiest 10 per cent of the UK population saw home values increase by 322 per cent between 1993 and 2003. For the poorest 10 per cent the rise was just 102 per cent, making the gap far wider than before;
- England and Wales has 22 times the 'housing wealth' of Scotland, yet has only 10 times the population. So while we all may be richer, some traditionally less well off areas retain that disadvantage.

This level of inequality does not just affect the immediate owners of properties – it hits future generations, too, because of inheritance.

The children of those with high levels of housing wealth will in most cases inherit it, and may enjoy similar long-term appreciation of their own properties if they live in similarly-affluent areas. In addition, as we have seen, the children and grandchildren in this category have a reservoir of family funds to call upon to buy their own first homes, as well as funding education and other social essentials.

However, those children born to parents with little or no housing wealth will inherit almost nothing and have no 'life start-up' advantages. Indeed, findings from a series of surveys suggest that the place that a child is born in may now have more effect in determining their potential wealth than the social class of their parents.

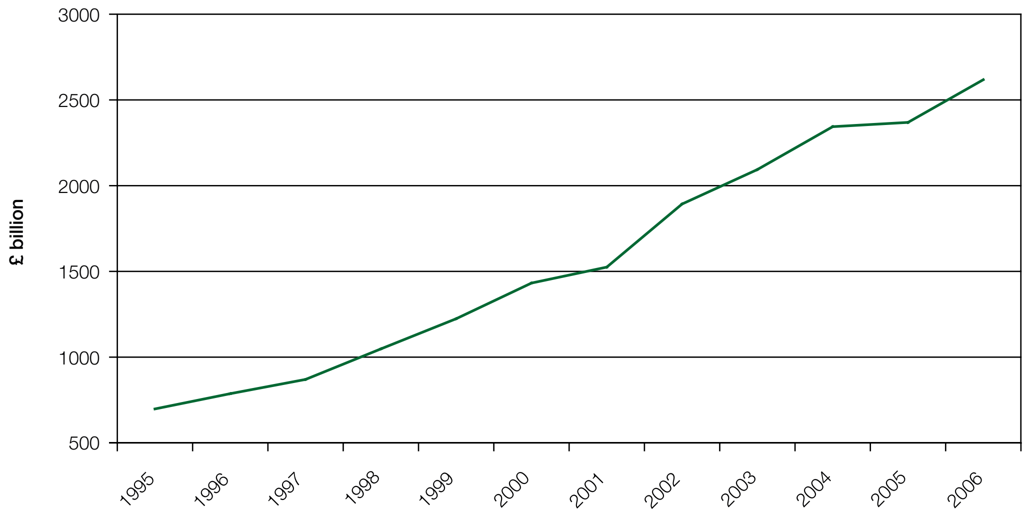
As a result there is overwhelming evidence that people buy larger properties or more than one home not solely for their intrinsic value, but in order to generate future wealth either through rental income or long-term capital appreciation. Once again, it is those who already have housing wealth who can do this most easily – those without simply cannot afford to do so, reinforcing their status as 'have nots' and further distancing themselves from the 'housing haves'.

There is also an interesting issue of attitudes here.

Conventional wisdom that people would move to smaller properties to free equity as they get older has not proven correct, at least to a degree – retirees have not 'traded down' to the extent expected and have not adopted equity release as often or as effectively as anticipated because of its complexity and poor reputation.

Partly this is because increasing numbers of older owners want to enjoy their properties in later life – we have all seen the "I'm spending my children's inheritance" car stickers – or want to keep a larger property to act as an alternative or supplementary 'pension' to be cashed in when they get still older. And partly it is, of course, because some want to keep the larger homes to pass on to their children and grandchildren after death. Figure 3 shows the upward trajectory of net personal housing wealth in the UK.

Figure 3: Net personal housing wealth UK



Source: UK Housing Review 2007/8 (Wilcox, 2008)

Whatever their attitudes to housing wealth, the number of older owners will certainly increase; one prediction suggests the proportion of older people in their own homes will rise from 71 per cent in 2006 to 75 per cent by 2026. There will be a similarly strong increase in the number of older people in rented accommodation, rising between 300,000 and 400,000 to a total of three million by 2026.

So amongst the owner-occupying elderly, can we see some signs that the inheritance of their properties will spread housing wealth in years to come?

Most research[20] suggests that the future distribution of inherited housing wealth will only reflect the same pattern as home ownership a generation or so ago – in other words, the 'haves' have more and the 'have nots' still have little or nothing.

In any case, only small proportions of housing wealth are inherited each year; just £16 billion in 2006 and no more than £30 billion expected annually by 2026. Because of healthier lifestyles and greater longevity, these are small figures when set against the predicted 2.8m rise in the number of older home owners in the next two decades.

In any case, as the current downturn demonstrates, there is no guarantee that housing wealth will rise to coincide with individuals' old age.

Some older homeowners have sub-prime mortgages or secondary loans secured against their properties; others may have 'stripped' much of the equity in their property to provide help to children and grandchildren and may even face negative equity if their property's value has fallen below any 'late life' mortgage they have taken out; a small proportion have participated in equity release, restricting future spending and removing any equity to bequeath to future generations anyway.

While the profile of the typical older home owner is varied and still evolving, one thing is clear. Those with higher levels of accumulated housing wealth are more likely to pass it on, pre- or post-death, to future generations; those without it, cannot do so.

But the potential inequality created by housing wealth is not restricted to this most obvious area. Housing wealth influences education and longevity, too.

Although few formal studies have been conducted in the UK to see the effect of family housing wealth on childrens' school performance, it is familiar territory to many educationalists that those from owner-occupied backgrounds are higher achievers than those living in the rented sector.

This is not necessarily because of the properties per se, but it is because of their association with better occupations, greater family wealth and more positive parental attitudes to school – all especially influential on children of secondary school age.

In addition to the health problems we have already highlighted in relation to repossession and struggles with mortgage debt, there is evidence that those in good quality housing – mainly but not exclusively owner-occupied housing – live longer.

What inheritance of property does take place in the next two decades will do little if anything to shift the in-built advantages currently accruing to many owner-occupiers.

We have studied many of these over the past sections of the report, so let us now turn to our conclusions.

Our Conclusions

This report has produced findings which we believe that, although emerging before the depth of the credit crunch and recession became apparent, still hold good even in today's changing market.

These can be summarised in a list of characteristics created by long-term affordability problems:

Access to Home Ownership:

- Individuals and households are priced out of the market;
- More severe credit controls can reduce access to ownership for many outside of wealthy families;
- Employers, especially in the public sector, face recruitment problems;
- Wage rises to assist employees meet housing costs risk fuelling wage inflation;
- Government aspirations to expand home ownership to 75 per cent in England put in jeopardy.

Access to Other Tenures:

- Frustrated would-be buyers move to the private rental sector;
- The result is extra demand on social housing, leading to over-crowding;
- Recruitment problems particularly hit rural areas with few rental properties;
- Demand for temporary accommodation therefore increases;
- Mental and physical health problems multiply because of housing stress.

Sustainability of Ownership:

- High prices and high borrowing multiples increase risks of default;
- The era of low inflation means debt burden 'lingers' for longer;
- Mortgage defaults rise with economic, social and well-being problems;
- Repossessions depress housing market and consumer spending;
- 'Safety nets' to minimise defaults are tested for the first-time.

Access to Housing Wealth:

- Some older people lifted from poverty thanks to accumulated equity;
- But remortgaging and secondary borrowing may make owners insecure;
- Accumulated equity helps family through funding and inheritance;
- Any mortgage equity that is released can help fuel consumption;
- But problems can arise if market slumps as older owners need equity;
- Uncertainty for government relying on equity funding pensions;
- Increased welfare support to renters and defaulting homeowners.

Social Inequalities:

- Where and when you own a home can influence your wealth;
- Gap grows between different types of owner, and owners and non-owners.

While there are significant upsides – for example, reduced housing costs for long-standing home owners in their old age – there are downsides, too; in this case, that elderly people risk losing their accumulated wealth if the market falls at a critical time.

That provides a timely opportunity to say that after the current downturn, we believe some problems with affordability will return. Some may even be more challenging in the future than in the past: recent government housing targets, for example, may be difficult to meet after a sustained period of low house-building.

We therefore hope that some of the findings of this report will be updated to reflect the new market that will inevitably emerge after the recession.

There is a need also to see how future affordability affects mobility for jobs or education, and its impact on young people and businesses in rural communities. We also believe there is a need for more information on social inequalities falling on renters and those with no access to owner-occupier housing wealth.

However, the current report contains substantial material to service the current debate on this country's serious affordability problems which may return with yet more force after the slowdown.

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This report is based on a report written for the NHPAU by the Centre for Housing Policy at the University of York entitled "Rapid Evidence Assessment of the Economic and Social Consequences of Worsening Housing Affordability." The report can be found on our website - www.communities.gov.uk/nhpau

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