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UK COLLABORATIVE CENTRE FOR HOUSING EVIDENCE

Approaches for improving affordability

Policy briefing

This policy briefing addresses one of the most important debates in housing today; the roles of supply shortages and "over-consumption" in explaining affordability problems in the UK. It draws on the research conducted in part two of the CaCHE project, *Policies to improve housing affordability at all spatial scales*, the full report is available on the CaCHE website.

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Key Points:

This report makes several key points in relation to understanding affordability:

- Affordability is not a problem for most households. The problems are primarily for those on lower incomes or those aspiring to be first time buyers.
- The most important factors affecting affordability come from the macroeconomy (e.g. interest rates) and labour markets (e.g. incomes).
- But initiatives specifically aimed at the housing market still have an important role.
- The rise in the ratio of house prices to incomes over time partly reflects low interest rates and so considerable caution is needed in its use as an affordability indicator.

The paper considered both demand and supply side policies;

- In recent years, more attention has been paid in policy to ways in which supply can be increased. However, the demand side of the market is also important and demand and supply side policies are complements rather than alternatives.
- Increases in private housing supply have to be large and long-lasting to have a major effect on affordability, and an important role remains for an expansion in social rented housing.
- The consequences of worsening affordability can already be seen in terms of lower rates of household formation and home ownership amongst the young.

Understanding affordability

That house prices in the UK, have risen faster in real terms than in most other countries has stimulated much discussion. However, **the main factors driving house prices – notably real incomes, interest rates and the cost of capital, and housing supply – are much the same now as in the late 1960's**. For example, the effect of a change in household income on house prices today is similar to the effect in the 1970s, and most (but not all) of the rise in house prices up to the Global Financial Crisis (GFC) can be explained by variation in these variables rather than by speculative bubbles. Deregulation of financial markets in the early 1980s and the credit shortages that emerged during and after the GFC certainly affected prices, but it is possible to incorporate both events into models.

The most important factors that affect affordability come from the macroeconomy and from labour markets: as shown in Figure 1, the incomes of younger individuals have risen at a slower rate than employees more generally, making it much more difficult for this group to become home-owners.

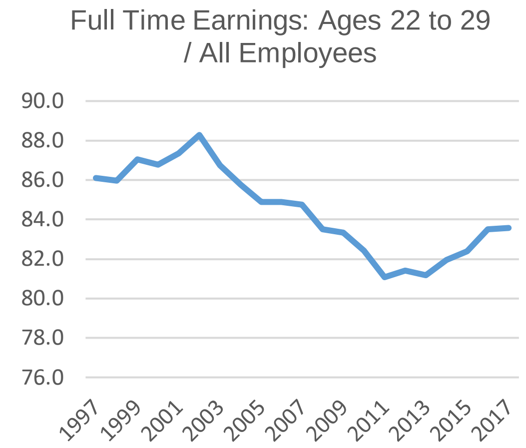

Figure 1. Median Gross Weekly Earnings of Full-Time Employees Aged 22-29 Relative to All Employees, 1997-2017. Source: Annual Survey of Hours and Earnings.

In term of **regional variation**, prices have historically exhibited "the ripple effect", increasing first in London and the South East, then gradually catching up in the other regions. The most recent cycle has, however, behaved rather differently, with prices in London rising faster for longer than has been the case in the past.

Although changes in house prices are well researched in the UK, the evidence on the determinants of market **rents** is less clear cut. This is partly because historical rent controls meant that data were poor and had little meaning and also because the size of the sector had been declining until the expansion of Buy-to-Let mortgages in the mid-1990s.

Policies to improve affordability

This report argues that demand and supply side policies which aim to improve affordability, are complements rather than alternatives.

Increases in private housing supply continue to play an important part in improving affordability, but they have to be large and long-lasting to have a major effect on affordability. This suggests that the benefits to those on low incomes from market provision alone are unlikely to be adequate and there remains an **important role for the expansion of social rented housing.** At current levels, there is little evidence that the construction of affordable rental housing negatively affects private house building.

Some argue that housing shortages could be reduced if owner occupiers could be persuaded to **reduce "over consumption"** of housing and downsize. While it is true that owners consume more housing than those in either the private or public rented sectors, there is little incentive to downsize given most have already paid off their mortgages and housing costs for most older owners are modest. If it were to be the case that property taxes were made more proportionate to income, the housing costs of older households would rise considerably.

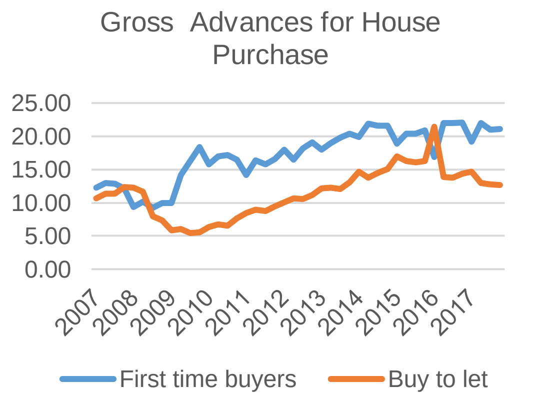

Figure 2. Mortgage Advances to Buy-to-Let Investors and First Time Buyers (% shares of total). Source: Bank of England/FCA MLAR Statistics.

Demand for housing is further enhanced by low yields on financial assets, which make Buy-to-Let properties attractive, and by the fact that **existing owners** are less constrained by deposit requirements than first-time buyers because of the ability to use the equity in the existing home. Our estimates suggest that the probability that a household on relatively high incomes will own a second home has risen in recent years. This contributes to a widening of the wealth distribution. Since the tax reforms to the Buy-to-Let sector in early 2016[i] there has been a fall in the proportion of buy-to-let mortgage advances (see Figure 2, above) but the *stock* of loans to Buy-to-Let investors has not fallen, suggesting that those already in the market are not necessarily attempting to seek other investments.

For **potential first-time buyers,** besides low incomes, the major barriers to home-ownership are low levels of mortgage lending and high deposit requirements. As

Figure 3, below, shows real net mortgage advances are lower than before deregulation in the early 1980s.

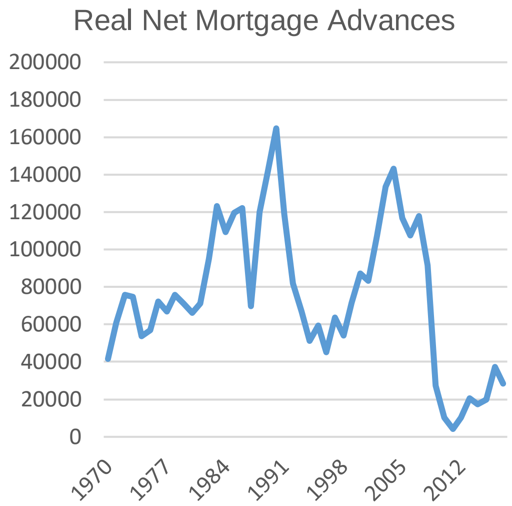

Figure 3: Net Mortgage Advances Divided by the House Price Index, 1970-2017, £m

Although the number of loans to first-time buyers has increased recently, required deposits remain high, and policies such as Help to Buy and Shared Ownership are primarily of benefit to those already on the fringes of home ownership.

If increases in new supply or a fall in demand by existing owners fail to materialise, the market will provide a solution, even if it is not considered socially acceptable; increases in market risk at times of high house prices could lead to a market collapse with consequences for macro stability. In addition, household formation and owner occupation rates will be lower, particularly for the younger cohorts and we have already seen evidence of this.

About the project

This is the policy briefing for part two of CaCHE research project, *International evidence review: policies to improve housing affordability at all spatial scales*. Part one, which looks at how best to measure affordability, can be found on the CaCHE website.

Get in touch

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[i] phased restrictions on the tax deductibility of mortgage interest payments and a three percentage point stamp duty rate surcharge for second home owners generally