

The economic and social limits to increases in sustainable home-ownership

Large increases in the number of households are projected into the next decade, creating substantial extra demand for housing, but this study, conducted by Stephen Radley of the Henley Centre for Forecasting, concludes that the scope for increasing home ownership is very limited.

- f** Owner-occupation, at just under 68 per cent, is now close to its sustainable limit of about 72 per cent, following a 17 percentage point rise in the last two decades.
- f** Almost all of the increase from current levels to the sustainable limit will result from the ageing of current owner-occupiers.
- f** A range of factors will limit the rate of entry into owner-occupation of the main first-time buyer age group (those aged under 35) to around the current owner-occupation rate of 68 per cent. These include the effects of low inflation, increasing job insecurity, reduced government financial support for housing and a general rise in economic insecurity for many households.
- f** Most important are the factors which effect both how far potential borrowers are prepared to extend themselves and the criteria used by mortgage providers in their lending decisions.
- f** These are determined by a range of influences, including the way in which the security of employment develops, the levels of economic stability and of support provided by the government to owner-occupation, and the ability of lenders to develop flexible lending policies. The government has an important role to play in at least the last three of these.
- f** Though lenders are developing new policies to cope with the changed environment, these are unlikely to be a vehicle for sustaining home-ownership for the more marginal groups of borrowers or for attracting them into the market.
- f** With the number of households set to increase significantly, slower growth in owner-occupation will increase the need for alternative forms of housing, such as that provided in the public or private rented sectors.
- f** The researchers conclude that, given the limited contribution that market forces are likely to make to expanding the private rented sector, government action will be required to increase the stock of rented accommodation.

The aim of the study

The housing market collapse at the start of the 1990s and its weak recovery since then has challenged the long-held assumption that levels of owner-occupation could increase indefinitely. At the same time, the Department of Environment is projecting a large increase in the number of households in Britain. Without continuing rises in owner-occupation, this will create a need for large rises in other forms of tenure. This study sought to estimate what the sustainable limit to owner-occupation would be. Sustainable owner-occupation is defined as that which:

- is compatible with stable economic growth, low inflation and a low level of public sector borrowing relative to GDP;
- does not require public subsidies to underpin the affordability or stability of home-ownership;
- is associated with low and stable exits from owner-occupation from year to year, triggered by events such as accidents, sickness or death of the major mortgage payer rather than economic shocks such as unemployment, business failure or higher interest rates.

Economic factors make house purchase less attractive

Most of the economic factors will make home-ownership both less attractive and riskier:

- The maintenance of low and stable inflation will be the top priority of government economic policy, whichever party is in power, so that the erosion of mortgage debt in real terms is less than during high inflation periods.
- The limited scope for tax cuts and an increasing focus by employers on controlling increases in labour costs will mean that growth in disposable income is much slower than in the 1980s.
- These factors imply that house price inflation will remain subdued as well as increasing the actual and perceived risk associated with mortgage borrowing.
- Pressures on public finances, together with the fact that the housing market has been identified as a contributor to past economic problems, mean that financial support for housing is likely to dwindle further.

Against this is the prospect that economic growth will continue to be more stable than it has been in the previous twenty years, making the future more predictable for potential home-buyers and reducing the risk of a repeat of the last recession.

The effect of employment trends on first-time buyers

The balance of evidence suggests that job insecurity has not yet increased significantly and that it mainly affects those groups where owner-occupation is low. However, it is starting to affect first-time buyer age groups and also those in occupations closer to the margins of home-ownership.

- Job tenure statistics reveal only a small decline in the length of time most people spend in their jobs, though they do point to increased polarisation, with those in less skilled and lower paid jobs suffering most.
- Unemployment rates for professional and managerial workers are below 4 per cent, while the redundancy rates are below 1 per 100 employees.
- The last fifteen years have seen no acceleration in the growth of part-time work, while temporary work until very recently has accounted for only 5 per cent of employment.

More recent information suggests that the labour market is becoming more insecure and less favourable to home-ownership:

- The number of new jobs on a part-time, temporary or self-employed basis increased from 48 per cent of new jobs in 1984 to 55 per cent in 1994.
- The employment of craft and skilled workers and clerical and secretarial staff has fallen or remained flat since the end of the recession in 1992.
- Concerns over job security have risen over the last twelve months according to the Henley Centre's own surveys.

Innovation in lending allows for gradual growth

Interviews with mortgage lenders and housing experts suggest that innovation in the lending industry will help to sustain a limited expansion in owner-occupation. However, it is unlikely to be a

vehicle for sustaining home-ownership for the more marginal groups of borrowers or for attracting them into the market. They are more likely to be used to ensure that good borrowers do not fall into difficulties. Within the mortgage market, the key trends are:

- Increasing competition in a slowly growing market driving down mortgage rates.
- The prospect of significant progress in the development of 'flexible mortgages' which allow some adaptability for changing circumstances; commitment to developing these is almost universal amongst the major lenders.
- Mortgage protection will be taken out by the majority of new borrowers, with some lenders making it compulsory and competition increasing the attractiveness of the products on offer. Current anecdotal evidence and past research does, though, call into question the proportion of borrowers that will keep up payments into the schemes beyond discount or compulsory periods, or at times of economic difficulties.
- The greater use and sophistication of 'credit-scoring' systems is likely to exclude more marginal borrowers from obtaining mortgages. Lenders' assessment of which groups they consider to be at risk may, though, change substantially over time.
- Lender interest in the private rented sector will remain low, held back by the limited returns it offers. The growing intensity of competition will mean that only activities with a clear commercial return will be justified.

Upbeat attitudes, cautious beliefs

Survey evidence suggests that all of the problems associated with the housing market in recent years have not made a dent in the overwhelming preference of British households for owner-occupation. However, questioning of potential first-time buyers suggests that the employment situation, an unwillingness or inability to take on debt, and difficulties in raising a deposit are all significant factors holding back potential buyers from entering the housing market.

There is an apparent contradiction between the continued strong attraction to owner-occupation, as expressed in response to surveys, and the lack of action from potential first-time buyers. It is best explained by distinguishing between 'attitudes' and 'beliefs'. The study defines attitudes as being more

emotional and generalised, while beliefs are more cognitive, rational and often specific to particular situations. Attitude statements related, for example, to preferred forms of tenure in ten years' time would be relatively stable over time. In contrast beliefs such as whether it is wise to buy a house in the short term are influenced more by prevailing economic circumstances.

The key determinant of what happens in the housing market over the rest of this decade and beyond will be whether attitudes move in the direction of beliefs or whether the reverse happens. The researchers conclude that the combination of trends in government policy, in corporate strategy and in the lending environment will combine to produce sufficient evidence that the housing market has changed to effect a fundamental shift in attitudes.

Conclusion

This analysis of the sustainable rate of owner-occupation suggests that the scope for its further expansion is fairly limited:

- Low, stable interest rates and the improved affordability of housing are being more than offset by other factors effecting the ability and willingness of borrowers and lenders to extend themselves.
- Owner-occupation at just under 68 per cent is now close to its sustainable limit of 72 per cent.
- The owner-occupation rate will not hit this level until well into the next decade, being driven by the gradual ageing of current owner-occupiers, rather than from the entry of new ones.
- The sustainable entry of traditional first-time buyers (those aged under 35) is no higher than the current overall rate of just under 68 per cent.

Overall the analysis suggests that it is not the straight economics of house purchase such as mortgage rates, tax relief, house prices and disposable incomes that will have the biggest influence on how far owner-occupation can expand sustainably. More important will be the factors that effect how far potential borrowers are prepared to extend themselves and the criteria used by mortgage providers in their lending decisions. These in turn are determined by a range of factors, including the level of economic stability, the way in which the security of employment develops, the level of support provided by the government to owner-occupation and the ability of lenders to develop flexible lending policies.

Table 1 shows estimates of these influences on the rate of entry into sustainable owner-occupation. In total, the range of influences analysed will reduce the sustainable rate of entry into owner-occupation by four percentage points, from just under 72 per cent to just below 68 per cent. The key negative influences are the increase in job insecurity and the trend to lower inflation. As the table shows, there are some offsetting positive influences, such as the development of flexible lending policies.

Table 1: Influences on entry into sustainable owner-occupation

(percentage point change in rate of entry into owner-occupation)

Low inflation	- 1.3
Economic stability	0.7
Job insecurity	- 2.0
Reduced government support	- 0.7
Tighter lending criteria	- 0.7
Flexible lending policies	0.7
Reduced investment motive	- 0.7
Total	4.0

Policy implications - a key role for government

This analysis suggests that it is the confidence factors which affect the willingness and ability of lenders and borrowers to extend themselves financially that will have the major impact on the extent to which owner-occupation can be sustainably expanded. In seeking to increase home-ownership, government has therefore a key role to play. This includes ensuring the economic stability that will allow potential borrowers to plan ahead with confidence and provide lenders with the opportunity to develop the necessary flexible lending policies. The study's estimates also suggest that the increases in sustainable owner-occupation will be facilitated by any measures that help to slow, or even reverse, the current widening in the distribution of incomes.

The research suggests that the rate of increase in sustainable owner-occupation will continue to be much slower than in the past. With the number of households set to increase significantly, this will

increase the need for alternative forms of housing such as that provided in the public or private rented sectors. This need will increase if employment becomes more insecure, as is widely predicted, with the negative consequences this would have for demand for owner-occupation.

The researchers conclude that, given the limited increase in owner-occupation, government action will be required to increase the stock of both private and social rented accommodation.

About the study

The study focused on the socio-economic influences on entrances into owner-occupation and exits from it. The key areas of analysis were: government policy and economic trends; the changing nature of employment; developments in the lending field; and attitudes to home-ownership.

In addition to an extensive analysis of trends in these areas, the study also included in-depth interviews with lenders and housing market experts and drew on the Henley Centre's own proprietary research data relating to attitudes to home-ownership, debt, job insecurity and other factors.

Further information

The full report is published by the Henley Centre and is available from York Publishing Services Ltd (price £11.95 plus £1.50 p+p).

Related Findings

The following Findings looks at related issues:

- 152 The danger of measures that would boost house prices (Aug 95)
- 154 Housing associations, private finance and market rents (Sept 95)
- 164 Household formation and tenure decisions among the 1958 birth cohort (Nov 95)
- 165 Funding shared ownership (Dec 95)
- 185 Housing costs, housing benefits and work disincentives (Jul 96)

For further information on these and other Findings, contact Sally Corrie on 01904 615905 (direct line/answerphone for publications queries only).



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