findings

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The future sustainability of home-ownership

The UK housing market has been subject to considerable changes over the last decade and there are continuing concerns regarding the future sustainability of the home-ownership sector. A team from the Universities of Glasgow and Reading, analysing local surveys and macro-economic models, has found that:

- Since 1992, first-time buyers have made more considered choices in entering ownership than in previous times of rapid house-price inflation.
- Ownership remains the 'prosperous' tenure, but owners now have less secure jobs. Loss of jobs and/or income affected a quarter of home-owning working-age households between 1992 and 1995.
- Lending patterns appear to be more secure than a decade ago in that high levels of housing debt relative to home values affect fewer people and the average proportion of income taken by mortgage repayments has declined.
- The half of new borrowers who take fixed-rate mortgages are generally established owners with incomes above the average for owners.
- Only a third of owners had taken out mortgage protection policies by the end of 1995; they were often the better-off owners.
- Labour market changes best explain the behaviour of the UK market in the 1990s.
- The supply of housing changes little in response to house-price changes in the UK. This allows a long-term trend increase in house prices of 6-7 per cent a year and means that interest rate changes are key in inducing cycles.
- The home-ownership share (including right-to-buy sales) in the UK will grow by only 0.3 per cent per annum to nearly 72 per cent by 2016 and regional tenure differences will be maintained. A substantial proportion of the increase in households over the next 20 years will therefore need to be met in the social rented sector. Currently the number of new homes in the social housing sector is 50-60,000 homes per year short of the required annual output to 2016.

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Sustainable home-ownership

Britain is now confronted with a likely growth of just under 5 million new households between 1991 and 2016. A key issue arising is the extent to which the emerging requirement for homes can be sustained by the economy and met within the owner-occupied sector.

Economically sustainable home-ownership is the level of home-ownership which is not subject to significant short-term contractions in times of economic downturn and which is consistent with the performance of the economy in the long term.

Two obvious questions arise:

- Have changes in consumer and lender behaviour raised the level of ownership that is sustainable throughout economic cycles?
- What scale of owner-occupation can be sustained by the economy in the future?

This study examined the changing profile, jobs, fortunes and motives of home-owners by using household survey data for the Bristol and Glasgow housing market areas.

Owners, motives, jobs and incomes

The owner-occupied sector remains Britain's relatively affluent tenure with two-earner households the norm. The surveys, however, reveal:

- a growing proportion of owners are young and old single people
- households with children are in the minority and in the 1990s first-time buyers have started families later than during the 1980s boom
- the majority of first-time buyers are in their mid-twenties and age of entry increased by a year in the 1989-93 period, though it has subsequently fallen
- two-fifths of first-time buyers have University or college degrees and graduates generally marry other graduates; proposed reforms to University fees and grants could delay sector entry for as long as 3 to 5 years and raise rental demand
- the share of right-to-buy purchasers in the flow of first-time buyers has fallen, especially in the South; right-to-buy purchasers were, in the past, relatively unlikely to get into mortgage difficulties

The household surveys probed the motives and expectations of first-time buyers. In contrast to the earlier samples, post-1992 first-time buyers:

- stressed the long-run financial and lifestyle advantages of ownership
- reported that their decision about when to buy was driven by demographic and job events rather than price cycles and that they bought without expectations of significant capital gains
- displayed less aversion to renting, with a fifth saying that they would consider renting in future

These entrants all aspired to be long-term owners and most would recommend home-ownership to similar households. By 1995 existing owners were more confident than in the 1989-93 period. Only 2 per cent of the sample said that they were affected by negative equity and slowly recovering prices (at the time of the survey) were re-establishing 'cushions' of housing equity. Cancelled moves were being re-considered and movement patterns were more closely related to labour market change than in the boom and bust periods. Equity withdrawal rates, either on moving or by additional borrowing, had continued to fall and, in contrast to 1985-88, such loans were exclusively used to upgrade housing conditions (and should not be labelled as housing equity withdrawal).

In broad terms, post-1992 purchasers appeared to have more mature motives and to make more considered, more secure choices. However, their employment patterns had altered over the three periods. Although after 1992 the proportion of working-age adults who were unemployed had fallen from 4 per cent during the 1989-92 period to 2 per cent:

- the proportion of working adults with permanent contracts had fallen from 95 to 84 per cent (1988 to 1995)
- a growing proportion of jobs were either part-time or in self-employment: 15 per cent for new entrants, 22 per cent for movers and 31 per cent for non-movers
- over the 1992-95 period owners experienced significant rates of job loss, 11 per cent for those in 'permanent' jobs and 16 per cent for those with non-standard contracts
- a further 10 per cent of households who retained jobs reported a significant loss of income

Although home-owners, on average, had high employment rates and growing incomes over the 1992-95 period, a third of households incurred significant disruptions in employment and income. One household in four had at least one non-permanent job underpinning their incomes. It is clear that the flexible labour market is now a reality which buyers and lenders must address as a major, enduring feature of housing activity.

Safer mortgages?

The UK experience from 1989 to 1993 made it all too clear that home-owners and the housing market are subject to three kinds of shock which compromise the sustainability of the sector. Variable rate mortgages mean that home-owners face rising mortgage expenditure when interest rates rise. Rising unemployment rates for home-owners create sharp increases in arrears and repossessions. Falling house prices undermine lender security.

The ways in which borrowers and lenders changed their behaviour after the 'bust' period were examined by way of the household surveys, the DoE/CML 5 per cent Sample Survey and qualitative interviews with 11 lenders (of different sizes and types). Just over three-quarters of UK home-owners are still repaying a mortgage and the stock of mortgages is still primarily 20-25 year, variable rate loans backed by an endowment policy, though lending patterns show important changes after 1990. The important conclusions from the research were:

- although average loan-to-house-value ratios rose between 1989 and 1995 (from 0.76 to 0.80) the distribution of loan-to-value ratios had shifted to a more secure pattern (the proportion exceeding 0.98 had fallen from 10 per cent to zero, and the proportion in the range 0.95 - 0.98 from 20 to 14 per cent)
- average loan-to-income ratios had fallen from 2.31 to 2.25 (1989-95); this reflected both greater credit scoring and screening by lenders as well as two-thirds of sample borrowers not seeking the maximum loan
- lower general and house-price inflation rates between 1992-95 (in contrast to the earlier period) meant that, for continuing owners, loan-to-income and loan-to-value ratios fell less rapidly than in the 1985-88 period

There were also important changes in the type of mortgages taken out and the use of insurance. After 1992:

- standard repayment mortgages began to displace endowment-backed loans
- fixed-rate mortgages rose sharply as a proportion of new loans after 1992, fell in 1996 and recovered to almost half in 1997. Econometric models suggest that the changing relative price of different types of mortgages explain these changes. Fixed-rate loans were more likely to be used by higher income, moving households with children
- just over a third of owners with mortgages, by the end of 1995, had taken out mortgage protection policies to provide for mortgage payments in (limited) periods of income or job-loss; the average monthly cost of these policies was £30 and the take-up was biased to higher income households; consumer knowledge of these products was, at best, confused

In broad terms, the housing and macro-economic environment was ‘safer’ for mortgage holders. Institutions had become more proficient in credit-scoring and arrears management and there was a sense that the early-1990s crisis had been ‘managed’ and had now passed. Two key concerns persist, however. First, with the proportion of variable rate debt still large, the UK market is still exposed to interest changes and this will become a particular difficulty should the UK join EMU. Second, the market is still exposed to job losses on the part of home-owners.

Understanding the 1990s

Policy changes, cyclical effects and labour market change all played a role in the sluggish housing market recovery relative to the rest of the economy in the mid-1990s. Econometric analysis shows that:

- labour market changes, encapsulated in the ratio of wages to GDP, best explain the observed patterns
- the response of housing supply to price changes is low in the UK (a 1 per cent change in price leads to a 0.3 per cent change in supply) and this means that interest rates continue to play a key role in market cycles and makes house-price inflation of 6-7 per cent per annum likely in the long term
- although (by 1997) house prices are now rising ahead of inflation, permanent shifts in the labour market mean that there will be no sudden recovery to real 1989 price levels

Economic estimates of sustainable ownership to 2016

Economic factors such as growth, income certainty and the capacity of the construction sector will shape home-ownership rates as well as demographic change. Econometric models were devised for the UK as a whole and for the standard regions and combined with projections for the overall economy drawn from Oxford Economic Forecasts. The base projections are indicated in Table 1 and the key implications (to 2016) are:

- average annual house price increases of 6-7 per cent
- average annual construction of 160,000 new homes in the owner-occupied sector
- a modest rise in the home-ownership share from 66.8 per cent in 1995 to 69.1 per cent (excluding right-to-buy sales) or 71.7 per cent (including right-to-buy sales) by 2016; the latter estimate implies a growth rate of 0.3 per cent per annum, in contrast to 1.7 per cent in the 1980s

At the regional scale, the models suggest that:

- inter-regional differences in the home-owner share will be maintained

Table 1: Baseline projections 1996-2016

Year	GDP (annual % change)	RPI (annual % change)	Mortgage rate (%)	Starts GB (000s)	House prices (annual % change)	Owner-occupn rate GB (%) (end period)	Owner-occupn rate ex. RTB (%) (end period)
1996-2000	2.3	3.0	7.5	162	5.3	68.4	67.7
2001-2005	2.3	2.7	8.4	160	7.4	69.6	68.2
2006-2010	2.3	2.8	8.4	158	6.0	70.6	68.6
2011-2016	2.3	2.8	8.4	161	7.4	71.7	69.1

Source: Joseph Rowntree Foundation Housing Model

- future household growth will be fastest in the regions which have historically had high growth, implying greatest housing shortages in the South

The modelling process assumed that present rates of construction in the rental sector continue, namely 40,000 housing association homes per annum. The econometric modelling drew two important conclusions in this regard:

- the market will not produce all the homes required for the future and, in line with demographically based estimates (see *Housing Research Findings* No 157), a further 50-60,000 homes are required annually to avoid shortage problems
- the case for these homes has to be made on 'social' or 'equity' grounds; the model estimates suggest that housing does not 'crowd out' other investment, but nor would faster housing investment raise the UK growth rate

Conclusion

The emphasis of UK housing policy is now no longer on expanding home-ownership. But there is no clear, successor policy to enhance housing market sustainability, though the more stable macro-environment helps the housing sector in the long term. The researchers conclude that to meet the future housing challenges in the context of global competition and flexible labour market the Government has to think beyond the final removal of MIRAS (mortgage interest tax relief). They suggest the following:

- fiscal policies for housing have to be considered, especially in the context of the European Monetary Union, which will enhance stability; taxing house price increases may make economic sense
- regional, urban and planning policies to augment the low responsiveness of housing supply to demand are imperative
- consumer information on the relative advantages and risks of different types of mortgage and tenure needs to be improved
- urgent attention to the current morass of mortgage protection plans and the low rate, by EU standards, of fixed-rate mortgages is required
- a clear strategy for private rental provision for the 'twenty-somethings', heading for ownership in the future, is required

Above all, if the present low rates of investment in affordable rental housing continue, then the market will be damaged and social exclusion in housing increased.

About the study

The study was undertaken by Duncan Maclennan, Kenneth Gibb and Mark Stephens of the University of Glasgow and Geoff Meen of the University of Reading.

Three surveys of home-owners covering the period 1985-88 (boom), 1989-93 (bust) and 1992-1995 (recovery) were undertaken, surveying first-time buyers, recent movers and non-movers. In addition, the study drew on data from the DoE/CML 5 per cent Sample Survey of Mortgages and a survey of lenders' behaviour. The study also involved extensive, technical modelling.

Further information

The full report, Fixed commitments, uncertain incomes: Sustainable owner-occupation and the economy by Duncan Maclennan, Geoff Meen, Kenneth Gibb and Mark Stephens, is published by the Joseph Rowntree Foundation. It is available from York Publishing Services Ltd, 64 Hallfield Road, Layerthorpe, York YO3 7NQ, Tel: 01904 430033, Fax: 01904 430868 (ISBN 1 85935 039 9, price £11.95 plus £1.50 p&p).

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