First-time Buying affordability

The Snakes & Ladders of the Property Ladder

Image: Wiktor Karkocha at Unsplash

Foreword

Chris Gardner, Co-Founder and Co-Managing Director, Atelier

As a financier of property transactions, from land purchases right through to the construction of entirely new homes, or the refurbishment or conversion of existing buildings, we take a keen interest in the health of the housing market, and in particular, in the fortunes of the first-time buyers on whom it depends.

After all, most property chains rely on new money entering the market at the bottom, to oil the wheels and keep people and transactions on the move, as their life, family and work aspirations evolve.

Atelier commissioned this paper as the market stands at a critical juncture – the pandemic has simultaneously created economic uncertainty, an unsteady employment backdrop and a rapid shift in buyer demand. It comes after the market received extensive Government support through Help to Buy and the Stamp Duty holiday. That stimulus, coupled with the reassessment many people made during lockdown of what they want from their home, has pushed up the demand for property to its highest level in 15 years. Some major mortgage lenders report that applications are up 50% on their pre-pandemic level, and Land Registry data shows average prices across the UK rose by 8.9% in the 12 months to the end of April.

Rising property prices and a surge in market activity have never been the friend of the first-time buyer. To better understand how the current market might impact them, and to assess the risks on the property development market and assist our professional borrower base, we asked our Consultant Economist, Bob Pannell, the former Chief Economist with the Council of Mortgage Lenders, to unpick the latest data.

Our findings shine a light on the tricky question of affordability for first-time buyers, shatter several myths, and identify a number of opportunities for mortgage lenders, the regulators and property developers to help struggling would-be buyers more.

Key findings at a glance

30% fewer first-time buyers today

Despite Government support and property ownership remaining the tenure of choice, there are 30% fewer first-time buyers today than there were at the peak in the 1980s.

First-time buyers are not getting older

Contrary to common perception first-time buyers are not getting older. The average age of a first-time buyer, 29, has barely changed in two decades.

Deposits have surged by 24% to £60,000 in the last year

The average mortgage deposit paid by first-time buyers has spiked to £60,000, favouring the well off and further pulling up the ladder for the less affluent.

Those on the ladder already are £1 trillion richer

Housing equity of around £1 trillion has been accrued by older borrowers.

The potential first-time buyer market is growing

There are now 10% more adults aged 25-34 – the cohort most likely to want to buy for the first time – than there were at the time of the global financial crisis (GFC).

Executive summary

- **Rapidly rising house prices** are making it harder for people to get on the property ladder, but the popular perception that aspiring homeowners are waiting years longer to buy is a myth. The average age a first-time buyer is 29, almost the same as it was two decades ago.
- **Affordability pressures** mean today's first-time buyers tend to be richer, not older.
- Mortgage **lenders axed low-deposit mortgages** when the pandemic hit, and during the past year the average deposit required by a first-time buyer has risen by a quarter, to £60,000.
- In much of the UK, **deposit requirements relative to incomes** are back to the onerous levels seen in the immediate aftermath of the GFC.
- Fortunately this should **mostly prove temporary**, given the recent recovery in the operating capacity and credit risk appetite of mortgage lenders.
- But even with the improving economy, some would-be first-time buyers will face **income uncertainties** as job support schemes are unwound this autumn, and others will struggle to cover the gap in their finances prompted by the strongest **house price inflation** in six years.
- Worrying too, are the signs that the factors that kept homes affordable even as prices rose, may be reaching their limits. For over a decade, **historically low interest rates have limited the mortgage costs** associated with high house prices. But the Bank of England may soon come under pressure to raise rates to tame surging consumer inflation.
- Although a significant relaxation of regulatory stress tests seems unlikely, lenders may find enough wriggle-room with their underwriting criteria to **keep first-time buyer numbers on an even keel** in the short term.
- But the time is fast approaching for **fresh market innovations** or policy interventions to be considered.

Introduction

The housing market has surprised on the upside, following the end of the first national Covid lockdown last June.

The recovery has largely centred on the renaissance of home-movers, who have returned to the market with gusto for the first time in more than a decade. Older home-owners have amassed more than £1 trillion[1] of housing equity over recent years, as well as a significant pool of unplanned savings during lockdown, and have decided to splash some of this to buy properties with more space or located away from urban centres, and/or second homes.

This positive mindset looks set to persist even as the Stamp Duty holiday ends and Government support arrangements unwind over the coming months.

Amid the current boom-like conditions and market distortions associated with stamp duty deadlines, it is easy to overlook the fact that first-time buyers have not been doing quite as well.

This is neither a new nor a short-term problem.

Those looking to get on the housing ladder, have faced significant affordability challenges over recent years, which as the title of this paper suggests, for first-time buyers has been similar to a game of snakes and ladders – just as progress is being made, fortunes change and there is a slide back down the ladder.

Such pressures have intensified post-Covid, and it is not clear what respite the future holds.

Image: Domenic Gentile at Unsplash

1 UK housing value hits record £7.56 trillion high, Savills, March 2021

2 See for example Home Ownership or Bust?, Council of Mortgage Lenders, 2016

The eternal dream of home ownership

Amazingly, the heyday for first-time buyers was as long ago as the mid-1980s, when Right to Buy sales helped to swell annual totals to half a million. Numbers have ebbed and flowed since, but, apart from a period around the millennium (following a sustained and lengthy period of income growth), first-time buyers have never looked like returning in such volumes.

"Today there are 10% more 25–34-year-olds (the key first-time buyer age cohort)"

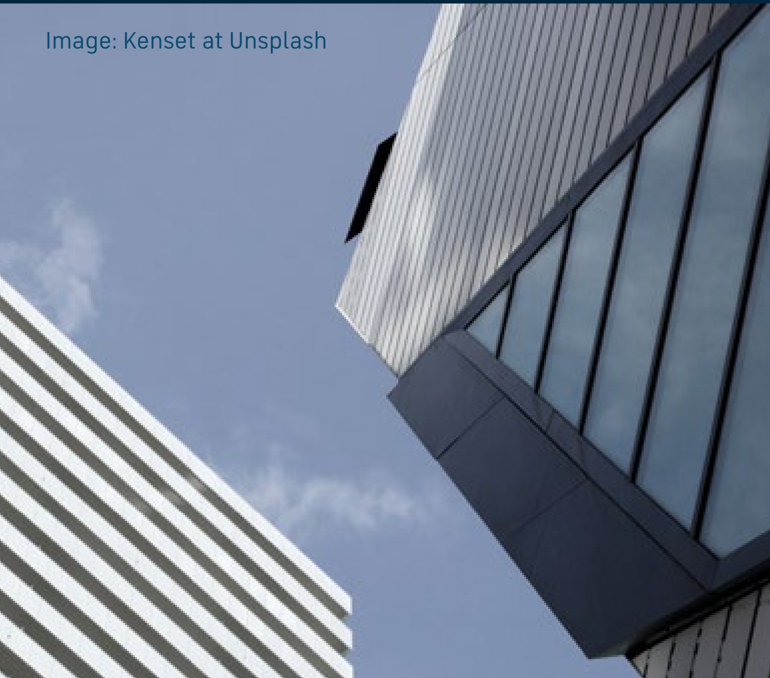
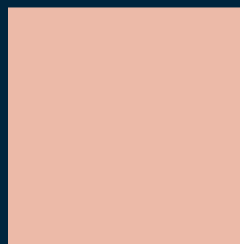


Image: Kenset at Unsplash

Annual first-time buyer numbers picked up sharply following the GFC, but the overall recovery to about 350,000 seems rather underwhelming when set against the historic backdrop. Especially given the significant Government interventions – most notably, the Help to Buy Equity Loan Scheme – over recent years, and the fact that today there are 10% more 25–34-year-olds (the key first-time buyer age cohort) than at the time of the GFC or the mid-1980s.

With ample survey evidence that young adults still aspire for home ownership[2], it is affordability that is holding them back. The rest of this article unpacks what has been happening to affordability over recent years, how the Covid-19 pandemic has impacted, and assesses prospects.



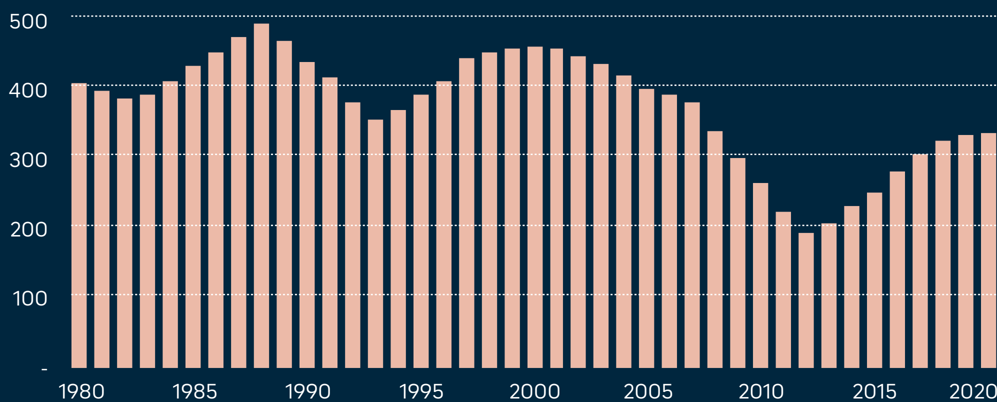
What do we mean by affordability?

Affordability has a wide variety of meanings, but for the purposes of this paper, our focus is on first-time buyers and their ability to buy a property and to meet any associated costs in the future. This means looking at whether the deposit and any mortgage they can arrange will allow them to buy a home, and their ability to service the associated mortgage payments over time (a more rigorous approach might also include insurance costs, utility bills, repair costs and the like).

No prizes for guessing that first-time buyer affordability is tightly bound up with property prices, a household's financial circumstances, and the cost and availability of mortgages.

> **"No prizes for guessing that first-time buyer affordability is tightly bound up with property prices"**

CHART 1: FIRST-TIME BUYERS, 000S PER ANNUM, 5-YEAR AVERAGES



Source: UK Finance Regulated Mortgage Survey (2005 to date); Holmans A. Recent Trends in Numbers of First-Time House Buyers: A Review of Recent Evidence and Information. Technical Report 1, Council of Mortgage Lenders (pre-2005)

Insights

- There are more potential first-time buyers than ever before, yet fewer are able to get on the ladder
- Despite "Generation Rent", home ownership remains the tenure of choice, but affordability is constraining the market

Image: Ludde Lorentz at Unsplash

> **"First-time buyers have managed to afford to buy progressively more expensive properties over 2005-18"**

All we hear is Ratio Gaga

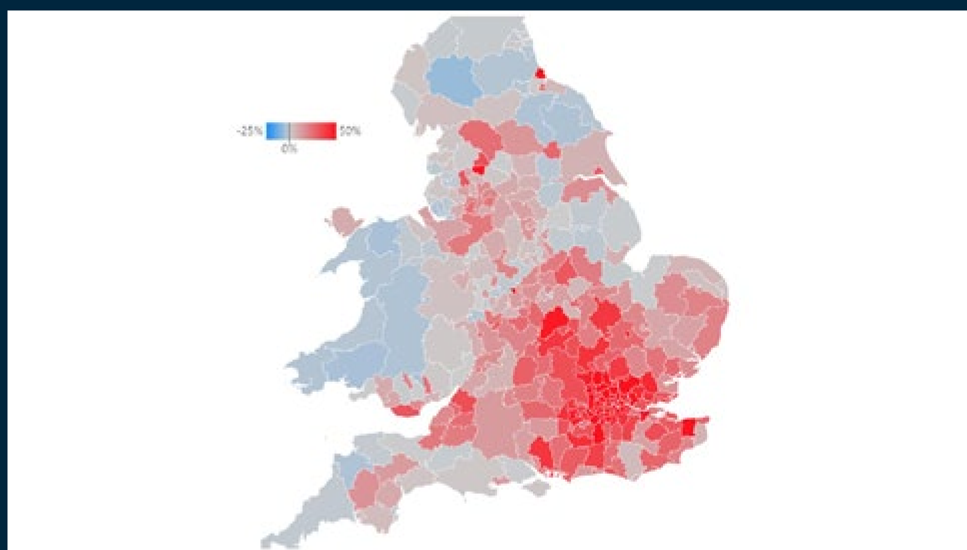
A good starting-point when thinking about affordability, is to look at the relationship between house prices and income or earnings.

While many different metrics can be used, a core theme is that housing has become significantly more expensive relative to earnings over time. As Figure 1 illustrates, such increases are evident across much of the country, but there appears to be a clear geographic focus in southern and central England.

While this matches the general perception, it is by no means the whole story. Affordability has lots of moving parts and these can be closely interconnected.

A recent Bank of England paper[3] analyses how first-time buyers have managed to afford to buy progressively more expensive properties over 2005-18 (a broadly similar period to that shown in Figure 1) and offers a helpful framework to explore what has been happening.

FIGURE 1: HOW HOUSE PRICE TO EARNINGS RATIOS HAVE CHANGED, 2005-2020



Source: Housing affordability in England and Wales 2020, ONS
Note: Shading shows the change in ratio of median house prices to median residence-based earnings.

3 First-time buyers: how do they finance their purchases and what's changed?, Bank Underground, September 2020

Richer not older

Higher incomes bridge much of the gap. This seemingly unremarkable finding becomes more interesting, when we consider the fact that the earnings of younger adults have been subdued over a protracted period[4]. As first-time buyers have not become significantly older – their median and mean ages have been steady at around 29 and 31-32 years respectively for the past 20 years – it seems that first-time buyers are increasingly drawn from higher income groups (and/or increasingly reliant on dual incomes).

One of the legacies from the GFC, is that borrowers must now put down large deposits. Although this has been a key hurdle for prospective buyers for many years[5], the situation had been improving slowly pre-Covid, as lender risk appetite revived.

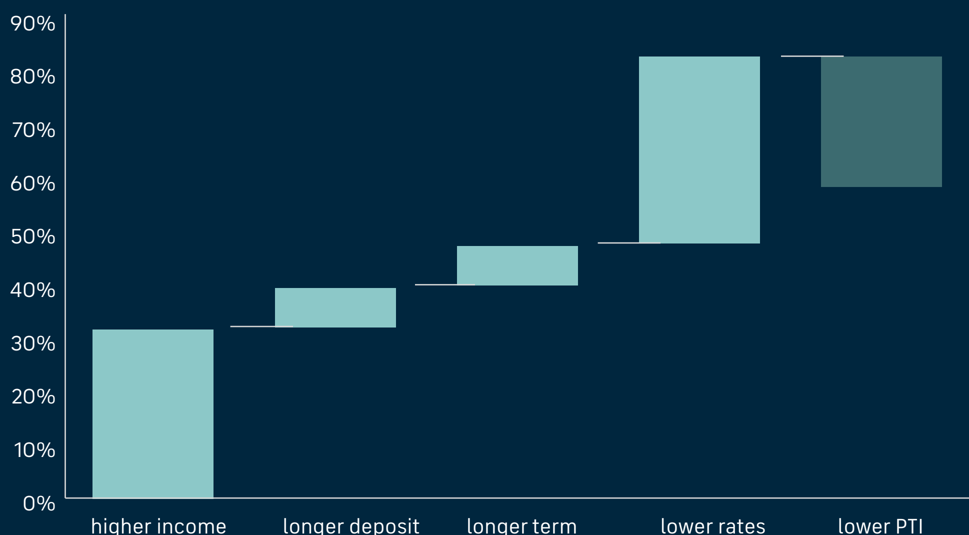
"First-time buyers are increasingly drawn from higher income groups"

On the mortgages side, historically low interest rates precipitated by the GFC have transformed the affordability picture. The Bank of England estimates that offer rates on 75% LTV mortgages have fallen by more than 350bps to less than 2%, over the period depicted by Figure 1. Other things being equal, this would enable a household taking out a 25-year repayment mortgage to service a mortgage that was half as big again. The upshot is that, notwithstanding sharply higher house prices, mortgage payments relative to earnings are likely to have fallen for first-time buyers in most of the local authorities in Figure 1.

The authors also recognise that longer mortgage terms have helped stretch borrowing capacity, but to a lesser extent. This seems intuitive, given that a shift from 25 to 35 years might improve borrowing capacity by a fifth. Although some households might be able to extend their mortgage term still further, the aggregate additional impact from doing so is likely to fall away rapidly, as more and more households would trigger the more onerous affordability tests associated with extending a loan into their retirement years.

Chart 2 offers a stylised view of the overall findings.

CHART 2: HOW FIRST-TIME BUYERS HAVE FINANCED HIGHER HOUSE PRICES, 2005-18



Source: Derived from First-time buyers: how do they finance their purchases and what's changed?
Note: Figures represent stylised estimates of the cumulative impact over the 2005-18 period.

4 An intergenerational audit for the UK, Resolution Foundation, October 2020
5 See BSA Property Tracker results showing that raising a deposit had been the key impediment to buying a home for the best part of a decade pre-Covid

Insights

- First-time buyers are not becoming older, they are becoming richer, buoyed by lower interest costs and higher earning power
- Less affluent borrowers are finding life far harder, constrained by lower earning, and rising deposit requirements
- Mortgage rates are now 3.5% lower than they were before the global financial crisis, halving the cost of borrowing

Stress tests take the strain

The authors note that mortgage payments relative to incomes (PTI) have fallen significantly since the GFC, and that this has limited the overall degree of income stretch. While they do not make the connection, it seems likely that this increasingly reflects the restraining hand of macro-prudential policy.

"Mortgage payments relative to incomes have fallen significantly since the global financial crisis"

Since 2014, the Bank of England's Financial Policy Committee (FPC) has applied two measures to regulate the housing market:

- A stress test of an extra 3% on mortgage rates, except for longer-term fixed rate mortgages.
- A 15% cap on the proportion of new loans with income multiples (LTIs) of 4.5 or above.

While the two measures work in tandem to limit the debt-service burden that households can take on, the stress test has done the "heavy lifting" in limiting activity to those with higher incomes and/or able to put down large deposits[6].

Insights

- Counter-intuitively, mortgage payments have fallen over the past ten+ years
- However, in the wake of the global financial crisis, well-intentioned regulation from the FCA and PRA has squeezed affordability
- Regulation now limits most home loans to a maximum of 4.5 times income, yet in 2020 the average property in England cost 7.6 times the average full-time worker's annual salary; and this mismatch is likely to increase as house prices rise sharply

6 Zoopla's report The Changing Shape of the UK Mortgage Market (UK Finance, December 2019) suggests that macro-prudential measures have a particularly restrictive impact in expensive regional markets of London and the South East, where stressed rates limit borrowers to relatively low LTVs.

Deposit requirements surge as prices rise and low deposit mortgages vanish under Covid

"Low deposit mortgages temporarily evaporated"

Image: Clem Onojeghuo at Unsplash

The Covid-19 pandemic has adversely affected first-time buyers and affordability in at least three important ways:

(a) The disruption to businesses has negatively affected employment and earnings, especially for the young and self-employed, with further adverse effects likely this autumn, as the Government unwinds its furlough and other support schemes.

(b) Low deposit mortgages have temporarily evaporated[7].

(c) The "race for space" that began with the end of the first national lockdown and Stamp Duty holidays, has uncorked significant buyer demand and the strongest period of property price inflation in six years.[8]

TABLE 1: HOW FIRST-TIME BUYER DEPOSITS HAVE CHANGED POST-COVID

	2019-20	2020-21	
	£	£	% change
Northern	25,400	31,200	23%
Yorkshire and Humberside	30,400	36,500	20%
East Midlands	38,400	46,200	20%
East Anglia	51,500	62,500	21%
London	142,400	160,300	13%
South East	71,600	85,000	19%
South West	52,500	62,900	20%
West Midlands	40,600	47,800	18%
North West	32,500	39,300	21%
England	56,000	68,400	22%
Wales	25,800	33,200	29%
Scotland	26,100	35,100	35%
Northern Ireland	27,600	33,800	22%
UK	50,200	62,200	24%

Source: UK Finance; author estimates. Note: We use financial years in the table, so that the most recent figures (those for 2020-21) reflect post-Covid conditions.

7 According to Financial Conduct Authority data, the proportion of mortgage lending above 90% collapsed to 1.22% in Q4 2020, the lowest rate since records began in 2007.

8 Currently approaching 10% per annum according to Acadata Ltd

One striking manifestation of the fresh affordability pressures post-Covid, has been the sharp increase in the size of deposit provided by first-time buyers (see Table 1).

Applicants' income moved higher, but deposits rose markedly relative to incomes, reaching new record levels across most of England (although not the other nations of UK). For England at least, this wiped out the gentle improvement of recent years, and took us firmly back to the challenging conditions seen in the immediate aftermath of the GFC.

Given that UK Finance metrics only tells us about those who managed to get on the housing ladder, the inference is that many young adults will have been locked out of the market, either because they could not put together a large enough deposit, or because their incomes could not support the larger mortgages implied by house price increases.

Insights

- The less affluent have suffered more employment uncertainty during the pandemic, further weakening their chances of getting a foot on the property ladder
- The average first-time buyer deposit has spiked by 24% to £60,000
- Competition for space and location has driven up property prices, locking out many first-time buyers

Image: r architecture at Unsplash

Pandemic pain should be temporary

The good news is that much of the extraordinary affordability pressures on first-time buyers should prove temporary, given that lenders' operating capacity and credit risk appetite have picked up in recent months. The Government's new mortgage guarantee scheme[9] should reinforce this trend.

That said, it is hard to see how first-time buyers will navigate the significant affordability challenges arising from sharply rising house prices and ongoing income uncertainties.

"Most would-be first-time buyers will not qualify for 95% LTV loans"

While 95% LTV mortgages have become more readily available, they come with onerous credit scoring and are set to remain relatively costly. And even if the pricing and availability of such mortgages reverts to pre-Covid levels, borrowers would still need to increase their deposits in line with property price growth. Most would-be first-time buyers will either not qualify for 95% LTV loans, or will choose to save for a larger deposit.

Further term extensions may stretch affordability a little bit more, but expectations of a sharp bounce-back in economic activity suggest that further significant mortgage rate reductions are unlikely.

Looking again at Chart 2, the most promising option would seem to be for lenders to relax their underwriting criteria. Some parts of the lending industry[10] are calling for the FPC to relax its macro-prudential rules, so that higher income multiples can be advanced. Although these tools are currently being reviewed by the regulator, previous reviews have not led to any relaxation and it is hard to see the authorities favouring wholesale relaxation, given the ramifications for future house prices and levels of household indebtedness. A recent speech by Sir Jon Cunliffe[11], Deputy Governor of the Bank of England, downplays the role that its macro-prudential measures have had in constraining mortgage availability.

TABLE 2: HOW STRESS RATES AFFECT MAXIMUM INCOME MULTIPLES

	Stress rate				
	7.0%	**6.5%**	**6.0%**	**5.5%**	**5.0%**
Term (years)					
25	3.75	4.00	4.25	4.50	4.75
30	4.00	4.25	4.50	4.75	5.00
35	4.25	4.50	4.75	5.00	5.50
40	4.25	4.75	5.00	5.25	5.75

Source: Author estimates
Note: These results assume a maximum payment to income (PTI) ratio of 33%.

9 The mortgage guarantee scheme, HM Treasury, March 2021.
10 First time buyers: Is the growth sustainable?, IMLA, May 2020
11 Housing – the Quiet Decade, Bank of England, May 2021

As Nationwide Building Society[12] has recently demonstrated, there is in fact already latitude within the FPC's rules to accommodate more generous lending criteria, where the mortgage is fixed for five years or more. By lowering its stress rate from 3% to about 1.5% over its prevailing Standard Mortgage Rate of 3.59%, Nationwide asserts that a first-time buyer taking out its 'Helping Hand' mortgage with a 40-year repayment term would be able to increase borrowing by a fifth (from 4.5 up to a maximum 5.5 times their income).

Specifics will vary from lender to lender according to their own underwriting rules, but Table 2 provides a ready-reckoner for the potential uplift to borrowing that a lower stress rate implies.

While some lenders may explore this option, the overall benefits (in terms of stretching borrower affordability) are likely to be modest. Lenders themselves remain subject to the FPC's overall cap on higher LTI business. For the first-time buyer, higher borrowing would increase repayment costs by at least the same percentage, and by more if the extra lending takes the borrower into higher LTV bands. And in some cases, borrowers may be limited by the lender's maximum LTVs or other underwriting criteria.

What next? First-time buyers in the post-pandemic future

The Covid crisis has undoubtedly made life harder for would-be first-time buyers, and it will take time to revert to the pre-Covid situation. At best, it feels like first-time buyer numbers may drift over the next year or two. The Government's recent adoption of a less generous Help to Buy Equity Loan Scheme may reinforce a subdued picture.

Longer term, we cannot rule out the possibility that several of the factors that have buttressed first-time buyers, such as historically low mortgage rates, lengthening mortgage terms and housing policy interventions, lose some of their effectiveness.

If so, it is not clear what comes next. One possibility would be that first-time buyer numbers shrink and the housing market becomes increasingly polarised according to household income and wider family wealth (through such channels as inheritance and the Bank of Mum and Dad). Another possibility would be fresh Government interventions. Yet another possibility – albeit one overlooked by successive governments over many years - would be reforms in the tax treatment of housing to drive different policy outcomes lengthening mortgage terms and housing policy interventions, lose some of their effectiveness.

Image: Rich Tervet at Unsplash

12 See Nationwide, 20 April 2021 press release

Insights

- Despite low mortgage rates and Government support schemes, first-time buyers were often locked out of the market even before the pandemic
- Contrary to popular perception, home ownership remains the tenure of choice for most young people, with the average age of a first-time buyer, 29, barely changing over the past two decades
- There are more potential first-time buyers now than ever before

Conclusion

- The property market shows little sign of cooling, and as prices rise more first-time buyers find themselves locked out, with affordability and supply being the primary obstacles
- Government initiatives such as Help to Buy, and regulation restricting lending, often work against each other, making buying and affording even more difficult
- Targeted measures such as a return to building "starter homes", and relaxing regulatory restrictions just for first-time buyers, could be considered
- Building more, high-quality affordable homes is likely to be the only long-term solution to the problem of first-time buyer affordability

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About the author

Bob Pannell is a leading housing and mortgage economist and the former Chief Economist of the Council of Mortgage Lenders. Bob has been at the forefront in analysing and forecasting the UK housing and mortgage markets for over 30 years, and is a trusted adviser and contributor to the property and mortgage markets, regulatory bodies, and Government.

In his capacity as Consultant Economist to Atelier, he is briefed with advising the Board of Atelier on trends and forecasts on the UK residential property markets.

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