Research Report

Can London private renters access the latest home ownership schemes?

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Shelter helps millions of people every year struggling with bad housing or homelessness. We provide specialist advice and support on the phone, face to face and online, and our legal teams can attend court to defend people at risk of losing their home.

However at Shelter we understand that helping people with their immediate problems is not a long-term solution to the housing crisis. That's why we campaign to tackle the root causes, so that one day, no one will have to turn to us for help.

We're here so no one has to fight bad housing or homelessness on their own.

We provide practical advice and support to over 4 million homeless or badly housed people a year via our website, telephone helpline and network of advice services. We employ over 200 advisers and 40 solicitors to give advice and offer representation.

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Summary

Recent government announcements have promised new products and renewed funding for several home ownership products. These are:

Help to Buy London: An extension of the previously existing scheme, where the government provides a 40% (currently 20%) equity loan on registered new builds priced below £600,000. Buyers must pay back the equity when the property is sold, or failing this, after 25 years. After 5 years, a fee of 1.75% is charged on the equity loan, which is uprated by RPI for each following year.

Shared Ownership: Buyers purchase between 25-75% of a property and pay rent on the rest to a housing association. Recent changes lifted the threshold on buyers' household income from £71,000 for a one or two bed or £85,000 for a three bed or more property to £90,000[1].

Starter Homes: A discount of 20% on market prices, available to first-time buyers under 40. The price of the property bought can be no more than £450,000 after the discount is applied.

This paper seeks to understand how affordable and accessible properties offered under these schemes are likely to be to the Londoners whom they are aimed at. Of course, the main alternative to home ownership is renting, so market and the 80% market rents included in the current government 'Rent to Buy' offer are also examined.

Although some recent first-time buyers were previously social tenants or sharing with other people, the majority were private renting households[2]. We therefore compare the annual household incomes needed to access or afford proposed housing offers to the distribution of incomes for London private renters, where the head of the household is under 40. This allows us to roughly estimate the percentage of younger London renters who are unable to access or are excluded by the housing policies on offer.

Estimating the distribution of renters' incomes

In order to estimate the distribution of private renters' incomes in London, the Households Below Average Income dataset is used. This is published by the Department for Work and Pensions and based on the Family Resources Survey[3].

The income considered is net earned income for the household. This does not include any benefits that household members may be entitled to, as this analysis is concerned with what households could hypothetically afford through work alone.

In order to obtain a large enough sample size, data from financial years 2011/12, 2012/13 and 2013/14 are used, with incomes uprated by RPI to 2015 values. Households that rent privately whose household reference person is under 40 are selected and income deciles are calculated.

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[1] '*Help to Buy – new announcements explained*' (HMT and DCLG, November 2015) https://www.gov.uk/government/news/help-to-buy-new-announcements Accessed 04/02/16

[2] In 2013-14, 72.1% of recent new home buyers were previously private renters. English Housing Survey, table FA4401 (DCLG, 2015).

[3] '*Households Below Average Income*' (DWP, 2015) https://www.gov.uk/government/collections/households-below-average-income-hbai--2

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		Weekly	Yearly
Percentile	10	0	0
	20	110	5,713
	30	280	14,580
	40	413	21,469
	50	557	28,949
	60	712	37,010
	70	867	45,074
	80	1,064	55,343
	90	1,493	77,651
	100	6,172	320,963

Market price homes

Whether a household can access a mortgage to buy a home is assessed by estimating the annual salary needed to obtain a mortgage on an average first-time buyer home in London.

The group of private renting households in London studied are comprised of a range of family sizes and types and as such will need homes of varying sizes, in various locations across London. We use the mix-adjusted mean of first-time buyer house prices as an average, in order to represent the homes that London private renters would be aiming to buy[4].

We assume households obtain mortgages with the average advance and loan-to-income multiple for first-time buyers in Greater London[5]. The average income needed is then:

$$Average\ income = \frac{average\ advance\ \times average\ house\ price}{average\ loan\ to\ income\ multiple}$$

Help to Buy London

A similar approach is taken in evaluating whether a household would be able to acquire a mortgage to afford the homes purchased under the new 40% equity loan offered on registered London new builds. Again, the most recent mix-adjusted first-time buyer price is used as a representative, average price.

The equity loan means that buyers require a smaller mortgage and should therefore be able to purchase a home with a smaller deposit than if they had to fund the entire purchase with a normal mortgage. Hence the average advance and loan to income multiple for London buyers using the existing 20% equity loan Help to Buy scheme is used as an approximation of what may be offered under the new scheme[6].

[4] For more detail see '*Official House Price Statistics Explained*', ONS (2013). http://www.ons.gov.uk/ons/guide-method/user-guidance/prices/hpi/official-house-price-statistics-explained.pdf
[5] Council of Mortgage Lenders table ML2R, available from: https://www.cml.org.uk/industry-data/industry-data-tables/
[6] '*The Help to Buy Equity Scheme*' (National Audit Office, 2014). http://www.nao.org.uk/wp-content/uploads/2015/03/The-Help-to-Buy-equity-loan-scheme.pdf

The average income needed is then:

$$Average\ H2B\ income = \frac{60\% \times average\ H2B\ advance \times average\ house\ price}{average\ H2B\ loan\ to\ income\ multiple}$$

Starter Homes

The average income needed to acquire a mortgage on a Starter Home is also assessed. Average regional first-time buyer advances and loan-to-income multiples are once again used.

In an impact assessment submitted to the House of Lords, the government describe Starter Homes as an ‘entry level property’ and as a result use the lower quartile of prices of new-build homes sold to first-time buyers as a representative price.

This may not, however, be the price at which Starter Homes are indeed valued. As pointed out by the CML in their response to the DCLG’s initial 2014 consultation on Starter Homes[7], if the homes built under the policy are all smaller properties in cheaper areas this may not match with local first-time buyer demand. An over-supply of these types of properties may mean that developers struggle to sell them and lenders are not happy to provide mortgages secured against them.

For the policy to be successful, therefore, it is likely that Starter Homes will be built in a range of sizes and locations. For this reason, the median price of new builds in London is used as an estimate of what a typical Starter Home will cost. To test what would happen if Starter Homes are all priced at the very low end of the market, an estimate is also calculated using the lower quartile price of new build homes .

The calculation of average income required for a Starter Home is then

$$Average\ Starter\ Home\ income = \frac{80\% \times average\ advance \times average\ house\ price}{average\ loan\ to\ income\ multiple}$$

Shared Ownership

The nature of shared ownership means that an estimation of how many renters can access it must take in to account both their mortgaged share and the costs that they pay in rent and service charges. For this reason, the annual household income needed for the sum of these costs to be no more than 35% of household income is used.

This is a generally accepted rule of thumb of affordability, assuming that spending more than this proportion of income increases the risk of a household cutting back on essentials, falling in to arrears or having to borrow to sustain living standards. It is likely that housing associations will use this rule of thumb when assessing potential shared ownership customers.

Figures from a 2013 National Housing Federation report[8] suggest that in London, average shared ownership prices were 12% lower than the mix-adjusted average price for first time buyers in 2011. To calculate a current representative average price of a shared ownership home, the most recent mix-adjusted first time buyer average is adjusted by this amount.

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[7] ‘*Stepping on to the property ladder response*’ (Council for Mortgage Lenders, 2015) https://www.cml.org.uk/policy/consultations/starter-homes-stepping-onto-the-property-ladder-high-quality/

[8] ‘*Shared Ownership – Meeting Aspiration*’ (National Housing Federation, 2013) https://www.housing.org.uk/resource-library/browse/shared-ownership-meeting-aspiration/

It is assumed that the minimum equity share of 25% is purchased and that buyers have a deposit equivalent to 20% of this share[9]. To calculate the average monthly mortgage cost, the most recent average fixed mortgage rate is used[10], assuming a 25 year fixed rate mortgage.

Rent paid to housing associations is assumed to be at an annual rate of 2.75% of the value of the housing association's equity, in this case 75% of the total price. This is in keeping with an average of rent charged from a sample of shared ownership properties listed on a government endorsed website where buyers can search for both shared ownership and Help to Buy properties.[11] It is also below the cap on rent chargeable on shared ownership properties of 3%. The London average monthly service charge based on a 2014 Ipsos MORI survey for CMA is also included[12], as the majority of the properties are likely to be leasehold in London.

Market Rent

Although these households are currently privately renting, it is interesting to see whether average rent is affordable for them, based on it being no more than 35% of their income. Some households will be paying more than 35% of their income on rent, however, as previously mentioned this is considered to be a good guideline for affordability.

The average number of bedrooms for private renters in London is two[13] and so two-bedroom lower-quartile rents were taken from the latest Valuation Office Agency (VOA) private rental market statistics for London[14].

Rent to Buy

The Government set out in September 2014[15] a new model of renting which would help renters to save for a fixed period by paying a lower rent (set at 80% of market rent). The tenant would be able to buy the home at any point during this period for the full market value.

Using the VOA private rental market statistics for a lower-quartile, two-bedroom property and applying a 20% discount, the affordability was again assessed based on discounted rent being no more than 35% of a household's income.

Results

The average annual household incomes needed to access or afford average market, London Help to Buy, Starter and shared ownership homes are shown below.

[9] This is calculated from the London shared ownership average total price, equity share and deposit as reported in National Housing Federation (2013). Interestingly, their data shows that this size of average deposit as a proportion of the share purchased was the same across England

[10] Council of Mortgage Lenders table ML5, available from: https://www.cml.org.uk/industry-data/industry-data-tables/

[11] Listed on sharetobuy.com on 28/01/2016

[12] Ipsos MORI Leaseholder Survey for CML, 2014.

[13] English Housing Survey, 2013-14

[14] Valuation Office Survey, December 2015.

[15] Homes and Communities Agency, Rent to Buy 2015 to 2017 Bidding Prospectus, September 2014.

		Estimated average annual household income needed
Market		£ 83,000
London Help to Buy		£ 68,000
Starter Homes	Median	£ 62,000
	Lower quartile	£ 45,000
Shared Ownership		£ 38,000
Market Rent		£42,000
Rent to Buy		£34,000

Comparing these average required incomes to the distribution of household net earned income gives a rough estimate of the proportion of London private renting households for whom these housing offers are likely to be out of reach, based solely on what they earn from work.

Looking at what decile is immediately below each estimated required income gives the approximate minimum proportion of households excluded. This means for private renting households in London aged under 40:

- A typical market-priced home is inaccessible for at least 90% of households
- A typical London Help to Buy home is likely to be inaccessible for at least 80% of households
- A typical Starter Home is likely to be inaccessible for between 70%-80% of households
- Assuming 25% equity, a typical shared ownership home is unaffordable for at least 60% of households
- Two-bedroomed homes at the lower-quartile are unaffordable for nearly 70% of households
- Rent to Buy homes at 80% of market rent are not affordable for at least 50% of households, making their ability to save slim

These results not only show just how inaccessible and unaffordable the London market is but also that London Help to Buy and Starter Homes schemes are only likely to help an extra 10-20% of London private renting households.

Moreover, both the estimated incomes needed and proportion of households helped suggest that London Help to Buy and Starter Homes are likely to be in competition if built in similar areas and sizes.

Even the most affordable option of a 25% share in a property is out of reach for well over half of these families. The high cost of current Rent to Buy rents means that households are likely to struggle to save even when they have access to current products designed to provide more affordable rents.

Conclusion

Based on estimated typical prices, the current and proposed home ownership schemes will not be accessible to households with low to middle net earnings. These results relate to an average home and whilst there may be cheaper properties on the market, they show that current offers designed to bring average properties back within the reach of low-to-average income households are unlikely to be successful.

This highlights the difficulty of addressing affordability issues by providing discounts on a market price, or reducing the proportion of the property that buyers need to find a mortgage for. If - as we have seen in recent years - market prices rise substantially faster than earnings, even large reductions in the mortgage needed to buy an average property are not enough to make them accessible to ordinary households.

Similarly, attempts to make rents more affordable by discounting their market rate become increasingly futile as market rents rise faster than earnings. A more appropriate solution may be to formulate an offer that includes rents that are pegged to local incomes, re-establishing the broken link between earnings and housing costs.

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