Housing affordability for first time buyers

March 2015

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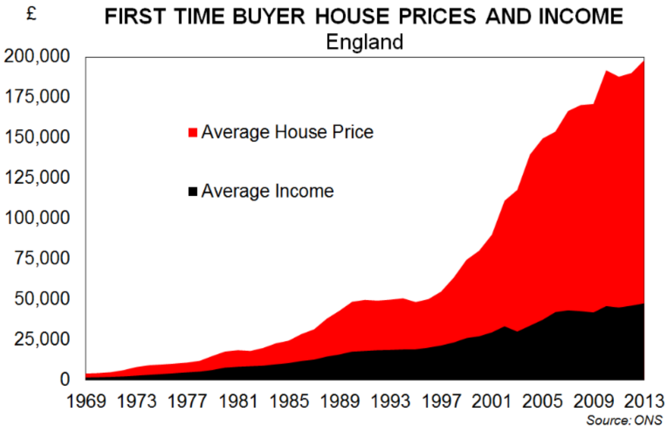
Contents

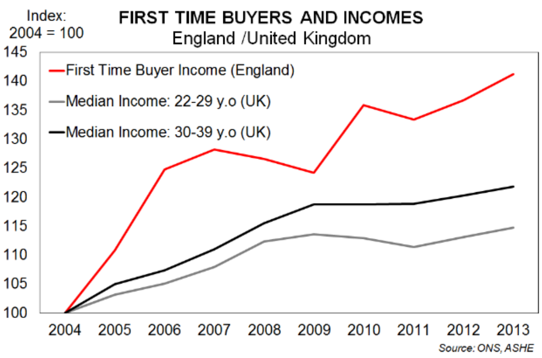
Summary of findings

Over the decades since 1969, house prices for first time buyers have increased by 48 times, far out-pacing incomes which have only grown 29 times. The average first time buyer house price of £4,136 in 1969 has grown to £198,039. By comparison, first time buyers' incomes have grown from £1,624 in 1969 to £47,574 in 2013. While this trend is played out across England, it is most stark in London. There, house prices are 59 times higher than in 1969, while incomes are only 34 times higher.

If house prices had increased at the same rate as incomes, the average first time buyer would be paying £76,873 less than they actually are. On average, if first time buyer house prices and incomes had increased at the same rate, first time buyers would be spending 30-40% less to own their home than what they actually spend today. Again, this is even worse for first time buyers in London, who would pay £139,203 (41.8%) less to own their own home if house prices increased in line with incomes.



House price increases have meant that first time buyers now need to save much larger deposits and borrow more, relative to their income. As housing became less affordable between 1997 and 2001, first time buyers simply saved larger deposits. However, as house prices and incomes diverged even further, they were forced to borrow more and between 2001 and 2007, the loan to income ratio increased by nearly a third.



First time buyers now need to be older and earn more, meaning middle income earners are being locked out of home ownership. Since 2004, the average income for first time buyers has increased by 41.2%, while income growth has been at around half that pace. First time buyers are now older as they need time to save deposits, and need above-average incomes both to save and to service a bigger mortgage. With far fewer first time buyers, it is low and middle income earners who are being locked out.

To turn this trend around, we need to build more affordable homes. These findings are the latest in our body of research demonstrating how the current housing market has a negative impact on opportunities for ordinary people to own their own home. The next government must set out a clear plan for building more homes, to ensure that once again we have enough affordable homes for everyone.

Context

It is now widely accepted that we have a desperate housing shortage in England. Each year, we build at least 100,000 fewer homes than we need and the extent of the housing shortage only increases. With this shortage has come very high house prices, making it difficult – and sometimes impossible – for first time buyers to become home owners.

The aim of this research was to understand how the circumstances of first time buyers have changed over the decades from 1969 to 2013, given this context of increasingly high house prices. Specifically, we sought to understand:

1. How house prices have changed for first time buyers over time, relative to their incomes;
2. How first time buyers have paid for these changes in house prices; and
3. The potential future implications of these changes on first time buyers.

Approach

The research examined average house prices, mortgage value and the average incomes of first time buyers taking out a mortgage across the different regions in England between 1969 and 2013[1]. All data is from the Office of National Statistics (ONS). Unless otherwise specified, the statistics in this report are for first time buyers[2].

The analysis compares the changes in these variables over time. It extrapolates what house prices would be today if they had grown in line with income growth for first time buyers, across the different regions in England. It then focuses on the broader results for England, to look at how these three variables have changed over time. In particular, it looks at how the relationships between these variables have changed.

We then set out the conditions that have underpinned the evolution of these relationships, and the implications of these findings, both today and into the future.

Definitions

The key variables used for the analysis are for first time buyers only, and are defined as follows:

- 'House prices' are mean house prices. Unlike some measures of house prices, they do not reflect any changes in the composition of housing being sold over time;
- The 'average mortgage value' is the average mortgage taken out for the purchase of a home in a given year, referred to by the ONS as the 'average advance'; and
- The 'average income' is the average of incomes recorded on the mortgage applications in a given year. This reflects the income of the entire household, so can be greater than income levels of a single individual.

[1] ONS House Price Index, Table 29
[2] ONS also publish data on purchases on different categories of dwellings.

Findings

Since 1969, average incomes of first time buyers have not increased as much as either the average mortgage taken out to buy a first home, or the average price of homes that they have bought. This is consistent across England, and has created a large gap between what house prices are now, and what they would be if they had increased in line with incomes.

Income adjusted house prices

Table 1 outlines average house prices in 2013 for first time buyers, and compares them to what the average price would be if prices had increased the same amount as incomes.

In nominal terms, the average price of a home for a first time buyer increased from £4,136 in 1969 to £198,039 in 2013. This is 48 times the original price in 1969. However, incomes of first time buyers have increased at a slower rate, from £1,624 in 1969 to £47,574 in 2013, an increase of 29 times over the 44 year period.

Table 1: Increase in house prices, mortgage sizes, incomes – 1969 to 2013

Region	Multiple increase in house prices	Multiple increase in mortgage sizes	Multiple increase in incomes	Difference between price and income
England	48	45	29	19
North East (North)	34	34	24	10
North West	37	35	25	12
Yorkshire and The Humber	42	40	26	16
East Midlands	39	38	25	14
West Midlands	36	36	25	12
East (East Anglia)	42	40	26	16
London	59	55	34	25
South East	42	41	27	15
South West	43	42	27	16

If house prices had increased at the same rate as first time buyer incomes, the average first time buyer house price in England would be £76,873 lower, a 38.8% decrease (Table 2). The divergence between prices and income was strongest in London, where house prices are 59 times higher than in 1969, whilst incomes increased 34 times. House prices would need to decrease by 41.8% or £139,203 to be in line with this rate of income growth.

Table 2: Average house prices linked to incomes – 1969 to 2013

Region	Average House Price (£)	Income-linked House Price (£)	Difference (£)	Difference (%)
England	198,039	121,166	-76,873	-38.8
North East (North)	113,606	79,428	-34,178	-30.1
North West	127,570	85,495	-42,075	-33.0
Yorkshire and The Humber	125,320	77,927	-47,393	-37.8
East Midlands	129,035	83,698	-45,337	-35.1
West Midlands	137,470	93,766	-43,704	-31.8
East (East Anglia)	159,052	98,959	-60,093	-37.8
London	333,057	193,854	-139,203	-41.8
South East	210,777	136,524	-74,253	-35.2
South West	168,578	105,891	-62,687	-37.2

House price growth was closest to income growth in the North East, where house prices increased by 34 times, whilst income increased by 24 times. However, house prices would still need to fall by 30.1% or £34,178 to be in line with income growth since 1969.

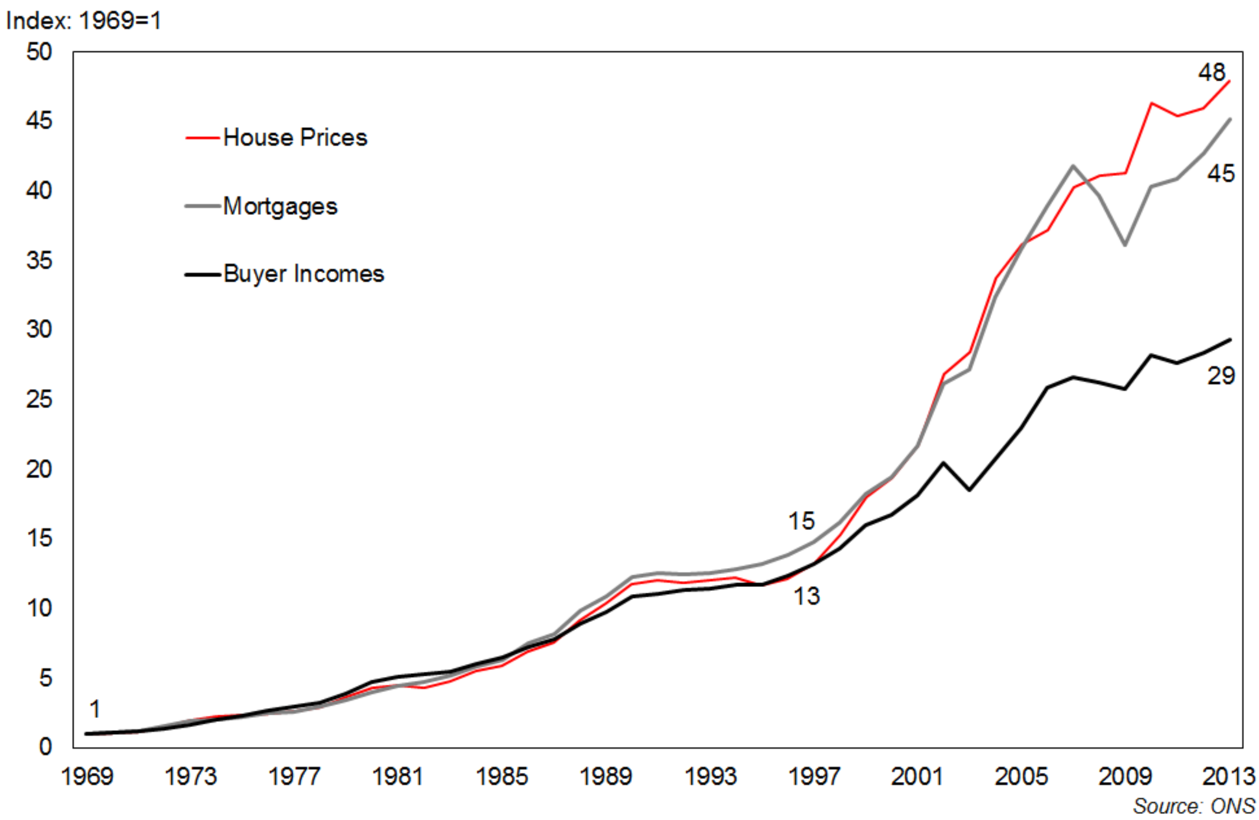
In the following section, we demonstrate how first time buyer incomes appear to have increased at a greater rate than median incomes (see '*How the first home buyer has changed'* on page 10). Therefore, for aspiring home owners on low and middle incomes that have been completely priced out of the market, the difference between the income-linked and average house prices would be greater than is stated above.

Additional tables outlining the statistics for each region are included in the Appendix.

How housing affordability has changed in England

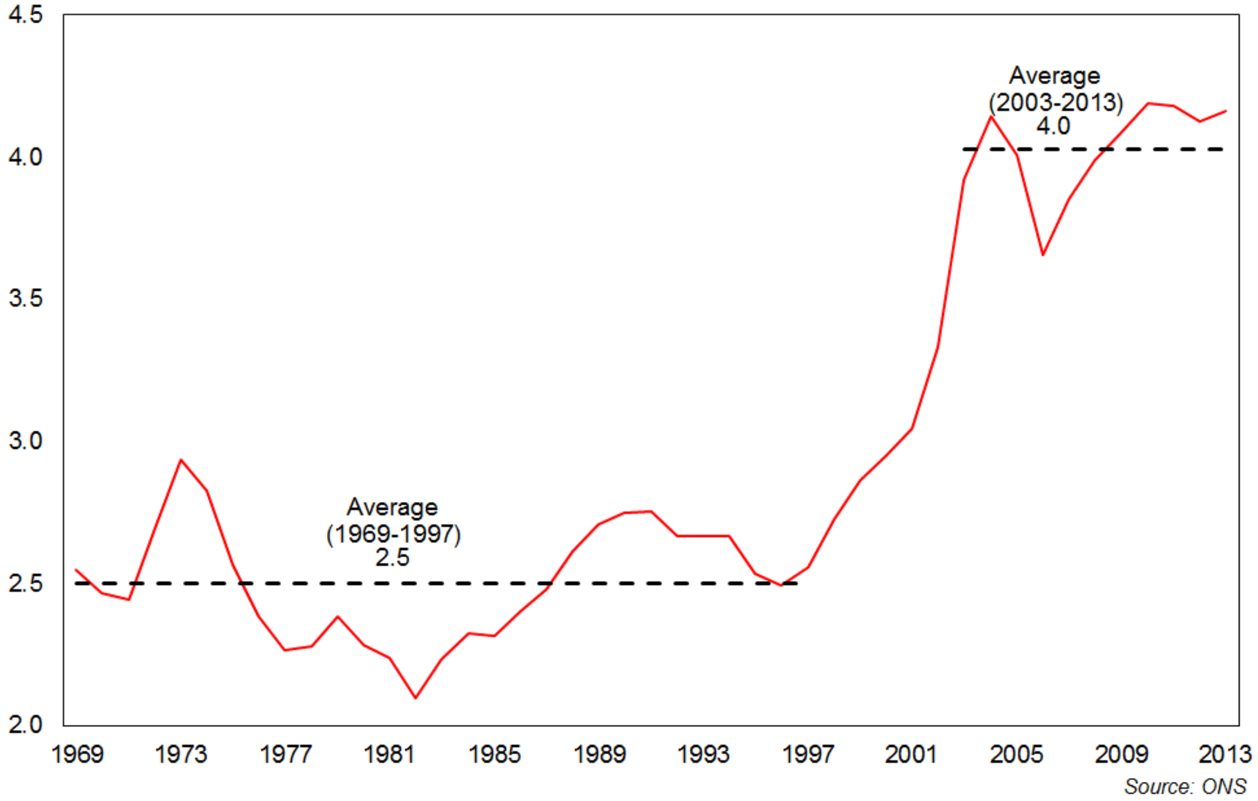
Across England house prices relative to incomes for first time buyers are now between 30% and 40% more expensive they were in 1969. To understand how this has happened, it's important to look at how this changed over time. Figure 1, below, illustrates how the increase of the first time buyer house prices and incomes was identical between 1969 and 1997, with both 13 times higher in 1997 than in 1969. In the same period, borrowing had increased at an only slightly faster rate, and was 15 times higher.

Figure 1: Average house prices, mortgages, and income for first time buyers in England



House prices for first time buyers really started to diverge from their incomes in 1997. First time buyers' incomes only increased by 1.2 times between 1997 and 2013, whilst the price of the homes they bought increased at double the rate (2.6 times). As shown in Figure 2, this resulted in the house price to income ratio shifting significantly from its long-run average level between 1997 and 2003.

Figure 2: House price to income ratio for first time buyers in England



Paying more for your first home

First time buyers had to pay for the strong increases in house prices somehow. They did it through using larger sized deposits, and increasing amounts of debt.

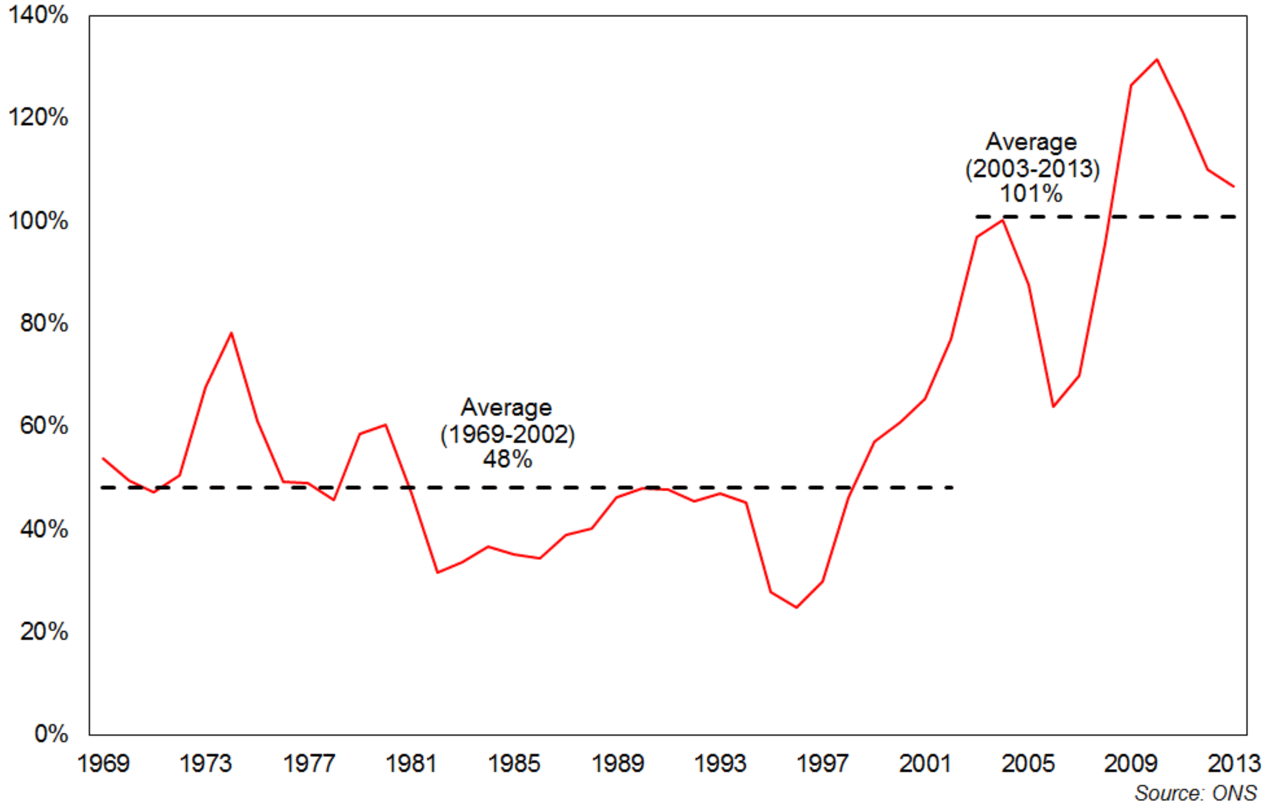
Bigger deposits

Our analysis suggests that in response to price rises, first time buyers initially opted to use larger deposits, rather than increased borrowing to compete in the market. As shown in Figure 3 on the next page, the average size of deposits increased four-fold from 25% of first time buyers' annual income in 1996 to 100% by 2004, before reaching a peak of 137% in 2010. The average size of deposits has declined somewhat since then, but historically still remain high with the average over the past decade double the average of the 30 years prior.

These large deposits now required by first time buyers take a long time to save up for, particularly given the low interest rate currently. Our previous research estimated that a couple with a child would have to save for over 12 years for a large enough deposit to buy their own home, whilst a single person needs to save for over 13 years[3].

[3] A Home of Their Own, Shelter, January 2015

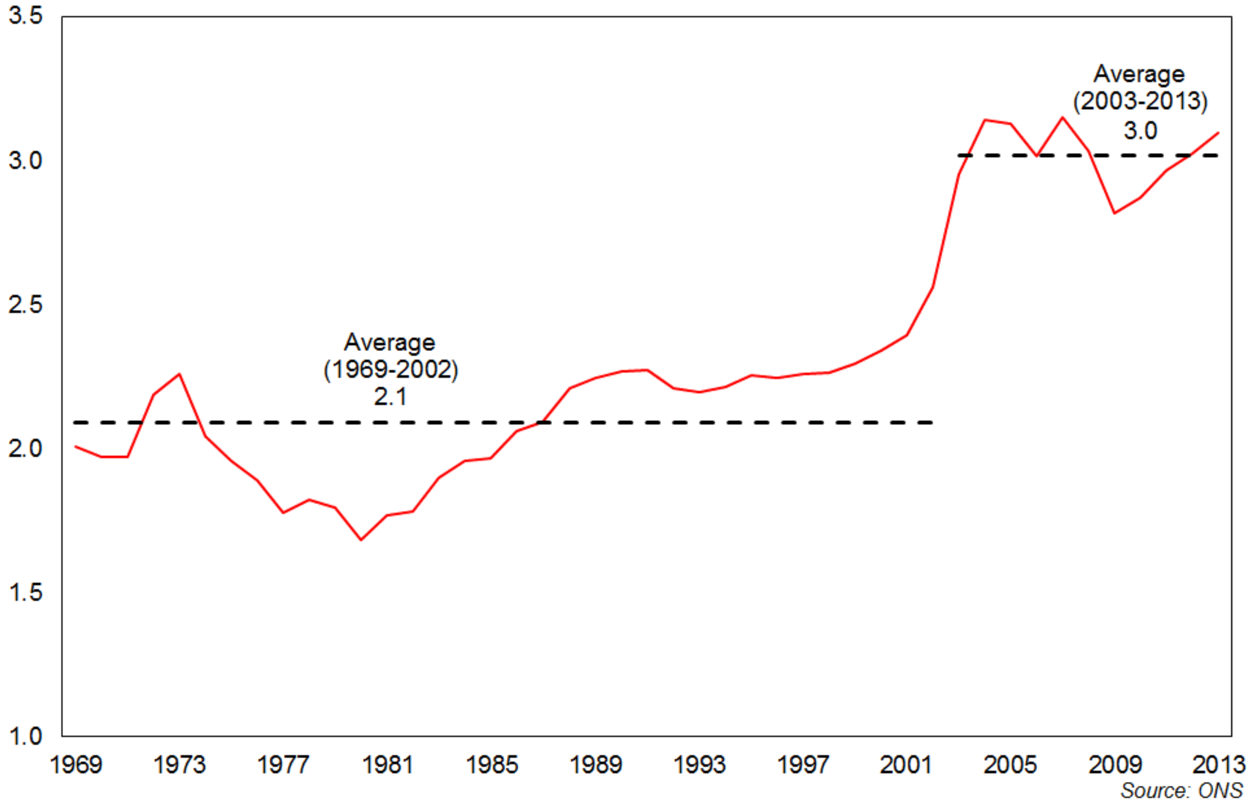
Figure 3: Percentage of annual income required for deposit for first time buyers in England



More debt

After initially increasing the size of their deposits, first home buyers were then forced to turn to increased borrowing in order to enter the property market. As Figure 4 on the next page shows, the loan to income (LTI) ratio for first time buyers increased by just 6.0% between 1997 and 2001 when price growth was funded by bigger deposits. However, between 2001 and 2007 it then increased by 31.7%, a change which appears to have been a permanent change in response to higher house prices. The average loan to value ratio over the past decade of 3.0 is significantly higher than the long-run average up to 2002 of 2.1.

Figure 4: Loan to income ratio for first time buyers in England



Affording your first home

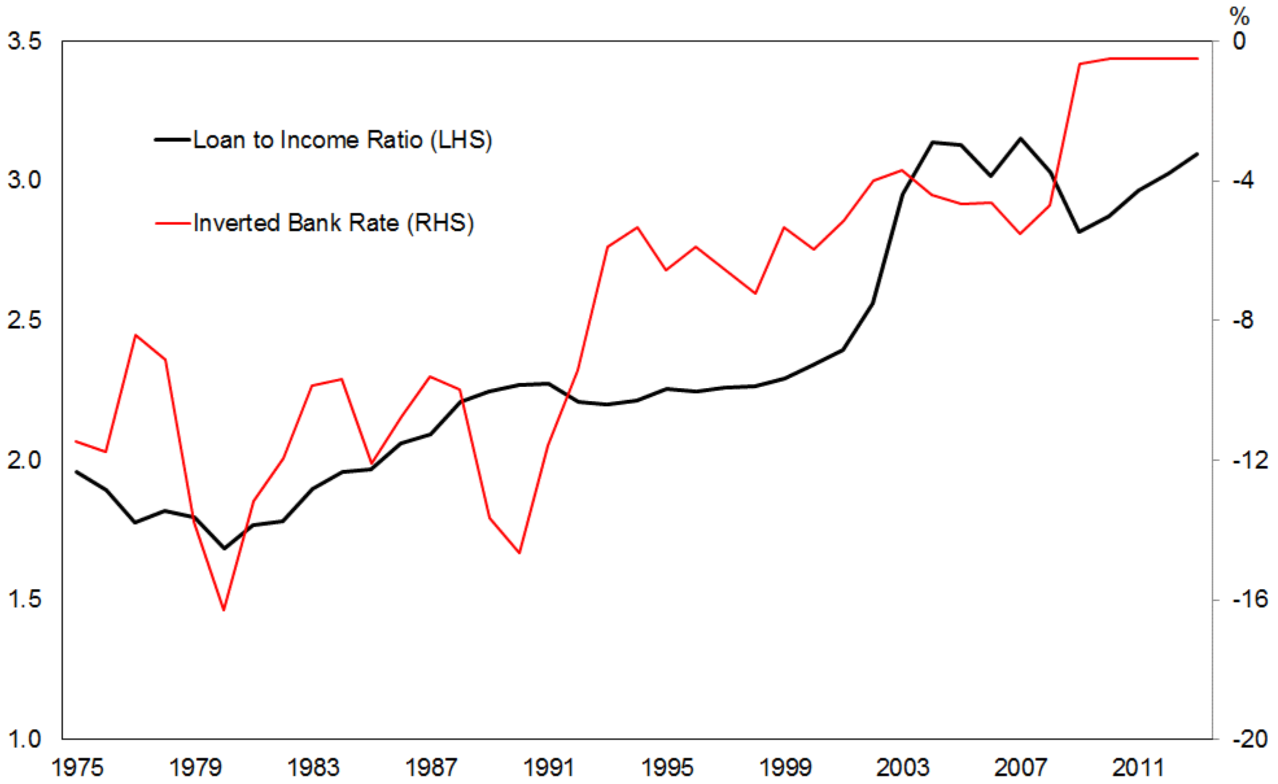
First time buyers have paid more for their homes by saving up larger deposits, and borrowing more. It is also important to look at how first time buyers have paid for these larger deposits and increased borrowing. It appears that the cost of debt, and changes in the characteristics of the first time buyer, have been important in funding higher house prices.

Cheaper debt

Figure 5 on the next page shows that there has been a gradual, long-term decline in the cost of debt since the 1970s which has allowed first time buyers to borrow more. This relationship is best demonstrated when the England Bank Rate reached a peak of 16.3% in 1980. Over the analysis period, this same year also had the lowest LTI ratio for first time buyers of 1.7.

However, as debt has become cheaper, first time buyers have borrowed increasing amounts relative to incomes. The LTI ratio was quite steady up until the mid-1990s when housing supply was sufficient to keep up with demand. Once demand exceeded supply for housing in the late 1990s, subsequent borrowing levels from first time buyers increased strongly in the early 2000s. Interest rates then began to slowly rise, whilst borrowing levels remained stable up until the global financial crisis. Following the economic downturn in 2008, interest rates plunged to historically low levels and borrowing levels decreased as a result of the economic uncertainty.

Figure 5: Loan to income ratio for first time buyers in England and the Bank Rate (inverted)[4]



Source: Bank of England, ONS

How the average first time buyer has changed

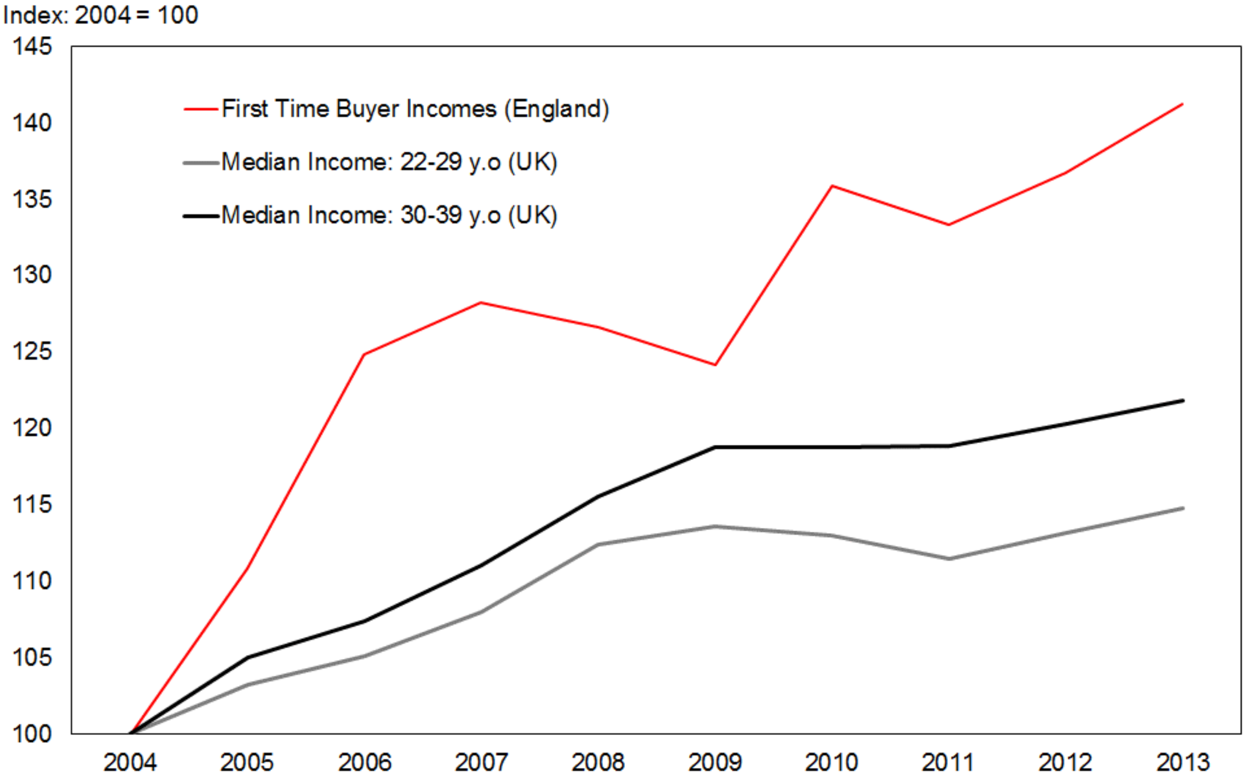
All of these changes mean that first time buyers today need higher incomes in order to be able to save the required amount for a deposit, and service a bigger mortgage. This has resulted in the income of an average first time buyer growing much faster than median incomes.

Since 2004, the average income for first time buyers has increased by 41.2%, or an average of 3.9% per year in England. However, median income growth in the United Kingdom over this period has been at around half that pace[5]. Average incomes for 22 to 29 year olds increased by 14.7% since 2004. Incomes of 30 to 39 year olds grew by 21.8% over the same period (Figure 6).

[4] The Bank Rate has been inverted to reflect the positive relationship between the LTI ratio and reductions in the cost of debt

[5] Data is not available for median income by age in England. However, first time buyer income for the UK of 42.8% is very similar to that of England of 41.2%.

Figure 6: First time buyers and incomes in England/United Kingdom– 2004 to 2013



Source: ONS, ASHE

This divergence between income growth for people in their twenties and thirties and that of first time buyers is an important trend. It appears that lower and middle income earners are being locked out from home ownership as higher incomes are required to save for a deposit, and service a mortgage.

The importance of incomes to home ownership has also become more important to entering home ownership, as historically low interest rates make it more difficult to save for a sufficient deposit, which is also much larger than it has been historically.

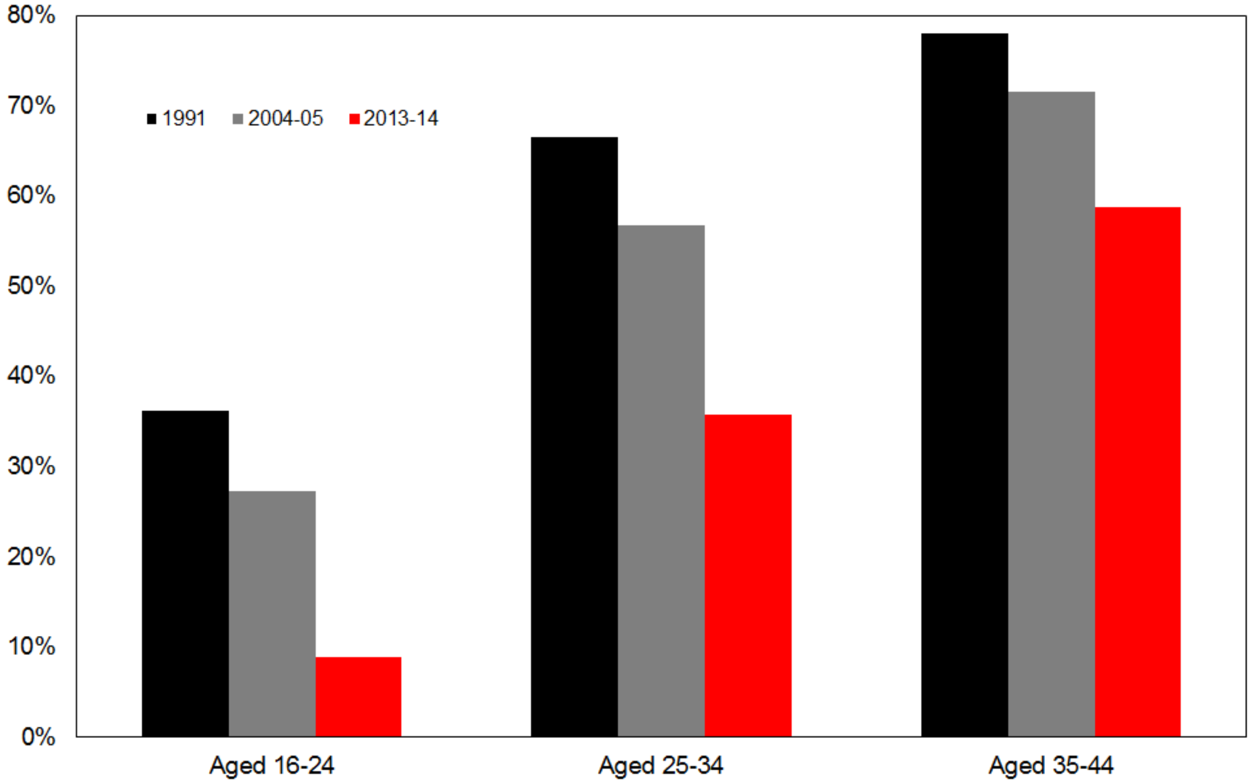
Unsurprisingly, these impacts have coincided with a significant decline in the number of first time buyers. The average number of first time buyers each year since 2007 is around half of the average level between 1980 and 2003[6]. According to the Council of Mortgage Lenders, assistance for first time buyers (such as the so-called “bank of mum and dad”[7]) is now far more common, increasing from 31% in June quarter 2005 to 66% in June quarter 2011. The increase in assistance for first time buyers under 30 was even stronger, with 77% buying a home with some form of assistance[8] in 2011.

This significant decline in first time buyer activity has flowed through to lower rates of home ownership for younger age groups, which has declined since the early 1990s. The decline has been particularly acute for 25-34 year olds. The proportion of 25-34 year olds owning their own

6 See: http://visual.ons.gov.uk/uk-perspectives-housing-and-home-ownership-in-the-uk/
7 Humphrey, A. & Scott, A. (2013) Support for First Time Buyers. London: NatCen (for Shelter)
8 Assistance also includes buyers returning to home ownership. See: http://www.cml.org.uk/cml/publications/newsandviews/104/390

home was 67% in 1991, but has declined to 36% in 2013-14. The decline was even stronger for those aged 16-24, amongst whom the number of homeowners has declined dramatically from 36% in 1991 to 9% in 2013-14 (Figure 7).

Figure 7: Rates of home-ownership by age – 1991 to 2013-14



Source: English Housing Survey

This implies that first time buyers have been getting older over time. This is consistent with the divergence in incomes for first time buyers from median incomes, and the much higher deposits required in order to purchase your first home. Households locked out of the property market have been forced into the expanding private rented sector. As a result, the size of the private rented sector has increased by more than two and a half times between 1989 and 2013-14[9].

Future implications

All of the changes in market conditions for first time buyers have important implications, particularly for those that have recently entered the housing market as well as those who aspire to do so in the future. How these characteristics for first time buyers continue to change will be of vital importance for those that hope to own their own home.

The level of future interest rates will be significant for recent and future first time buyers. Interest rates are currently at historical lows, with expectations that they will begin to increase, and slowly return toward more normal levels. If these expectations are met, this would be the first time since the 1970s where interest costs for households with a mortgage have increased, rather than

[9] English Housing Survey, 2013-14

decreased, over the long-term. Mortgage holders seem to be aware of this risk, with almost half of households with mortgages concerned about the level of their mortgage debt[10].

Currently the large deposits required by first time buyers is locking low and middle income earners out of home ownership, and first time buyers are getting older. If the number of new homes being built does not increase significantly from current levels in order to meet demand, this trend is unlikely to change.

Conclusion

Our analysis has found that homes are now 30-40% more expensive to first time buyers than they were in the 1960s. This has resulted in the first time buyers of today now having to save very large deposits to buy a home, borrow amounts that are far higher than historical averages relative to their income, and have incomes that are significantly higher than those on average wages.

This affordability problem is consistent with our previous research into the difficulties aspiring homeowners face in saving a deposit. In England, a typical family with one child would have to save for over twelve years, just to have a large enough deposit to buy the average home in their area[11].

Affordability is not just a problem in London and the South East. Our previous research has found that in more than half of local authority areas across England, only one in ten available properties are affordable to a working couple with children on average wages[12].

Our analysis last year of the latest census shows the impact of housing unaffordability on the way young people live. Almost a quarter of people aged between 20 and 34 lived at home with parents, and two-thirds of this group said that they were doing so because housing costs were too expensive[13].

All of this research highlights that the housing market in England is a problem that needs to be fixed. Last year, our report with KPMG, *Building the Homes We Need*, set out a package of policies that would begin to fix the housing market[14]. The next government needs to implement these policies, to ensure that once again, there are enough affordable homes for everyone.

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10 Bank of England Quarterly Bulletin, December 2014
11 *A home of their own (2015)*
12 *How much of the housing market is affordable (2014)*
13 *The clipped wings generation (2014)*
14 *Building the homes we need (2014)*

Appendix – Regional Tables

Below are the results from the analysis of the ONS data that underpin the findings presented in this report. The tables reflect the simple average house prices, the average mortgage size, and average incomes of borrowers. This data is used to calculate the house price to income ratio, and the LTI ratio.

Finally, the growth in income is used to calculate the income adjusted house price, and how this differs from actual house prices.

Table 3: England

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£4,136	£3,261	£1,624	2.5	2.0
2013	£198,039	£147,243	£47,574	4.2	3.1
Multiple Increase	48	45	29		
Average Growth Rate	9.2%	9.0%	8.0%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£121,166				
Difference (£)	-£76,873				
Difference (%)	-38.8%				

Table 4: North East (North)

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,376	£2,708	£1,474	2.3	1.8
2013	£113,606	£91,308	£34,679	3.3	2.6
Multiple Increase	34	34	24		
Average Growth Rate	8.3%	8.3%	7.4%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£79,428				
Difference (£)	-£34,178				
Difference (%)	-30.1%				

Table 5: North West

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,461	£2,878	£1,495	2.3	1.9
2013	£127,570	£101,672	£36,930	3.5	2.8
Multiple Increase	37	35	25		
Average Growth Rate	8.5%	8.4%	7.6%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£85,495				
Difference (£)	-£42,075				
Difference (%)	-33.0%				

Table 6: Yorkshire and the Humber

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£2,970	£2,499	£1,356	2.2	1.8
2013	£125,320	£99,301	£35,579	3.5	2.8
Multiple Increase	42	40	26		
Average Growth Rate	8.9%	8.7%	7.7%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£77,927				
Difference (£)	-£47,393				
Difference (%)	-37.8%				

Table 7: East Midlands

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,347	£2,684	£1,430	2.3	1.9
2013	£129,035	£102,279	£35,760	3.6	2.9
Multiple Increase	39	38	25		
Average Growth Rate	7.2%	6.9%	5.2%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£83,698				
Difference (£)	-£45,337				
Difference (%)	-35.1%				

Table 8: West Midlands

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,771	£3,022	£1,482	2.5	2.0
2013	£137,470	£107,426	£36,850	3.7	2.9
Multiple Increase	36	36	25		
Average Growth Rate	8.5%	8.5%	7.6%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£93,766				
Difference (£)	-£43,704				
Difference (%)	-31.8%				

Table 9: East (East Anglia)

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,779	£3,003	£1,516	2.5	2.0
2013	£159,052	£121,007	£39,699	4.0	3.0
Multiple Increase	42	40	26		
Average Growth Rate	8.9%	8.8%	7.7%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£98,959				
Difference (£)	-£60,093				
Difference (%)	-37.8%				

Table 10: London

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£5,640	£4,216	£2,066	2.7	2.0
2013	£333,057	£231,606	£71,011	4.7	3.3
Multiple Increase	59	55	34		
Average Growth Rate	9.7%	9.5%	8.4%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£193,854				
Difference (£)	-£139,203				
Difference (%)	-41.8%				

Table 11: South East

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£5,055	£3,907	£1,838	2.8	2.1
2013	£210,777	£159,274	£49,640	4.2	3.2
Multiple Increase	42	41	27		
Average Growth Rate	8.8%	8.8%	7.8%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£136,524				
Difference (£)	-£74,253				
Difference (%)	-35.2%				

Table 12: South West

	Average House Price	Average Mortgage Size	Average Income	Price to Income Ratio	Loan to Income Ratio
1969	£3,944	£3,078	£1,507	2.6	2.0
2013	£168,578	£128,061	£40,461	4.2	3.2
Multiple Increase	43	42	27		
Average Growth Rate	8.9%	8.8%	7.8%		
	Income adjusted house price (1969 – 2013)				
Average House Price	£105,891				
Difference (£)	-£62,687				
Difference (%)	-37.2%				