Helping Generation Rent become Generation Buy:

Addressing housing market challenges

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A. Overview

1. Summary and policy implications

The Government needs to seize the initiative in the housing market and shift its policy focus. If it does then there is every reason to expect future success, with more houses being built and with generation rent becoming generation buy as more first-time buyers are able to access the mortgage finance that they need.

Addressing the UK's housing challenge needs to figure prominently in any Government policy reset after the pandemic. The solutions to the housing crisis can be found on both the supply and on the demand side.

On the supply side, more properties need to be built. This is the biggest challenge facing the housing market. Not enough properties have been built of the right type and price in the areas needed. But building more properties, while vital, will not be enough. As this need for more supply is widely acknowledged, the focus here is on the challenges on the demand side.

This Briefing's contribution to the policy debate is that it outlines the policies that are needed on the demand side. Too often, on the demand side, the Government's policy interventions have resulted in higher house prices, exacerbating the challenge facing buyers. Now, there needs to be a shift away from direct interventions such as help to buy or temporary freezes in stamp duty.

The policy implications are:

a. **The biggest and most immediate issue that needs to be addressed is more supply of affordable properties and on a massive scale**. A house building boom is needed.
b. **Challenges on the demand side need to be addressed and overcoming them will complement the building of new housing that is needed**. If more properties are built, then people need to be able to afford them and be able to access the finance to buy them.
c. **There needs to be a fundamental shift in policy away from measures that, while helping some, have tended to boost housing prices, pushing them more out of the reach of many**. Official interventions in the housing market often can push prices higher and not provide lasting solutions to those who wish to get on the housing ladder. The Government needs to move away from

intervening directly in the market through Help to Buy (HTB) or temporary changes in property taxes.

d. **The Government's focus should shift to facilitating the market in the provision of sustainable market solutions that help first-time buyers (FTB) gain access to mortgage finance.** This support should not be financial[1] but should be to draw attention to market success and remove any barriers that may exist. The biggest problem is that many potential buyers cannot afford the deposit needed, but can afford the mortgage payments. Indeed, many may have been paying rent regularly for some time, demonstrating an ability to pay. Challenges have been exacerbated during the pandemic by a collapse in the choice of mortgages available to FTB with a low deposit[2]. This is a worry, particularly as the mortgage market has been characterised by a lack of innovation and new products. The problem is access to very high Loan to Value (LTV) mortgages. The Government should embrace, and perhaps actively draw attention to, both existing and new market developments that address the challenges facing FTB.[3] The growth of what might be called a blended mortgage product is an example of the innovation that is now occurring and that is needed as the main way to meet the aspiration of creating a new generation buy. There is no need for the government to intervene financially, either directly or indirectly through the provision of a guarantee.

e. **The current stamp duty holiday should become permanent with stamp duty being abolished on lower valued properties**. Temporary freezes in stamp duty are not a solution as they prompt a spurt in demand as people try to buy before the tax is raised again, pushing prices higher, out of the reach of many FTB. More generally, as there is a need to improve turnover in the housing market, stamp duty on housing transactions is a bad tax. Ideally, stamp duty should be abolished, but as a first step it should cut to zero permanently on lower valued properties and reduced on higher valued properties.

f. **An easing of macro-prudential regulatory requirements makes sense** - particularly an easing of the current stress test requirement where before people can borrow, they need to show they can afford repayments in the very unlikely scenario where interest rates were to rise by three percentage points. This unnecessarily precludes some from being able to borrow. **More generally, there needs to be a reassessment of lending rules and criteria, to ensure that they are conducive to increased innovation and lending.**

g. It is always possible that in the face of a shortage of high LTV mortgages that **the Government could reintroduce, even in the forthcoming Budget, the HTB Mortgage Guarantee Scheme** that it closed in 2016. While we could understand this given the present lack of high LTV mortgages, it is not our preferred option,

1. By financial one might include provision of a government guarantee.
2. In the first two months of the pandemic, the number of mortgage products available to those with a deposit of 5% (which is equivalent to a Loan to Value mortgage of 95%), fell from 391 to only 16. See *Housing Today*, 'Death of first-time buyer mortgages as availability dries up', by Joe Gardner 22/June/2020 https://www.housingtoday.co.uk/news/death-of-first-time-buyer-mortgages-as-availability-dries-up/5106594.article
3. One recent innovation, for instance, is Market Mortgage which, "*is a lending platform, working in partnership with retail lenders to provide high-LTV mortgages more efficiently to prime borrowers*".

as it competes with rather than compliments market solutions. Indeed, while it has played an important role, **HTB does not need to be extended beyond the currently announced schemes.** HTB has played a vital role in plugging a gap left by mortgage providers who shied away from FTB and thus helped many aspiring homeowners onto the property ladder. Government interventions through HTB cannot meet the scale needed for FTB. Moreover, in a post pandemic world, there is no reason why the new builds that the current HTB equity scheme favours are in locations where FTB will wish to live.

2. The policy dimension

Addressing challenges in the housing market has been a feature of the policy debate for some time.

Ahead of the 2019 election, for instance, Labour's housing manifesto, which covered a raft of areas, included a focus on building 150,000 new council and housing association homes[4]. It also noted that, "*The number of younger home-owning households has fallen by almost 900,000 since 2010*" and proposed "*a new programme of homes for first-time buyers, discounted with prices linked to local incomes.*"

There was some consistency across other political parties in terms of the need to build more. For instance, the Liberal Democrats mentioned, in their manifesto, the aim for[5], "*New direct spending on housebuilding to help build 300,000 homes a year by 2024, including 100,000 social homes.*"

Addressing the challenge facing first-time buyers is key. At the Conservative Party Conference last October, the Prime Minister stated, "*We need now to take forward one of the key proposals of our manifesto of 2019 – giving young first-time buyers the chance to take out a long-term fixed rate mortgage of up to 95 per cent of the value of the home, vastly reducing the size of the deposit, and giving the chance of home ownership – and all the joy and pride that goes with it – to millions that feel excluded. We believe that this policy could create two million more owner occupiers, the biggest expansion of home ownership since the 1980s. We will help turn generation rent into generation buy.*"

Major political parties in the different nations of the UK also have a strong focus on boosting housing supply.[6]

Across the political spectrum there is agreement on the need to address challenges in the housing market, including more supply.

As the Prime Minister highlighted, the need to help generation rent become generation buy is critical to addressing the housing challenge.

4. See the Labour Party's Housing Manifesto for the 2019 general election, '*Labour's Plan for Housing*

https://labour.org.uk/wp-content/uploads/2019/12/13218_19-Housing-Manifesto-v4.pdf

5. See the Liberal Democrats' 2019 general election manifesto, '*Plan for Britain's Future*', https://www.libdems.org.uk/plan

6. See the SNP, 'What is the SNP doing to boost affordable housing?' https://www.snp.org/policies/pb-what-is-the-snp-doing-to-boost-affordable-housing/ Also, Plaid Cymru would create a national housing service that would borrow against rents and pledged the construction of 20,000 green social houses. https://www.telegraph.co.uk/politics/0/plaid-cymru-manifesto-2019-general-election-guide/

B. Policy implication: Demand and supply side solutions are needed

3. The supply-side solution: build more houses

The biggest challenge facing the UK housing market is on the supply-side. However, such economic issues need to be looked at from the demand and from the supply side. It is no good, when it comes to housing, to say it is a supply-side problem and then overlook the issues on the demand side. This is even more so when one considers that, in terms of housing, all too often the policy interventions have been on the demand side. Thus, the major challenges within the UK housing market can be viewed in terms of:

- both supply (the numbers of properties on the market to be sold).
- and demand (namely whether buyers or prospective buyers can access the mortgage finance that they need).

Too few, and too much is one way to think of this. **There are too few properties in terms of the numbers available, in the location they can be found, or of the appropriate mix for different types of households, and for many FTB they cost too much.**

More housing supply is needed. Not only is there a huge backlog of supply that needs to be addressed but supply also needs to increase to keep up with future demand, as the population rises[7].

To put the backlog in perspective, as Cheshire and Hilber, two academics at the LSE note[8], "*In the 30 years 1959-1988, 7,449,160 houses were built in England: in the 30 years 1989-2018, only 3,328,850 were built. That suggests a shortfall of 3,120,310 homes – 104,000 a year – over the last 30 years.*"

There is the need for continued ongoing policy interventions where help should be focused on boosting the supply of housing. Such interventions can include, but are not limited to:

- easing planning restrictions and giving communities power to densify, to ensure more supply is available of affordable and variable sized units, given the scale of demand from many different types of households.
- ensuring that when permission to build is granted that this

7. In 2019-20 there were 220,600 new builds in England. This represents the seventh successive year of increase since a recent low of 118,540 new builds in 2012-13. The previous peak before then had been 200,300 new builds in 2007-08. See Table 120, '*Components of housing supply, net additional dwellings, England 2006-07 to 2019-20*' https://www.gov.uk/government/statistical-data-sets/live-tables-on-dwelling-stock-including-vacants.
8. LSE 29/11/2019, '*The UK's housing crisis, what should the next government do?*' Paul Cheshire and Christian Hilber, https://blogs.lse.ac.uk/politicsandpolicy/housing-crisis-what-should-the-next-government-do/

building occurs within a short but sensible time frame and that land does not lie idle for a long time.

- while attention is often focused on the important issue of building new homes, focus needs to be paid also to improving turnover across the market and allowing improvement and intensification of existing stock, in the process unleashing the supply of already occupied homes.
- in addition to removing impediments to new supply by the private sector, ensuring the provision of sufficient social housing should play an important role too.

On the basis that these issues linked to the supply-side are well known and, on the whole, widely accepted the focus in this Briefing is on the demand-side, as there the problems are acute and a solution needs to be found.

4. Why demand is an immediate issue

The issue of generation rent becoming generation buy is important in its own right and as part of the Government's overall policy, including the need to rebalance the economy and meet the levelling-up agenda.

Thus, there should be a sense of urgency about ensuring an environment for a sustainable market solution.

One of the biggest challenges is affordability.

In addition to the vitally important supply-side issue noted above of a lack of affordable homes, there are many facets to this affordability problem, including peoples' income, the current level of house prices and the ability of people to access finance to be able to buy a home.

Often the challenge for FTB can be affording the necessary deposit and thus accessing the finance needed to buy.

Wage growth has lagged behind the growth in asset prices, including property prices. The challenge of this is outlined below, in terms of the high level of house prices to earnings. Central bank policy over the last decade, or so, has contributed significantly to asset price inflation and to the growing challenge in terms of affordability in the housing market.[9] There is no indication that this is about to change.

There have also been other influences, such as within London the overseas buying of properties.

Buy to let has also been a key influence across the country. Even though tax changes in recent years may have dampened the attraction of buy to let, this area of the market remains vitally important and has competed with first time buyers in areas where it is popular for people to live.

Another important flank of demand side policy is an acceptance of inter-generational wealth transfers from parents to potential borrowers. Naturally, there should be nothing to stop people giving money to their children (or indeed to whoever they like) to buy properties and that should not be a focus for policy.

Surely, though, it should not be the case that we now accept both the

9. While the focus here is on the property market, the impact of monetary policy on inequality is an area receiving some attention and meriting further analysis. See, for instance, IMF, 30/Sept/2020, "*Monetary Policy for all? Inequality and the Conduct of Monetary Policy*", Niels-Jakob Hansen, Alessandro Lin and Rui C. Mano, https://blogs.imf.org/2020/09/30/monetary-policy-for-all-inequality-and-the-conduct-of-monetary-policy/. Also, in an interesting Bank of England Staff Working Paper No. 720, March 2018, "*The distributional impact of monetary policy easing in the UK between 2008 and 2014*" by Philip Bunn, Alice Pugh and Chris Yeates, the authors state that, "*Our results suggest that the overall effect of monetary policy on standard relative measures of income and wealth inequality has been small.*" Rising property prices was one of six main channels through which different types of households were impacted. But as the authors note, referring to other research, "*The transmission of monetary policy, in part, depends on the existence of heterogeneity and the fact that assets and liabilities are not equally distributed.*" https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/the-distributional-impact-of-monetary-policy-easing-in-the-uk-between-2008-and-2014.pdf?la=en&hash=AB17C765D8244FFFBF43E8EF9505FBF10DB65600

"bank of mum and dad" and the Government's HTB schemes as essential aspects of ensuring that many people can afford a deposit or the assistance that they need to buy. What about the large numbers who cannot access the bank of mum and dad nor can take advantage of the HTB scheme?

C. Policy implication: The Government should help facilitate innovative change

5. Product innovation is needed

In a report in December 2019[10] looking at emerging themes in the mortgage market, UK Finance noted (in the first point in their executive summary), that "*The expansion in gross lending has been achieved with limited mortgage product innovation.*"

Yet, such product innovation is necessary to ensuring that sufficient appropriate mortgage products are available and to achieving the Government's aims of boosting the numbers of FTB.

That same UK Finance report noted a number of themes now evident in the housing market, including a change in product terms such as a lengthening of mortgages, the growth of five-year fixed rate mortgages, a rise in the share of higher loan to income and loan to value (LTV) mortgages and also "channel splits" for new lending whereby intermediaries are originating an increasing share of mortgages. This suggests that some change is occurring, but given the challenges faced, one might say it is not yet enough.

It also noted that, "*An unintended consequence arising from the ring-fencing of retail banks from the start of 2019 is that they have a much greater ability/willingness to offer mortgage loans. This has changed the competitive dynamics of the UK mortgage market for the next few years at least.*"

It may be hard to imagine that banks used not to lend to the mortgage sector, (see the paper referenced here by Duncan Needham[11]) but that changed during the 1980s[12].

Banks now play a critical role in mortgage provision. They have also been impacted by greater regulatory intrusion in the wake of the 2008 global financial crisis.

In view of this, the environment is conducive to new approaches of mortgage provision, particularly in terms of FTB.

Of course, the telling issue with very high LTV mortgages, is what happens if house prices were to fall, perhaps sharply? Negative equity, when the value of the property is less than the amount borrowed would be the issue here. Negative equity can impact mobility, as it becomes a problem if the borrower needs to move and sell. It also can become a financial problem for the borrower, particularly if higher borrowing

10. UK Finance report December 2019, "*The changing shape of the UK mortgage market*", The-changing-shape-of-the-UK-mortgage-market-FINAL-ONLINE-Jan-2020.pdf (ukfinance.org.uk)
11. See the paper by Duncan Needham, Cambridge Judge Business School, "*The Changing Risk Culture of UK Banks: A Historical Perspective*" No date, but Dr Needham presented this paper the same day I spoke to the Marshall Society Conference at Cambridge in January 2017. https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2016risksummit-riskculture-slides-needham.pdf
12. In particular, there was the demutualisation of the building societies, plus deregulation that impacted the banks.

rates also meant the borrower was unable to afford the mortgage, possibly forcing default. In terms of the latter, borrowing at a long-term fixed rate would mitigate this risk. While in terms of the former, this might justify limiting the scale of the LTV and thus the deposit would act as a shock absorber. There are other lending issues here, too, were prices to fall sharply, that will warrant attention from the regulators. One being asset encumbrance[13]. The exposure of retail banks to the mortgage market necessitates the need for lenders to regularly stress test where house prices might fall.

In his Conference speech the Prime Minister alluded to the mortgage product he felt comfortable with, 95% fixed rate loans. The fact that he felt the need to highlight this one product might suggest this implicitly supports the point raised in that UK Finance report mentioned above, about the need for more innovation.

The innovation that is needed is that which increases the offer available to credit worthy borrowers, achieving the scale needed to turn generation rent into generation buy. While people should decide the product they want, the reality is they do not have as much choice as one might expect.

6. The emergence of a market solution

Sensibly, ensuring financial market stability has been a key focus since the 2008 global financial crisis. That should remain a key focus. In the area of mortgage finance, though, while ensuring that regulatory controls on lending or borrowing do ensure stability, it is important to re-examine these to ensure that they do not unnecessarily curtail innovation. Such measures should be re-examined to ensure that they do not have the unintended consequence of constraining the ability of credit worthy borrowers to access finance, by for instance, placing excessive restraint upon lenders.

Since the global financial crisis, regulatory intrusion has highlighted issues for lenders now of, for instance, the risk of exposure to high loss given default risk, of borrowers who have no or low deposits, of the need for IFRS 9 provisions[14] particularly for banks who would have to make forward-looking loan provisions for the part of the loan that might default, as well as increased regulatory capital costs. In short, a vast array of areas.

The market failure is the inability to provide sufficient finance to those who want to buy.

The issue then is the perceived risk, which has triggered constraints on the lender. As people repay their mortgage, this may be more of a perceived than a real risk.

But with house prices so high, the risk cannot be overlooked. It is not for the government (ultimately the taxpayer) to absorb this risk. Instead, it is to encourage a shift – already underway it seems – to where the risk can be allocated to those institutions best placed to handle it, and to do so in a way in which the general public still take out their mortgage from regulated mortgage providers.

13. Elevated asset encumbrance in normal times can pose certain prudential risks. See the Bank of England, Prudential Regulation Authority, Consultation Paper CP24/19, 'Asset encumbrance', September 2019, "*The risks will depend in part on firms' business and funding models, and on other factors such as their capital adequacy. Firms whose business is primarily focused on the UK residential mortgage market, for example, are likely to have a less diverse pool of assets to encumber as needed than firms with a more diverse balance sheet.*" Also, in terms of firms' recovery strategies, "*the amount of funding which can be secured against a given pool of UK residential mortgage assets may be significantly reduced if the stress scenario in question affects, in particular, the UK housing market.*"
14. IFRS refers to International Financial Reporting Standards and IFRS 9 relates to the measurement and impairment of financial assets.

7. Pandemic impact

These challenges that need to be addressed have been exacerbated during the pandemic and, if anything, this reinforces the urgency of the need for embracing and encouraging more widespread market change:

- There has been a collapse in the number of mortgage products available to first time buyers who have low deposits. As the Money Super Market website[15], which collates information about mortgages available, states, "*almost every provider closed their 90% and 95% mortgage deals to new customers very early on [in the pandemic]*."
- This reflects the sensitivity of lenders to the perceived risk mentioned above and reinforces the need for policymakers to embrace greater innovation in this market – and perhaps for the government to champion those private sector innovations that provide the products needed for generation buy. In so doing this would allow the government to step away from its present direct involvement.
- At the same time, the mortgage rates on offer to FTB have almost doubled from 1.9% in the spring to around 3.5% – despite a record low policy rate that has fallen from 0.75% last spring to 0.1% – as lenders have taken advantage of a rush by buyers to take advantage of the temporary stamp duty holiday.
- The combination of these features should have raised concerns about whether the market in its present format, with little innovation, is able to provide a solution.
- What one needs is increased availability of very high LTV on all types of properties that FTB wish to buy. Additionally, again quoting Money Super Market, "*most 95% mortgages on the market are not available to the majority of buyers*." Citing latest data, covering the end of October 2020, Money Super Market points out that the LTV for mortgages provided to the buy to let market was 58%, for house purchase was 67%, remortgages 52% and for FTB was 82%.

Naturally, too, the pandemic has restricted house building, adding to the sense of urgency for policy to make progress in this whole area of generation buy post the pandemic.[16]

8. Blended mortgage products

Just as the 1980s triggered a move from building societies to banks as significant providers of mortgages the opportunity now is for policy to support the growth of blended mortgage products provided by an array of institutions in which non-deposit taking institutions like investment banks work alongside existing lenders, through lending platforms perhaps, to help to close the existing 'financing gap' that exists for FTB.

This could meet immediate needs for FTB of the provision of more long-term mortgages with high LTV ratios.

15. See Money Supermarket, https://www.moneysupermarket.com/
16. For example, according to Homes England, in the six months 1/4/2020 to 30/9/2020, "*Levels of starts were the lowest since 2012-13 and levels of completions were the lowest since 2015-16. The reduction in both starts and completions are as a result of a slow-down in housebuilding activity caused by the Covid-19 pandemic.*" Homes England, *Housing statistics* 1 April 2020 – 30 September 2020 Published 8 December 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/941829/Housing_Statistics_December_2020.pdf

- As noted earlier, the Prime Minister stated in his conference speech the aim to give young first-time buyers the chance to take out a long-term fixed rate mortgage of up to 95 per cent of the value.
- If that were to become a policy aim then it is important to understand that there are two components: one is the ability to borrow at 95%; the other is to borrow long-term. If one was to look at the mortgage lending market now, one could see that there is little difficultly in borrowing long-term at a fixed rate[17]. These can stretch out to 15 years. But as LTVs rise, the availability declines and the hurdle is the ability to be able to borrow at a 90% or a 95% LTV. So, in relation to the quote by the PM, of these two components, it is the 95% LTV that is the challenge, and the availability of these products collapsed during the pandemic.[18] But, as economic prospects improve, one would expect such products to become more available.
- The Government does not need to intervene financially in trying to address this issue. It need not, for instance, financially back a long-term fixed rate high LTV mortgage, because it would likely distort a market in this area that already exists, but which appears to need to be nurtured and encouraged.
- Two features of the market are unlikely to change: the borrower, as now, takes out a single, homogenous mortgage, say a standard repayment over an agreed term; the mortgage provider that originates and provides the mortgage and will most likely be a retail bank or a building society.
- While that aspect is the same, the mortgage platform provides the innovation, with the blending of the product. This can be in the mechanics of the mortgage, with the lending provided by an array of lenders who are repaid over different time frames. Any complexity is behind the scenes (and it is less complex than it sounds). The net effect is that this can allow high LTV mortgages to be available to FTB, whether they wish to buy new homes or homes that are not new builds.
- For instance, while for the buyer, he, she or they are borrowing as usual, the funds are provided through the lender in a different way. And the different components of the mortgage could be repaid at different times, to reduce borrowings for the buyer, and risks for the lenders.
    - An example might be that there are three providers of the funds. To meet their own balance sheet requirements, they provide funds over different maturities and thus at different rates. They absorb different risks. The interest rate that they receive reflects the term and the risk of their lending.
        - For instance, let's assume the mortgage is over 25 years at a 95% LTV. The retail bank sells the mortgage to the borrower.
        - 10% of the mortgage that allows it to rise from a LTV

17. There are many examples that can be cited. For instance, Virgin Money provides 2,3,5,7,10 and 15 year fixed rates for a LTV of 65%, see https://intermediaries.virginmoney.com/virgin/tools/useful-downloads/ HBSC provides fixed rates for 2 and 5 years at LTVs up to 90% http://www.intermediaries.hsbc.co.uk/ Fixed rates at 90% LTV are hard to find and likewise at 95% LTV.
18. See note 1, in the executive summary.

of 85% to a LTV of 95% is provided by a lender that is prepared to absorb the higher risk for this part of the loan, but charges a higher rate and expects to repaid first, over a shorter time frame, say five years. This lender might be an investment bank.

- 55% of the lending is provided by the retail bank itself. This is the LTV component from 30% to 85%. The risk is lower and thus the interest rate is lower than on the first component above, and is repaid second. The retail banks may have their ability to lend capped at LTVs of 85%, hence the need to see the providers of finance who are able to absorb the higher risk associated with the 85% to 95% LTV part of the loan.
- The third component, is provided by longer-term lenders, say pension funds, who because their liabilities are longer-term do not need to be repaid in this situation early. In this example here they would provide 30% of the finance and would be repaid last, and at a lower rate.
- The three different rates provided by those providing the finance would be averaged into one mortgage rate for the borrower and one monthly payment. The knowledge by the different providers of funds of when they will be repaid allows them to be able, through their market and funding operations, to be able to provide the finance to the borrower at the cheapest possible rate, thus keeping the cost of the mortgage down.

- Moreover, such a blended product, could develop further. As the average age of the FTB has risen, and as the future of work has changed, with many more people living and working longer, it is not only the maturity length of the mortgage that may change and lengthen, but there may be a situation where more people have to repay their mortgage after their peak in earnings, and as they are much older.
- There may be the need for multiple fixed (or floating) terms within a product life-time in order to allow mortgage payments to taper – as people age. Such greater flexibility in terms of the offer would fit with scope for future innovation alluded to above and fit with the idea of later in life FTB. As more capital is repaid, the interest rate charged to the borrower could naturally fall. This is particularly important as the amount people have to borrow is now, often, so high, the time over which they may borrow is longer, and also the average age at which people take out a mortgage or, indeed, pay, it back, may well rise in the future. All of this being a consequence of higher house prices. Thus, over time, the rates at which people repay may naturally fall, reflecting that the finance provided has, ultimately emerged from different providers.

The gap between the 85% and 95% LTV becomes the primary risk – covered by the investment bank, say, or the non-deposit taking institution. The secondary risk (again more a perceived risk, but the rigorous and necessary Bank of England stress tests on banks suggest in exceptional circumstances that it would materialise as a risk) would be borne by the existing retail lender. The tertiary risk in the example above is absorbed by the pension fund.

The issue is the need for increased availability of such high LTV loans.

Refinancing has been available and more widely accepted in the US for some time. Here, a blended product at a tapered rate, that falls over time, may become a feature of the mortgage product.[19]

Naturally, it is up to mortgage borrowers the approach they take, but they need to have access to finance in the first place in order to make that choice.

If the government was minded to see even longer fixed rate mortgages how might they proceed? HTB is considered in this context, below but beyond that, could they financially intervene in some way to subside such mortgages? That would seem hard to justify, as it is difficult to see how they could justify and construct the product; it would involve high cost and possibly risk taken on by the government (and thus ultimately the taxpayer). It would likely see the government absorb a distortive role in the market, with an official backed and probably subsidised product competing versus others, thus dampening innovation as other providers would be wary of gaining much market share.

Perhaps, instead, the focus should be as above, in helping the market develop, with the private sector providing the products, minimising direct government intervention. Thus, there would be access to a wider array of higher value LTV mortgages[20] that is seeking to address this gap for FTB. Here, FTB can access mortgages with a low deposit, banks are able to lend with very high LTV mortgages whereas currently they are not, and the additional risk is held outside the deposit taking banking system.

The key is for the Government to shift from their direct interventionist approach to embrace and encourage a wider array of market solutions. This should be supported by other policy changes, too.

19. There are innovations talked about such as increased use of virtual reality to allow FTB and other buyers to view and not visit homes, or even, in the US, try before you buy where people live temporarily in a place before deciding to buy it. Whether this innovation works is not the issue here, instead the focus is on the need for innovation in the area of finance provision, which is the big bottleneck. Such innovation is needed and now seems to be emerging and needs encouragement.

20. Using, for instance, the new platform from Market Mortgage cited earlier.

D. Policy implication: Cut stamp duty and review property taxes

9. Stamp duty: time to abolish on lower valuation properties

Holidays in stamp duty land tax (SDLT) are also not the answer to creating a generation buy.

Stamp duty is an important part of the financial equation in buying a property – and not just for FTB.

From 8/7/2020 to 31/3/2021 SDLT was lowered to zero for properties up to £500,000. From 1/4/2021 the zero threshold is reduced to properties up to £125,000 but will return for properties over £125,000 and up to £500,000[21].

Such temporary measures as a tax holiday usually have the undesirable effect, as we are seeing now, of boosting house prices as people rush to beat the expiry deadline. This unintended consequence of such policy actions should hardly be surprise; it was first seen as long ago as the March 1988 Budget when Chancellor Lawson pre-announced the withdrawal of multiple mortgage tax relief from August that year, which prompted a surge in house prices following the Budget announcement as people rushed to beat the expiry deadline.

While the focus here is on FTB and generation buy, there are other problems with stamp duty. As the IFS's Mirrlees review of 2011[22] pointed out, "*Stamp duty land tax, as a transactions tax, is highly inefficient, discouraging mobility and meaning that properties are not held by the people who value them most.*"

Ending the current temporary holiday would not address this problem. Houses are sold, with stamp duty paid on top. Thus buyers, usually, are not able to borrow to pay the stamp duty. There are often various schemes, particularly if a new build is being purchased, but generally speaking – and particularly if one is looking to buy a home that is not a new build – it exacerbates the financial challenges, particularly for FTB seeking to raise a deposit.

To avoid this problem, in the general debate about stamp duty, one suggestion has been that it should be paid by the seller. Of course, the seller would include this in the price of the property, so in effect it would still be paid by the buyer, but it may, in some cases, make it easier to raise the finance.

As it is such a prohibitive tax, it does not help turnover.

21. See https://www.gov.uk/stamp-duty-land-tax
22. See "*Tax by Design*", The Mirrlees Review, Conclusions and Recommendations for Reform, IFS, https://www.ifs.org.uk/mirrleesreview/pamphlet.pdf

Ideally, stamp duty should be abolished.

If it was abolished completely it would help turnover across the whole property market, including making it easier for people to downsize from properties that are too big for them.

If abolishing was seen as too radical, then another approach would be to lower stamp duty across the board and to cut it to zero permanently on lower valued properties, up to half a million pounds, or so. This would help FTB.

This would imply that the present stamp duty holiday on lower valued properties should become permanent.

There is a wider issue as to whether the current debate on stamp duty could, perhaps be the first stage in an overall review of property taxation.

10. By all means review property taxes, but reforming them may be hard to execute

A review of overall property taxation is occasionally talked about and may well be seen as necessary were there to be any permanent changes to stamp duty. But the complexity of property taxes means that, aside from changes to stamp duty, reform may be hard to execute.

The UK already taxes property more heavily than other OECD countries[23].

One approach may be to say that taxes on property should be cut. Another might be to say that there should certainly not be any further tax rises.

More likely, at a time when the Chancellor is already looking at ways to close the huge post-pandemic budget deficit, he may prefer any reform of property taxes to be revenue neutral. That is, losses to tax revenue in one area being made up in another. As changes in any one of the existing property taxes may result in winners as well as losers, an initial focus from the Treasury might be on whether it is possible to make changes in a tax neutral way to reduce windfall gains to particular groups with offsetting tax changes elsewhere. This, though, would not be the best route to take. Each tax should be seen in terms of its own merits, and the impact it has as well as the revenue it raises.

Ideally taxes should not distort behaviour.

There is a need to differentiate land from property. With land, it is easy to identify who should pay, and there is an economic rent where the owner can make windfall gains. Land value tax should be seen as part of any review, not as a new tax but as a different way to tax.

Property taxes cover business properties, owner occupied and rented properties. Here the focus would be on taxing the consumption part of living in a property and the investment and savings part that comes from owning a property, but to do so in a way in which there is consistency with areas outside of property, across the taxation of consumption and of savings and investment.

If there were to be any reform of property taxes it would need to be gradual, as there are not only transition costs to change, but changes in tax can result in significant winners and losers, as touched on above.

23. See https://data.oecd.org/tax/tax-on-property.htm

This would likely be the case even if proposed tax reforms were revenue neutral.

It is also important to avoid unintended consequences from changes. A tax on housing values would represent a double taxation of the money spent on home improvements. It might discourage people from renovating properties or improving them. Also, this would not be helpful to many small businesses dependent upon this part of the economy.

The need to reduce business rates has already received much attention in recent years.

Criticisms of the present tax system relate to stamp duty and to council tax. With stamp duty the problems are, as cited above, that it is an expensive tax for those who pay it and it impedes mobility.

As property prices are quoted without stamp duty which is then added on top, it is not necessarily the case that the stamp duty component is already capitalised into property values. If it was, then the abolition of stamp duty would be seen as benefiting most the owners of more expensive properties[24].

Alongside stamp duty, a long-standing issue is council tax, where current council tax rates are based on valuations from 1991 in England and 2003 in Wales. Thus, a revaluation has been talked about for some time. Given the increase in prices since, a large number of properties would be moved into higher bands. However, if there was not to be any planned aggregate increase in revenue from council tax then, at the same time, there would need to be a reassessment of the amount of tax a property in each new band would be charged. So more properties might go into higher valuation bands, but the amount paid in each band would change.

When one considers some of the issues touched on here, it should be clear that the complexity of property taxes makes it a very complicated area to change. It would likely cause major upheaval, with little impact on revenue, but many unintended consequences on homeowners. By all means, review the taxes to see whether this is the case, and who are the winners or losers but, in all likelihood, the tax that merits change is stamp duty.

24. This point regarding abolition of stamp duty benefiting owners of more expensive properties was made in the Mirrlees review, cited earlier.

E. Policy implication: Need for flexible lending and regulatory criteria

11. Macro-prudential regulations need to change

If the mortgage market is to be fit for purpose in the 21st century, being innovative and without threatening the stability of the financial system, then there is the need for greater flexibility in macro-prudential policy and in rules overseeing lending in this area.

In the past house prices have often been driven higher by what proved to be a lethal combination of cheap money (because of low borrowing rates), leverage (in terms of the ability to borrow many multiples of income) and one-way expectations about the future direction of house prices.

We are not focusing here on the perennial discussion issue about the price of housing[25]. Even though price falls may be thought of as unusual based on UK experience, that does not mean that they cannot occur.

One of the challenges on the lending side is how this fits with the ability of banks to provide finance, given their need to meet regulatory requirements.

Macro-prudential regulations, focused in particular on constraints on the LTV ratios that can be offered by lenders have added another degree of complexity to the mortgage market and the ability of both banks to lend and people to borrow.

Ahead of the 2008 global financial crisis, it was not uncommon for mortgages to be granted without deposits or in some cases, because the mortgage was self-assessed, for peoples' financial details not to be checked. House prices, after all, were rising, and lenders were seeking to grab a larger slice of the market.

In the wake of 2008 this changed significantly. Tighter lending criteria were implemented. This has continued, and even now, despite record low policy rates, borrowers are stress tested about their ability to be able to borrow at much higher rates[26]. Currently borrowers are stress tested to see if they could pay if interest rates were three per centage points higher than the mortgage rates on offer. Given how low rates have been for so long, and the expectation in financial markets that they will remain low, this stress test seems unnecessary.

The UK Finance report cited earlier, correctly notes, "*macro-prudential*

25. It can be argued that house prices are too high, but we would not advocate a Diocletian approach to this issue. Facing rising inflation, Emperor Diocletian tried to control the limit the price of vegetables, through his Edict on Maximum Prices (301), but this early attempt to limit price rises through price controls did not prove successful.

26. Bank of England, The Financial Policy Committee's Powers Over Housing Policy Instruments", November 2016, https://www.bankofengland.co.uk/-/media/boe/files/statement/2016/the-financial-policy-committee-powers-over-housing-policy-instruments.pdf

housing tools – both stress-test requirements and loan to income caps" have been "*restrictive*". That is, that have limited the ability of banks to lend and of people to borrow. This is an additional concern, particularly for those finding it difficult to raise mortgage finance.

The December 2020 Financial Stability Report[27], from the Bank of England's Financial Policy Committee, recommended, sensibly, a re-examination of such stress testing, given that rates have remained low, for so long.

To be clear about this, this stress test should be relaxed significantly.

27. https://www.bankofengland.co.uk/financial-stability-report/2020/december-2020

F. Policy implication: Less focus on Help to Buy

12. Help to Buy: it has worked, still has a role to play but should become less important

Since its introduction in 2013, a central feature of official policy towards the housing market has been intervention through Help to Buy (HTB)[28].

Although HTB has been through a number of iterations since, the underlying principle is unchanged, namely the government absorbs some of the risk in helping buyers to be able to access a mortgage, in order to buy a property.

It has been successful:

- The success of HTB can be measured in terms of the numbers who have taken advantage of the scheme. Its focus has been on FTB, allowing them to access lending that they might not be otherwise able to take advantage of. As last May's official Housing Statistical Release[29] reported, since the launch of HTB from 1/4/2013 to 31/12/2019 "263,297 *properties were bought with an equity loan*." The mean purchase price of a property bought under the scheme was £266,849 using a mean equity loan of £58,258.
- Under the current scheme, the HTB equity loan, which can be used only for new builds, the buyer will need to provide a 5% deposit – the Government will then lend up to 20% of the property value – or up to 40% in London – for a maximum purchase price of £600,000. This is to end at the turn of this fiscal year, replaced with a new version, outlined below.
- The latest available data shows that from its launch, on 1/4/2013 to 30/6/2020
    - 278,639 properties were bought through HTB
    - This included 228,896 by FTB
    - The breakdown by local area[30] shows that of this 228,896 FTB,
        - 60,425 were in unitary authorities (of which over the lifetime of HTB, the highest total was 3,003 in Central Bedfordshire),
        - 24,390 were in London boroughs,

28. https://www.helptobuy.gov.uk/
29. Ministry of Housing, Communities & Local Government, "Help to Buy (Equity Loan scheme) Data to 31 December, 2019, England", Housing Statistical Release 7 May 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883419/Help_To_Buy_Equity_Loan_Statistical_Release_2019_Q4.pdf
30. '*Help to Buy Statistics*', data to 30 June 2020, ONS https://www.gov.uk/government/statistics/help-to-buy-equity-loan-scheme-statistics-data-to-30-june-2020

  - 44,407 in Metropolitan districts (within this, the highest cumulative total was 3,120 in Wakefield, 2,801 in Leeds and 2,049 in Birmingham),
  - And 99,674 in shire districts (with 2,202 in Aylesbury, 1,838 in Colchester and 1,757 in Dartford).
- HTB thus filled an important gap left by mortgage providers who shied away from FTB. The importance of this was not only reflected in the numbers of dwellings bought, but also in terms of the large number of FTB who were only able to provide a small deposit.
  - 134,858 provided a deposit of up to 5%, 52,749 a deposit between 5.1% to 10%, 17,311 between 10.1% to 15% and 23,978 a deposit over 15.1%. These small deposits under HTB reinforce the importance of high LTVs mortgages for generation buy.
  - Although HTB extends up to £600,000 23% of properties bought were between £150k - £200k, 20% between 200k to 250k and 25% between 250k to 350k.

However, despite its success:

- The numbers that have been helped are overwhelmed by the numbers the PM alluded to that he would like to see be able to buy a home, as opposed to rent.
- HTB inflates house prices. The Government's intervention props up prices, if anything pushing them higher, out of the reach of more people, exacerbating problems in terms of affordability and the ability of new buyers being able to raise sufficient finance. Or, where it may not have inflated prices it may have prevented them from falling to more affordable levels.
- Through a focus on new-builds it has helped house builders.[31] The current HTB equity loan scheme, for instance, is only available for new builds.
- It has led the government to play too dominant a role in the sector. In a rising house price market such underlying risks have not materialised but in an uncertain economic climate – and where house prices are already high, by many criteria – such risks cannot be overlooked. These risks should be absorbed by the market, not by the Government.
- Also, in a post pandemic world, where the future of work is changing, the danger is that people are being encouraged to buy where the new builds are, and this may not be the same as where want to or need to live and work in the future. In the future the secondary market – in terms of turnover of existing homes - and not new builds, may provide a solution.

Next steps with HTB

31. See page 9 of the report by the National Audit Office, 13th June 2019, Ministry of Housing, Communities & Local Government, '*Help to Buy: Equity Loan scheme – progress review*' https://www.nao.org.uk/wp-content/uploads/2019/06/Help-to-Buy-Equity-Loan-scheme-progress-review.pdf It pointed out that "Between 36% and 48% of properties sold" by the top five builders "were sold with the support of the scheme in 2018."

- A new HTB equity loan scheme is available from 1/4/2021 to 31/3/2023. As the Government's web-site outlines, "*The government lends you up to 20% (40% if you're in London) of the cost of your newly built home,*" where the buyer pays a deposit of 5% or more and arranges a mortgage of 25% or more to make up the amount.
- The Government should, naturally, continue with this next phase of HTB that it has committed to, from this spring, as plans of builders and buyers are already likely to be well advanced.
- The HTB Mortgage Guarantee[32] that was phased out at the end of 2106 could even be reintroduced, in the same or slightly amended format, given the current shortages of high LTV mortgages. This was introduced in the wake of previous challenges facing the mortgage market and ran from 2013 to 2016. If the Government were minded to intervene this would be a natural option, even in the forthcoming Budget. It could apply to existing properties as well as new builds.
- While such interventions can fill a gap in the market, they could also crowd-out market solutions. Thus, this should not be a preferred option, with market solutions emerging as touched on above and also with the economy likely to rebound later this year, as we emerge from the health crisis linked to the pandemic.
- The HTB Mortgage Guarantee Scheme was phased out at the end of 2016. The report, referenced here[33] captured the issue, "*It actually does very little for consumer directly though - instead, it gives lenders a guarantee so that they can offer 5% deposit mortgage but only take the risk as though they were offering a 20% deposit mortgage, with the Government backing the rest of it.*"

Notwithstanding this possibility, it makes sense that, once the already announced next phase of HTB has run its course, the Government should exit from this intervention in the market.

32. See HM Government, 'Help to Buy', https://www.helptobuy.gov.uk/mortgage-guarantee/
33. See Money Saving Expert, by Faye Lipson, 29/9/2016 'Help to Buy Mortgage Guarantee Scheme to Close', https://www.moneysaving-expert.com/news/2016/09/government-to-scrap-help-to-buy-mortgage-guarantee-scheme/

G. Understanding the financial challenge that people face

13. The housing stock

Housing is a devolved policy across the UK, hence there is different availability of the official data[34].

In Wales, where the latest data is available up to March 2020, there are 1,438,000 dwellings, of which 1,003,000 are owner occupied, 348,000 rented privately and 87,000 rented from local authorities.

For Northern Ireland, in March 2020, there were 808,000 dwellings, but the breakdown by type is not available since 2014, but around five out of eight of these are likely to be owner-occupied.

In England, data available up to March 2019 shows, there were 24,414,000 dwellings, of which 15,581,000 were owner occupied, 7,204,000 rented privately and 1,587,000 rented from local authorities.

For Scotland, in March 2018, there were 2,605,000 dwellings, of which 1,619,000 were owner occupied, 671,000 rented privately and 314,000 rented from local authorities.

Aggregating this data, across the UK there were there were, in total, 28,993,000 dwellings in March 2018. Then the latest comprehensive breakdown is for across Great Britain, when there were 28,204,000 dwellings, of which 17,924,000 were owner occupied, 8,241,000 rented privately and 1,994,000 rented from the public sector. There were also 43,000 other public sector dwellings.

14. Numbers of homeowners

Liam Halligan, in his book *Home Truths*, pointed out that, "*Over the last twenty years, every region has seen the share of 25-34 year-olds who are owner-occupiers fall by at least 10 percentage points.*" This included declines from 46% to 20% in London, from almost two-thirds to less than a third in the south-east, or in Yorkshire and Humberside from 63% to 35%.

The situation appears to have now stabilised.

Let's take England as an example, using the official annual English Housing Survey[35]. It states that, "*Owner occupation rates remain unchanged for the sixth year in a row.*" Indeed, "*Of the estimated 23.5 million households in England, 15.0 million or 64% were owner occupiers. The proportion of households in owner occupation increased steadily from the 1980s to 2003 when it reached its peak of 71%. Since then, owner occupation gradually declined to its current level. However, the rate of owner occupation has not changed since 2013-14. The increase from 63% in 2016-17 to 64% in 2018-19*

34. See ONS, "Dwelling stock by tenure", 25/1/2021. https://www.ons.gov.uk/peoplepopulationandcommunity/housing/datasets/dwellingstockbytenureuk
35. National Statistics, 'English Housing Survey 2018 to 2019: headline report', 23 January, 2020 https://www.gov.uk/government/statistics/english-housing-survey-2018-to-2019-headline-report

is not statistically significant."

In particular:

- The proportion of 25-34 year-olds buying a home has risen above those renting for the first time since 2012
- The Government data, based on the financial year 2018/2019, showed 41.2% of those aged 25-34 are homeowners, up from 37.6% in 2017/2018, while 40.9% are private renters
- This is the first time the proportion of 25-34 year olds owning a home has been higher than those renting since 2011/2012
- In contrast, the proportion of 35-44 year olds who are homeowners fell from 56.5% to 54.6% between 2018 and 2019 and the share of those renting in this age group rose from 27.6% to 29.2%
- The data also showed 72.9% of 55-64 year olds are homeowners, rising to 78.7% among those aged above 65
- Of the estimated 23.5m households in England, 15m, or 64%, were owner occupiers and 19% or 4.6m were in the private rented sector.

15. Help ensure the rented sector works properly too

The figures mentioned above show there are large numbers renting in both the private sector and from public authorities.

Although the focus is on turning generation rent into generation buy, it should go without saying, that if people want to be able to rent then they should, secure in the knowledge that there are proper guidelines in place to help those that rent.

So there needs to be a clear policy focus on tenants too, not just owners.

An active private sector rented market is needed. This, too, could benefit from increased supply of properties. The need for an adequate supply of public sector rented accommodation should also be an important area, too.

For comparison, data from Eurostat[36] shows a wide divergence across western European countries and also reflects the importance of tenants as well as owners. Based on their latest comparable data (2019) this ratio shows the ratio of tenants was 48.9% in Germany and 58.4% in Switzerland. In France it was 35.9% and the comparable UK data (which was for 2018) was 34.8%. The average for the EU 28 was 30.8%.

Breaking this down further, tenants (as a proportion of the whole population) that were paying market rent were 52.8% in Switzerland, 41.1% in Germany and 29.7% in the UK but fell significantly to 19.5% in France. There are many factors, cultural as well as economic, helping explain this difference in numbers.

Policy, naturally, should allow the rental market to be sound and fair for those who wish to remain in generation rent. After all, many people may prefer to rent.

But, at the same time, given how high rents are, and the clear evidence

36. See Eurostat, data browser. For, "Distribution of population by tenure status, type of household and income group", see https://ec.europa.eu/eurostat/databrowser/view/ILC_LVHO02__custom_460039/default/table?lang=en

that many younger people want to buy, policy also should be geared to ensuring the right environment for market solutions for generation buy. Without this the scale of the challenge for turning generation rent into generation buy is too great.

While there needs to be a clear policy focus on tenants too, not just owners, the issue over renting should not change the debate about official policy when it comes to the demand side of housing. It reinforces the policy issues outlined here, not least the need to facilitate access to finance so that people can then be in a position to make up their own mind as to whether they wish to rent or buy. That is, people should not be forced to rent because they can't afford to buy, as opposed to people knowing that they have the ability to buy or rent and then they make their own choice.

16. The affordability challenge for first time buyers

Nationwide, the financial services firm, provide quarterly data on the ratio of house prices to earnings for FTB[37]. Their figures highlight the problem.

In the latest quarterly data, for the last three months of 2020, the UK average of house prices to earnings for first time buyers is 5.2. The variation across the country is huge, from lows of 3.2 in Scotland and 3.3 in the North of England to a high of 9.2 in London. In the West Midlands it is 4.8, in the North-West 3.9.

The UK's ratio of house prices to earnings for first time buyers was 4.3 at the beginning of 2013, but since HTB was first introduced it has increased, being above 5 in every quarter since the second quarter of 2014. Ahead of the financial crisis, it reached its high, of 5.4 during the final three quarters of 2007. For comparison at the peak of the late 1980s housing boom this ratio peaked at 3.9.

Wage growth has lagged house price growth, over a prolonged period, and thus housing is increasingly unaffordable for many British based workers.

Affordability is also influenced by the rates at which people can borrow.

Interest rates are at an all-time low. Nationwide's affordability index for first time buyers shows how much mortgage payments are in relation to take-home pay. In the latest available data, for the third quarter of 2020, mortgage payments as a percentage of take-home pay ranged from 18.9% in the North to 55.8% in London for FTB. That ratio in London had reached a high of 69.6% in 2007 (Q4).

Across the UK, the ratio of mortgage payments for FTB, in relation to take-home pay, was 30.8% in the second quarter of last year, the lowest since 30.0% in the fourth quarter of 2002.

The challenge for moving from generation rent to generation buy is that many who are renting in the private market are paying very high rents – with amounts even higher than those paid by mortgagors. This, naturally, makes it even harder for them to acquire deposits.

This is highlighted by the findings of the latest English Housing Survey, which is a national survey of people's housing circumstances.

Covering the period 2018-19[38] it finds that average weekly housing

37. https://www.nationwide.co.uk/about/house-price-index/download-data

38. Ministry of Housing, Communities & Local Government, 'English Housing Survey, Housing Costs and Affordability, 2018-19, published 9 July 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/898397/2018-19_EHS_Housing_costs_and_affordability.pdf

costs were, £200 for private renters and £172 for mortgagors. They were £96 for local authority tenants and £106 for housing association tenants. In London, the weekly figures were £341 for private tenants and £242 for mortgagors. In terms of gross income, private renters spent 33% on rent, mortgagors 18%. In London, these figures were 40% and 22%, respectively.

Many credit worthy borrowers that rent may even require close to 100% LTV mortgages. Their rental history and proven track record of paying rent should be taken in account in assessing their credit worthiness, not just whether they can afford a deposit.

77% of private renters paid a deposit when moving into a private rented property.

In terms of the ability to have a deposit, this Survey found that, "47% *of households in England had no savings*." This varied from 82% for social renters, to 61% for private renters and 33% owner occupiers.

Such figures might suggest that up to 100% LTV mortgages be made available to those credit worthy borrowers who have a good track record of paying rent, but not enough money for a deposit. Yet this would not fit with current regulatory requirements placed on lenders.

At the very least, it highlights the case for high LTVs and helps shed light on why the difficultly to accumulate a deposit is such a challenge. This is even more understandable when one considers that, according to Nationwide, the average house price in December 2020 was £230,920.

17. The challenge of high deposits and the need for high LTV mortgages

Raising the average deposit has compounded the problem, particularly it seems for first time buyers.

- For instance, the norm used to be to a five per cent deposit.
- For a property costing four times incomes, that would have meant the potential buyer having to *raise 20% of annual income* for a deposit.
- If the necessary deposit rises to 15% (equivalent to a LTV of 85%) with prices unchanged, at four times income, then the buyer would *need to raise 60% of annual income for the deposit*. That is a multiple of three times (60% versus 20%) higher than what was needed previously.
- Imagine, if both the deposit increased to 15% and house prices rose to six times national income (which is not exceptional in a rising house price market), then the necessary deposit *would have to increase to a massive 90% of annual income*.
- If lenders demanded a 20% deposit and house price to earnings were six times earnings, the *deposit needed would rise to 120% of annual income*.

The amount of the deposit needed is thus very sensitive to the percentage scale of the deposit needed and to the level of house prices to one's earnings highlights. In many respects this highlights the challenge seen for many potential buyers in recent years.

There may also be scope for increased flexibility on the loan to income ratios that are used in determining the maximum amount that a person may be able to borrow. This is particularly so for FTB where a loan to income ratio at a fixed long-term rate may result in a situation where future mortgage payments are less than the rental rates that this borrower has demonstrated an ability to pay. There may be scope too, to allow higher loan to income ratios alongside lengthening the maturity over which the mortgage may be repaid.

The key is flexibility for credit worthy borrowers.

H. Conclusion

If generation rent is to become generation buy then there is a need to address challenges in the housing market on the supply side and on the demand side.

On the supply side, the challenge and opportunity is the need to build more properties. There is the need to remove impediments to new supply in the private sector and for necessary social housing.

In terms of generation buy, as more supply is built, people need to be able to afford the properties and need to be able to access finance to buy them.

What one needs is for good prospective borrowers to have access to high LTV mortgages. This might include those who have savings but can only afford a 5% deposit and thus need a 95% LTV mortgage. It might include those who have a good track record of paying rent but who do not have savings for even a 5% deposit and thus need access to a LTV mortgage above 95%.

In the past such high mortgages posed problems for the banks and financial system. Just as the mortgage lending market evolved from building societies to retail banks from the 1980s, onwards, there is scope for the market to see a greater involvement of non-deposit taking institutions in the ability to provide the finance that retail banks and other mortgage providers have access to.

The government should step back from intervening through HTB and stamp duty holidays that often provide a boost to prices, exacerbating problems for FTB. In saying this, it should be noted the HTB has achieved success in providing mortgage finance for many borrowers and that the HTB mortgage guarantee scheme could be reintroduced. Notwithstanding this, and as noted above, we believe that there is a case for no extension of HTB beyond existing schemes.

The present stamp duty holiday should be extended as there is case to cut stamp duty across the board and to abolish it completely for lower value properties.

Whatever the policy that is taken in these areas, the Government should encourage and embrace the growth of private sector solutions to widen the scope for mortgage finance to FTB and to other credit worthy borrowers.

This Briefing has focussed on addressing issues on the demand side. The steps outlined here will complement the increase in housing supply that is needed and are essential in helping generation rent become generation buy.

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