Affordability *still* matters

NHPAU
Building Awareness For The Future

Affordability *still* matters

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Foreword by the Chairman of the National Housing and Planning Advice Unit

This time last year, as we launched the NHPAU, news bulletins and papers were full of stories about the housing market. These focused on the inexorable rise in house prices. There was unease about a lending regime that enabled some people to take on mortgages up to six times their annual earnings. And there was concern about deteriorating affordability which was pricing first time buyers out of the market, with the ratio of lower quartile house prices to earnings reaching its worst ever position of 7.25.

One year on and the headlines are very different. Major house price indices have recorded a cooling in the market and there are forecasts of further price falls in 2009. Mortgage finance is very much harder to secure and more expensive, and this is dampening demand from already hard pressed first time buyers. Existing homeowners face increased costs and repossessions are rising. Sentiment about the house building industry has been reflected in falling share prices and now there are predictions that the number of new homes delivered next year will be less than 100,000.

So, a lot appears to have changed. And yet fundamentally nothing has changed, at least not in terms of the affordability challenge.

England is a growing and aspiring nation. Over the medium and long term the number of potential households will continue to increase, incomes will rise and interest rates are likely to be relatively low and stable. And as people become more prosperous they will demand bigger and better homes. While we are at the beginning of a period of adjustment in the housing market, which reached the top of the current price cycle last year, there have always been ups and downs. But actually the trend in prices over the past 30 years has been relentlessly upwards with real house price growth averaging 2.8 per cent a year.

This all means that based on current regional housing plans the affordability problem will get worse. For those still able to access the market, the prospect will include having to finance a deposit and/or mortgage which is even bigger than today relative to earnings. People who cannot access the housing market will have to consider alternatives, perhaps renting or sharing. But some will have no choice; they will not be able to form a household and may have to live in overcrowded conditions. Our modelling suggests that current plans would mean one million fewer households will form by 2026 than official projections indicate.

There are profound social and economic consequences for communities and future generations across England if we are unable to address the affordability problem. So while inevitably at present there is a focus on short-term prospects in the housing market and some uncertainty arising from this, it is vital that planners and decision makers keep an eye on the medium and long term. We must plan now for the upturn that we know will come.

Last week I wrote to the Minister for Housing with our advice about the housing supply range that NHPAU believes should be tested by Regional Planning Authorities in future reviews of their spatial strategies. We expect that our advice will contribute to a more transparent debate about the trade-offs being made between providing more homes and other competing objectives. It should also provide the basis for a more consistent approach across the regions. But I hope it achieves a lot more than this.

We know that the house price cycle and trend in England have many negative consequences, for individuals and the economy. Over the next year or two we will feel these effects more keenly. The challenge has never been clearer. If we are to moderate the house price cycle we must increase housing supply, delivering the right number of new homes, of the right type, in the right place and at the right time. We must act now to ensure that the next upturn does not follow the same path as those in the past.

Stephen Nickell

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1. What does a cooling housing market mean for affordability?

1.1 We have recently seen the biggest falls in house prices since the 1990s, with further falls forecast during the rest of 2008. However it would be a mistake to think that housing has become more affordable in a broad sense.

1.2 Since 1997 house prices have increased by more than 150 per cent in real terms, while lower quartile house prices reached 7.25 times lower quartile annual earnings. Furthermore, despite recent falls in prices the number of first time buyers has continued to plummet as a result of historically stretched affordability and the 'credit crunch', with first time buyers currently facing significant mortgage rationing.

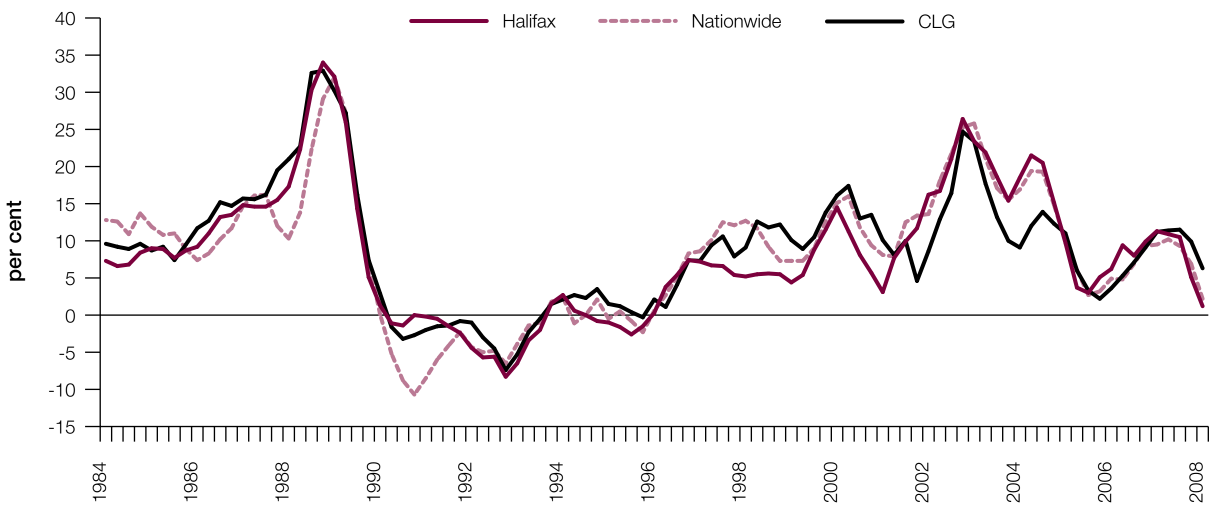
1.3 The affordability of housing *still* matters. It matters for everyone. It is a key determinant of the type of home you, your partner, your family and friends live in. It influences where you live, the condition of housing, the space available to you, access to local amenities and services and whether you can afford a home at all. Homes can have a big influence on life chances.

1.4 So it is not surprising that housing remains a top domestic policy priority. Successive governments have had a goal for housing policy which can reasonably be summarised as 'a decent home for every family at a price within their means' met by the social, private rental or owner occupied sectors.

House price growth has slowed in recent months

1.5 Since September 2007 house price inflation has slowed and continues to slow as indicated by all of the major house price indices. Nationwide and Halifax report house prices to have fallen by 4 per cent during the year to May 2008. Figure 1 shows UK annual house price inflation by quarter as reported by Halifax, Nationwide and CLG.

Figure 1: Annual house price inflation by quarter (UK)



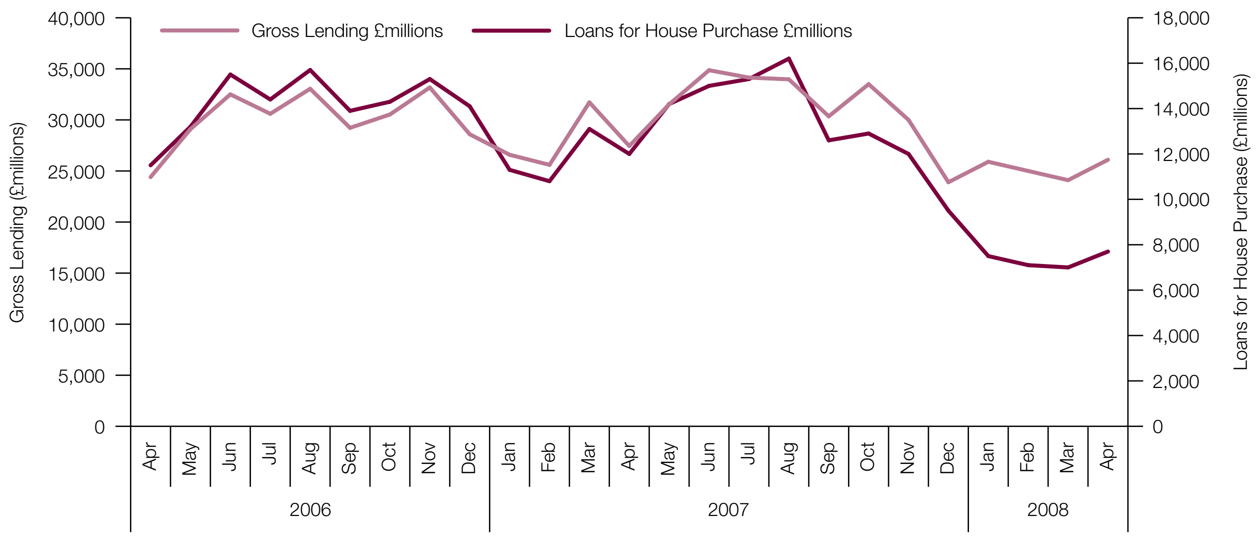
Source: Halifax, Nationwide & CLG

1.6 Independent forecasts suggest further price erosion is likely. The Council of Mortgage Lenders (CML) expect a 7 per cent fall in house prices during 2008[1], while The Royal Institution of Chartered Surveyors expect house prices to fall by 5 per cent[2].

1.7 The main trigger for this slowdown has been the 'credit crunch'. There has been a reduction in lending between banks because of the uncertainty surrounding the risks associated with exposure to the US sub-prime mortgage market. As banks seek to rebuild reserves and margins they are unlikely to lend as easily as they have in the last few years. Banks have struggled to find funds to meet mortgage demand and have turned instead to look for ways to manage demand.

1.8 The effects of the 'credit crunch' are evident in recent mortgage statistics published by the Council of Mortgage Lenders. Since September there has been a significant fall in both total mortgage lending and lending for house purchases. Lending for house purchases was 40 per cent lower during the six months to April 2008 than during the previous six months[3], as illustrated in Figure 2. The British Bankers Association have also reported mortgage lending to have slumped, in May 2008 the number of new mortgage approvals to home buyers was down 56 per cent from May 2007.[4]

Figure 2: Monthly gross mortgage lending and loans for house purchase



Source: CML

[1] Housing and mortgage market forecasts: 2008, CML, May 2008.

[2] 2008 Housing forecast, RICS Economics, May 2008.

[3] CML Table ML1

[4] May figures for the main high street banks, British Bankers Association, June 2008.

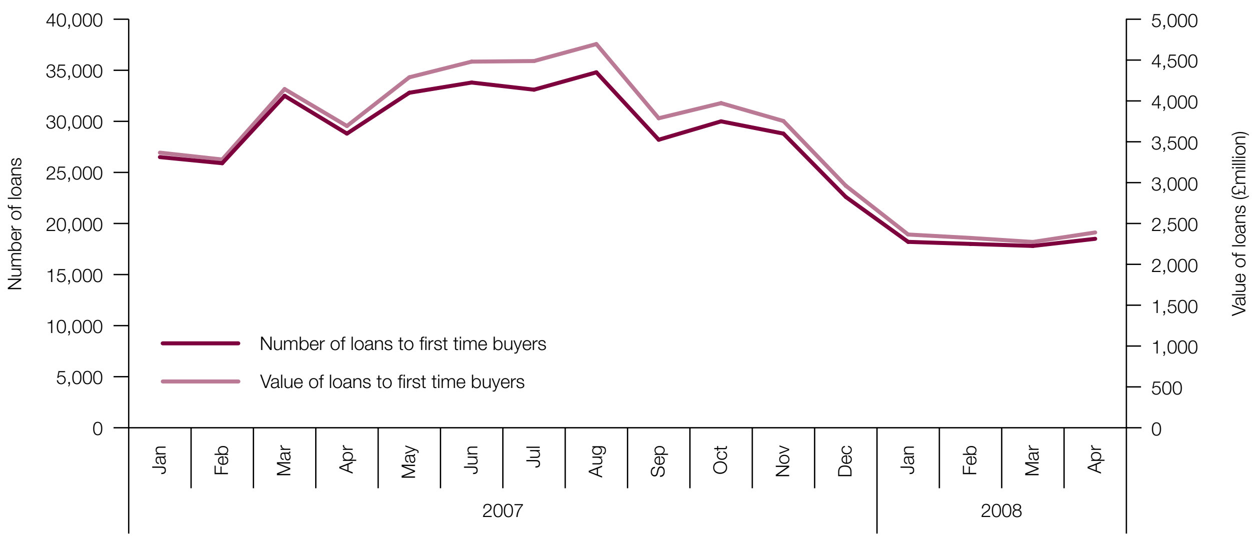
1.9 First time buyers and high risk borrowers will be most affected by the tighter lending conditions, finding it increasingly difficult to access mortgage funds due to:

- a drop in the number of mortgage products available;
- increased arrangement costs;
- increased deposit requirements;
- increased monthly repayments required due to higher interest rates for mortgages with higher loan to value ratios; and
- mortgage applications being declined by lenders.

1.10 During the final quarter of 2007 both the value and number of loans issued to first time buyers dropped significantly, by nearly 50 per cent between August 2007 and April 2008[5], as shown in Figure 3.

1.11 While such a fall will inevitably result in weaker housing demand, limiting inflationary pressures on house prices, many young families will still be unable to access home ownership.

Figure 3: Number and value of loans to first time buyers issued each month



Source: CML

[5] CML Table ML2

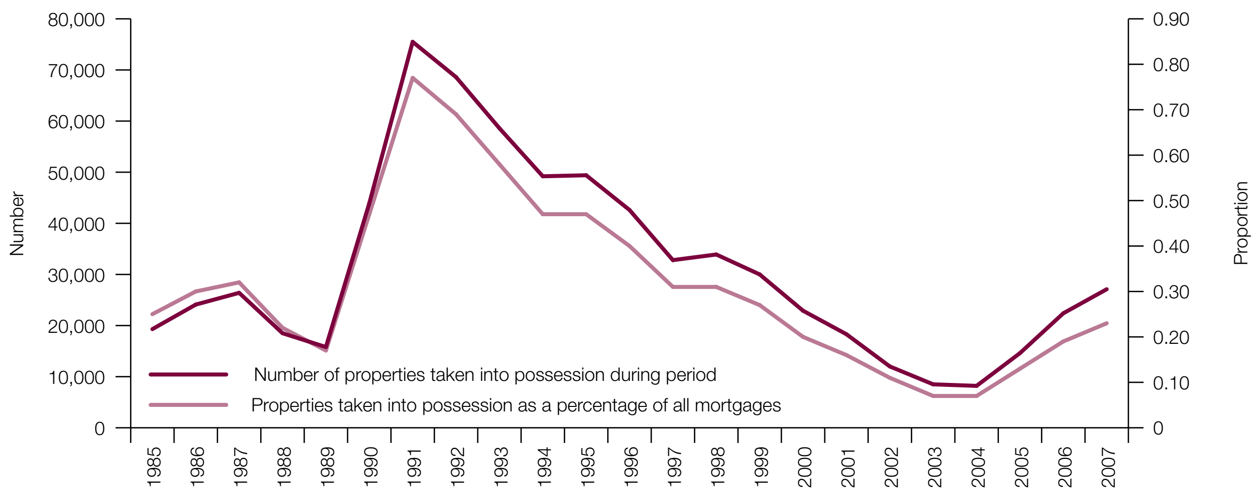
Can we compare the current slowdown to the 1990s?

1.12 It may be tempting to compare the current house price slowdown with the house price crash in the early 1990s. However we are entering the current slowdown under quite different economic circumstances.

1.13 Unemployment rates were higher prior to the house price crash in the early 1990s[6], with the average unemployment rate during the 5 years before being 10 per cent. More recently unemployment has been low and stable, at around 5 per cent. Interest rates were also higher in the period before the house price crash, the average building society mortgage interest rate was 13 per cent in the second half of the 1980s[7], considerably higher than the average mortgage interest rate of 5 per cent since the turn of the century[8].

1.14 Higher unemployment rates and interest rates are likely to influence the housing market through mortgage default rates and therefore repossessions. As illustrated in Figure 4, the number of repossessions gradually increased during the late 1980s, to a peak of 75,500, 0.8 per cent of mortgages, in 1991[9]. Repossessions then averaged 0.46 per cent of all mortgages during the first half of the 1990s. We have seen an increase in the number of repossessions recently, the repossession rate in 2007 was 0.23 per cent of all mortgages, however, neither the number nor the proportion of properties repossessed have neared the levels observed in the 1990s.

Figure 4: Number and proportion of properties taken into possession during a period



Source: CML

[6] LFS 5 Year (1985-1989) average UK unemployment rate, all aged 16 and over, seasonally adjusted, ONS.

[7] The context for housing policy since 1975, Statistical time series with commentary, ODPM, 2005

[8] CML Table ML5

[9] CML Table AP4

1.15 Recently published statistics from the Ministry of Justice indicate an increase in the number of possession orders, the first stage in the repossession process. Total claims in England and Wales increased by 16 per cent to 38,700 during the first quarter of 2008, compared to 33,300 in the same period of 2007[10]. Not all of these claims will result in the property being repossessed, but this does indicate that the level of repossessions could increase. Actual repossession figures for the first half of 2008 will be published by CML in August. Furthermore, the latest Bank of England Inflation Report[11] suggests an increased use of possession claims to encourage payment of arrears.

1.16 Clearly there is no room for complacency. Whilst we have enjoyed a period of relatively low interest rates, this has enabled households to borrow more, average income multiples for first time buyers have increased from 2.42 in 2000 to 3.36 in 2007[12]. Stretched affordability has been noted as an issue since 2004.

1.17 In addition, the level of consumer debt will also influence the number of repossessions. Since the early 1990s unsecured lending to individuals has increased, from £52 billion in 1993 to £230 billion this year.[13] The average household debt in the UK is now £9,223 (excluding mortgages), this increases to £21,450 when the average is based only on households who have some form of unsecured loan.[14] The point here is that some people may have little room to manoeuvre because of high overall debt levels.

1.18 In an attempt to reduce the impacts of the ‘credit crunch’ on the UK banking system and the economy, the Bank of England has issued £50 billion of secure Government bonds that banks can swap for higher risk mortgage assets.

1.19 It is of note that in a recent report[15] the Bank of England indicated that credit markets may be over compensating in the face of losses on US sub-prime loans, for example a simple measure of the risk-neutral annual implied loss rate on UK prime loans has risen to around 2.7%, from 0.6% in July 2007. The report comments that ‘there is little evidence to support such an increase in projected loss rates, particularly as arrears rates remain at low levels.’ Asset prices may have become detached from credit fundamentals.

The long-term trend in house prices

1.20 House prices have always moved up and down in the past, but over the last 30 years the long-term trend has been upwards, see Figure 5. Therefore, while we may have reached the peak of the current house price cycle it is unlikely that prices will permanently stagnate. Over the last 30 years the trend rate of real house price growth has been 2.8 per cent per year, significantly higher than the EU average of about 1.1 per cent.

1.21 If we are at the top of the house price cycle and are undergoing a readjustment this is likely to be a relatively short-term deviation from the long-term trend. Using the CLG Affordability Model we have simulated a short-term cooling in the housing market, assuming a 5 per cent fall in house prices in 2008 and a 10 per cent fall in 2009.

1.22 Comparing this to the base case, where we have made no adjustment to house prices in the short-term, and assuming the same number of new homes built, we can see that a fall in house prices will not improve the affordability prospects in the long run. The affordability ratio converges under both scenarios by 2018, as shown in Figure 6. This is because prices will be driven by the fundamentals in the market, such as income growth and demographic trends.

[10] Statistics on mortgage and landlord possession actions in the county courts – first quarter 2008, Ministry of Justice, May 2008.

[11] Inflation report, Bank of England, May 2008

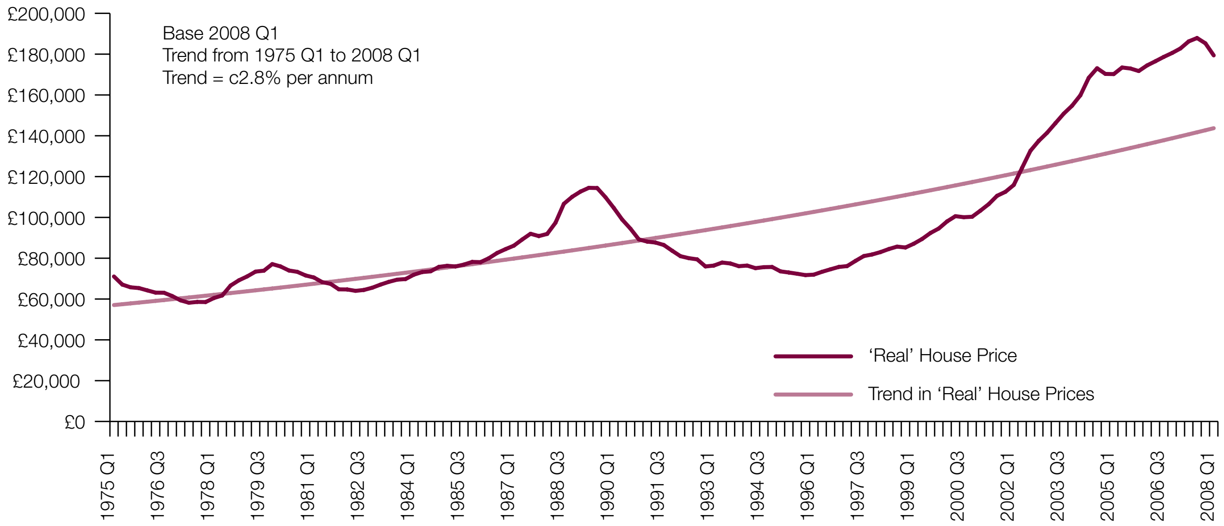
[12] CML Table ML2.

[13] Bank of England, Data series LPMVZRI, June 2008

[14] Total UK personal debt, Creditaction, June 2008

[15] The Bank of England Financial Stability Report, Issue No. 23, Bank of England, April 2008

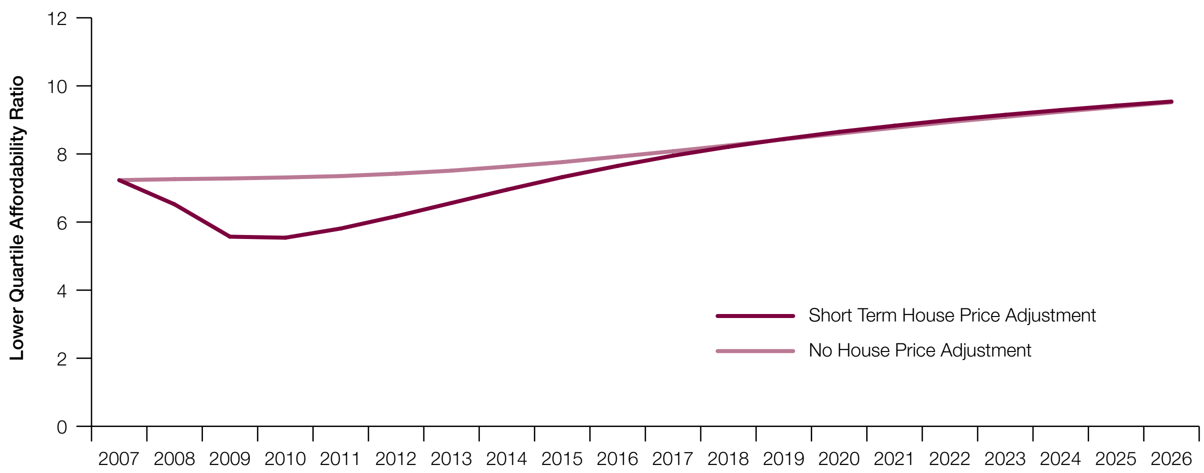
Figure 5: Long-term trend in real UK house prices, Quarter 1 1975 to Quarter 1 2008



Source: Nationwide real house price time series[16]

1.23 A cooling housing market is not the solution to the affordability problem in the short-, medium- or the long-term.

Figure 6: Long-term affordability outcome if the housing market cools in the short-term



Source: NHPAU analysis using CLG Affordability Model

[16] UK house prices adjusted for inflation, Nationwide.

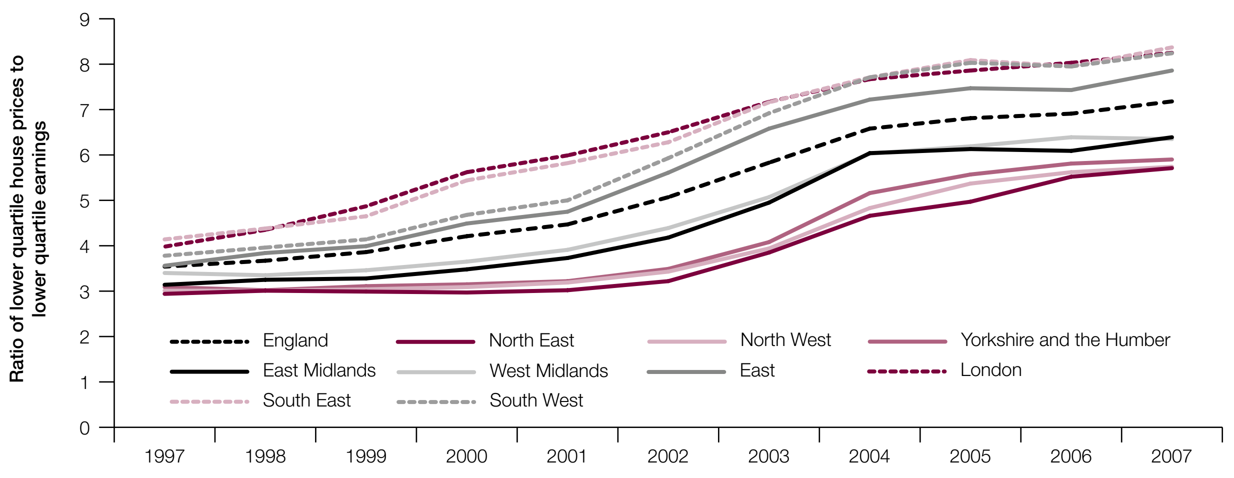
2. Why does housing affordability *still* matter?

2.1 In 2004 the Barker Review of Housing Supply[17] recognised housing affordability as a real and growing problem, stating that:

> *For many people, housing has become increasingly unaffordable over time. The aspiration for home ownership is as strong as ever, yet the reality is that for many this aspiration will remain unfulfilled unless the trend in real house prices is reduced. This brings potential for an ever widening social and economic divide between those able to access market housing and those kept out.*

2.2 Since that time the position has deteriorated further, as Figure 7 shows. In 2004 the ratio of lower quartile house prices to lower quartile earnings was 6.3, by 2007 it had deteriorated to 7.25, its worst ever position.

Figure 7: Ratio of lower quartile house prices to lower quartile earnings by Government Office Region



Source: CLG[18]

[17] Review of housing supply: Final report – Recommendations, Barker, 2004.

[18] CLG Table 576

2.3 This ratio was discussed by Barker in her review of housing supply[19] as a possible target measure of affordability and is now the key indicator in the Government's Public Service Agreement (PSA) 20. The lower quartile affordability ratio can be used straightforwardly at a national, regional and sub-regional level.

2.4 There are many alternative measures, for example the percentage of income consumed by housing costs (including mortgage payments or rent) or a household's residual income after housing costs. In 2000 mortgage interest payments consumed an average of 14 per cent of a first time buyer's income, this increased to 20 per cent by April 2008[20], and total mortgage costs including capital repayments now consume an average of 25 per cent of a borrower's income.

2.5 Access to mortgage funds is also relevant, for example deposit requirements will be preventing some people from achieving home ownership. Mortgage lenders now require higher deposits and are charging higher interest rates on loans with higher loan to value ratios. 100 per cent and 95 per cent mortgages are now few and far between. The average first time buyer put down a deposit of 13 per cent in April, the highest level in over 3 years[21].

2.6 To put this into context, an individual or household buying a lower quartile house[22] would have required a deposit of £6,500 with a 95 per cent mortgage, and would now need £13,000 to secure a 90 per cent mortgage. Consequently even if house prices were to fall over the next year, deposit constraints would not become much less binding under the current mortgage market conditions. For example, a 10 per cent fall in the lower quartile house price would result in households still requiring a deposit of £11,700 to secure a 90 per cent mortgage.

2.7 So, irrespective of which measure of affordability is chosen, all show a significant deterioration in recent years, and all indicate significant pressure on first time buyers.

Worsening affordability affects everyone

2.8 Results from a recent survey[23] commissioned by NHPAU indicate that 78 per cent of people support action by Government to tackle affordability.

2.9 Affordability influences tenure choice and can even determine whether a household will form. There are five broad tenure outcomes for potential households.

Households continue to form in the owner occupied sector

2.10 Owner occupation remains by far the preferred tenure. Our survey showed that 76 per cent of people wished to own their own home, however of these 29 per cent did not think that they would ever be able to achieve it.

2.11 At present 70 per cent of homes are owner occupied and the Government has set a target of 75 per cent by 2016. Home ownership not only provides a place to live, it can also provide a greater sense of comfort, security and affluence. Property can be used as collateral to secure loans, provide rent-free accommodation in retirement and can provide children with an inheritance. Research suggests that home ownership may also encourage investment in social capital because households are more likely to invest in the communities they live in.[24]

2.12 For some households, the affordability constraints will not be binding. These households will still be able to buy a home, although they may have to stretch themselves financially. On average, in the first quarter of 2008 first time buyers were lent 3.36 times their income and paid 20 per cent of their income on mortgage interest payments, significantly higher than in 2000 when the income multiple was 2.42 and 14 per cent of income was spent on mortgage interest payments[25].

[19] Review of housing supply: Final report – Recommendations, Barker, 2004.

[20] CML Live table ML2

[21] Resurgence of fixed-rate loans in April, CML, June 2008

[22] Calculated using the lower quartile house price in England in quarter 4 2007: £129,995, CLG Live Table 583

[23] NHPAU YouGov survey, 2955 respondents, May 2008.

[24] DiPasquale, D. and Glaeser, E. (1999). 'Incentives and social capital: are homeowners better citizens?' Journal of Urban Economics, vol. 45 (2), pp. 354–84.

[25] CML Table ML2

2.13 For many households the owner occupied sector is not affordable, our survey[26] found that only 12 per cent of respondents, including existing homeowners, would be able to afford to buy a home now at current average prices given their household income and savings.

2.14 It is not appropriate to promote home ownership to those for whom it is not a sustainable tenure. For some households an alternative tenure may be preferable.

Households form in the 'intermediate' market sector

2.15 The Government has recently extended its intermediate housing[27] programme. An additional package of measures has been made available to key workers and first time buyers to support them into home ownership. By 2011 the aim is to deliver at least 25,000 low cost homes per year. Such schemes will remove the affordability constraints for some households, enabling them to become home owners. However there will be resource constraints limiting the number of households able to access this sector.

Households form in the private rental sector

2.16 Affordability constraints will be binding for some households in the owner occupied sector. If they are also unable to access the intermediate sector, the private rental sector may be an affordable option.

2.17 In recent years the private rental sector has played an important role in accommodating those households unable to buy. Private renting has grown since the late 1980s, and now accounts for 12 per cent of housing. The number of households in the private rental sector has risen from 1.7 million in 1992 to 2.6 million in 2007, and has increased by 27 per cent since 2001 and 17 per cent since 2004.[28]

Households form in the social rental sector

2.18 If there are binding affordability constraints in the owner occupied (including intermediate) sector and the private rental sector then if households are to form this must be in the social sector. Constrained supply in the social sector will limit its capacity to house all of the potential additional households.

2.19 The number of households on the housing register has increased by over 500,000 between 2002 and 2006, compared to an increase of 73,000 between 1998 and 2002. The register does overstate the numbers in need as it includes some deadweight – people who have since moved away or who would not be housed, and has been boosted by households wanting to access low-cost home ownership schemes – however the observed increase undoubtedly indicates increased pressure in this sector.

Households do not form at all

2.20 Affordability constraints may prevent households from forming at all. This will include 'grown up' children continuing to live with parents through their twenties and early thirties, as well as sharing rented accommodation with other younger people.

2.21 A recent report by NHPAU (summarised in Research findings A) considers the impacts of worsening affordability on the demand for social and affordable housing and on household formation[29]. The report suggests that at a worst case there could be around 1 million households unable to form by 2026 due to affordability pressures.

2.22 More households would form if: the supply of affordable and social housing was increased further; the private rental sector expanded further; or if the supply of market housing increased. Easing affordability pressures, by increasing housing supply from the level set out in emerging regional plans to a total of 300,000 additional dwellings per annum by 2016, would enable 500,000 more households to form in the market by 2026.

[26] NHPAU YouGov survey, 2955 respondents, May 2008.

[27] Affordable housing available to eligible groups at prices lower than the market but higher than social rented homes. Includes shared equity low cost home ownership (eg HomeBuy) where the purchaser buys a share of a home and the housing provider holds the remainder. Also includes 'intermediate rented' homes.

[28] Survey of English Housing.

[29] The impact of worsening affordability on the demand for social and affordable housing: tenure choice and household formation, NHPAU, July 2008.

2.23 Affordability constraints will be affecting different households and individuals differently. For some households affordability constraints will not be binding and they will continue to form in the owner-occupied sector. For others the choice is to rent or not to form a household. If affordability constraints become binding for more households, new owner occupiers or first time buyers will find it increasingly difficult to enter the market. Demand for private renting will continue to increase as will pressure on social housing. Ultimately the number of people living in temporary, unsuitable accommodation and in overcrowded conditions will increase[30].

[30] Research by Shelter published in December 2007 reported that 905,000, or 1 in 10 children in England are living in overcrowded housing (Key Statistics www.shelter.org.uk).

Research findings A: The impact of worsening affordability on the demand for social housing: tenure choice and household formation.

If we fail to deliver enough market housing more people in the future will require state support to meet their housing needs. A key mechanism of pricing people back into the market is to tackle the affordability problem by building the right number of new homes, of the right type in the right place and at the right time.

Based on emerging regional housing plans we could expect:

– **Increased pressure on intermediate and social housing.** There was a rise of over 500,000 households on the housing register between 2002 and 2007 compared with an increase of 73,000 between 1998 and 2002.

– **Household formation to be inhibited by affordability pressures.** Analysis using the CLG Affordability Model suggests that as affordability continues to deteriorate, by 2026 around 1 million households would not have been able to form.

– **The end of the downward trend in average household size established since the 1960s.** Our modelling suggests the average household size could reach 2.3 in 2026, as compared to 2.1 persons per household under official projections[1].

Solving the affordability problem is not about building more social and low-cost homes at the expense of market housing. We have modelled the effect on affordability of doubling the number of social homes a year from the planned 45,000 by 2011 to 90,000 with an equivalent reduction in the number of market homes delivered. All things being equal, increasing the share of social build worsens the ratio of lower quartile house prices to earnings from 8.7 to 9.6.

There would be adverse economic and social consequences of the reduction of household formation if this were caused by affordability pressures. For example, an increase in overcrowding and households sharing when they would prefer not to.

There are three developments which would support more households forming:

– **An increase in social rented and intermediate housing in addition to current RSS targets.** Bramley and Leishman estimate a total requirement for around 150,000 homes in these tenures up to 2021 (including allowance for backlog). The Government has set targets for 70,000 new affordable homes by 2011, of which 45,000 are to be social homes, with an aspiration to increase this to 50,000. Any further substantial increase would depend upon the finite resources available through taxpayer funding and contributions secured through the planning system, and competing priorities.

– **A further expansion of the private rental sector.** The sector now caters for about 12 per cent of households in England having grown by 27 per cent since 2001. As a rule of thumb, a 10 per cent increase in the private rental stock would equate to a further 260,000 dwellings.

– **A supply of housing that was more responsive to demand.** If long-term price trends were dampened by delivering an adequate supply of market homes this would have an important bearing not only on the number of people able to access home ownership, but also put pressure on the quota of intermediate and social housing.

Increasing the supply of market housing will be vital if this challenge is to be met. Our modelling indicates that if the level of delivery of new homes increased from 205,000 as set out in emerging RSS plans, to about 300,000 per annum by 2016, then this would ease affordability pressures and enable 500,000 more households to form in the market as owner occupiers by 2026.

[1] CLG Revised 2004-based Household Projections

Worsening affordability has wider social and economic consequences

2.24 Worsening affordability will not only be detrimental to potential first time buyers and households looking to move up the housing ladder. Worsening affordability will have wider social and economic consequences.

2.25 Rapidly deteriorating affordability tends to be associated with house price volatility. This can translate into wider macroeconomic instability through the impact house price changes may have on household spending decisions[31].

2.26 The growth of regional economies is in part driven by a flexible supply of labour. A ready supply of labour requires a responsive housing supply, with owner occupation a desire for the majority of skilled and qualified workers.

2.27 Higher house prices mean that significant numbers of workers are unable to buy a home in an area where they work. This makes it increasingly difficult to recruit and retain the best staff, with adverse consequences for the quality and delivery of important services, especially in those regions with the highest house prices. A report by the Halifax[32] showed that the average house in more or less every town across Great Britain is unaffordable[33] for the typical nurse.

2.28 There may also be environmental consequences of worsening affordability. If households cannot afford to live in the area in which they work they may be driven to live in a more affordable area further from work, thus increasing commuting, impacting on environmental and sustainability objectives.

2.29 The impact of worsening affordability is particularly felt by younger people trying to buy their first homes, or to move to one where they can best raise a family. This group experiences the real costs of rising house prices and deteriorating affordability. For those who do get on the housing ladder, mortgage repayments eat up an increasing proportion of their incomes. Rising mortgage payments may make it difficult for them to meet these costs, meaning that they will find it difficult should they wish to trade up to a bigger property. And in an era of lower general inflation, high repayment costs persist for longer than they did for earlier generations.

2.30 Rapid and sustained house price inflation means that individuals who are not home owners lose out. Existing home owners benefit from capital growth, while non home owners struggle to access a home. Analysis of the British Household Panel Survey (BHPS), outlined in Research findings B, shows that housing wealth is unevenly distributed across the population, with 10 per cent owning a third of the housing wealth.

2.31 Against this backdrop, it is not surprising that housing is one of the highest priority areas of domestic policy, and that affordability does still matter.

[31] Housing policy: an overview, HM Treasury/ODPM (2005)

[32] Halifax Key Worker Housing Review, 13th April 2007.

[33] A town is classified as unaffordable if its house price to/first time buyer household income ratio is above 4.

Research findings B: UK Housing Wealth, 2005/06, Analysis of the British Household Panel Survey (BHPS).

It is estimated that UK homeowners had housing wealth totalling more than £3.5 trillion in 2007. More than 40 per cent, or £1.5 trillion, was in the hands of households that owned their properties outright; and while home owners had mortgage debt of more than £1.1 trillion, total housing equity stood at a record £2.5 trillion.[1]

Figures also reveal that housing wealth is concentrated among 70 per cent of UK households. Therefore the estimated £3.5 trillion of housing wealth is concentrated among 17.5 million home owning households, with around 7.5 million households having no housing wealth because they are either renting in the private or social housing sectors[2].

In terms of gross housing wealth, the richest 10 per cent of households hold about 28 per cent of all wealth when the value of the main residences are considered, and 31 per cent when all properties are considered (see Table B1).

Table B1: Share of UK housing wealth by households, 2005/06

Cumulative sample share (deciles)	Total gross housing wealth (all prop)
Lowest	0.0
2	0.0
3	0.3
4	5.4
5	7.8
6	9.8
7	11.9
8	14.5
9	19.3
Highest	31.0

Figure B1: Cumulative share of UK housing wealth by households 2005/06[3]

Source: NHPAU analysis of British Household Panel Survey

Source: NHPAU analysis of British Household Panel Survey

[1] CML news and views, Household wealth and housing equity, Issue no. 6, April 2008.

[2] There were an estimated 25m UK households in 2007. Around 70 per cent were home owners (Source: ONS)

[3] Figure B1 shows Lorenz curves of housing wealth ownership – the further away the curve is from the solid diagonal line the less evenly housing wealth is distributed.

3. Fundamentals indicate that affordability will worsen in the long run

3.1 We know the key drivers of house prices and worsening affordability, holding all else equal:

- If the number of households increases by 1 per cent, house prices will increase by about 2 per cent;
- A 1 per cent rise in real incomes would increase house prices by 2 per cent;
- If interest rates increase by one percentage point then house prices will fall by around 3 per cent; and
- If housing stock increases by 1 per cent, house prices will fall by around 2 per cent.

Demand from households

3.2 The most recent household projections[34] indicate that the number of households in England will increase by 233,000 per year until 2016 and 223,000 per year until 2026.

3.3 Household projections are driven by population projections. ONS have recently published their 2006-based Population Projections, showing the revised 2004-based projections to have underestimated future population growth by nearly 3 million people by 2026.

3.4 Growth in the population is being driven by increasing life expectancy, fertility rates and increased migration. The growth in the number of households also reflects the trend in people living in smaller households.

3.5 We have calculated the rough order of magnitude effect of the new principal 2006-based Population Projections and a low migration variant projection on household numbers[35]. The low migration variant is important in the context of statements by the Home Office that international migration will not reach the levels projected in the standard population projections. As shown in Table 1, even with conservative assumptions the number of households in the future could be significantly higher than currently planned for.

Table 1: Official Revised 2004-based and NHPAU derived 2006-based Household Projections, average annual increase from 2008-2026

	Official Revised 2004-based	NHPAU unofficial derived 2006-based	NHPAU unofficial derived 2006-based low migration
England	223,300	268,600	237,000

Source: CLG & NHPAU

Households who have not been able to form in the past will also impact on future housing demand

3.6 Recent affordability constraints have prevented some households from forming, creating an element of pent-up demand. NHPAU have estimated the scale of this pent-up or constrained demand to inform our Supply Range Advice [36]. This includes sharing, concealed and overcrowded households and households in temporary accommodation. Table 2 shows that up to half a million additional homes are required to accommodate this backlog[37].

[34] CLG Revised 2004-based Household Projections; based on the Revised 2004-based Population Projections.

[35] Meeting the housing requirement of an aspiring and growing nation: Taking a medium and long-term view, NHPAU, June 2008.

[36] Meeting the housing requirement of an aspiring and growing nation: Taking a medium and long-term view, NHPAU, June 2008.

[37] Constrained demand based on analysis of the Survey of English Housing, Labour Force Survey and Local Government Finance Returns.

3.7 If affordability constraints were to weaken or if the social housing programme was extended further, some of these households could realise their housing requirements, further increasing demand above the official household projections.

Table 2: Total constrained demand in England

	Traditional constrained demand[38]	Households in temporary accom-modation[39]	Other constrained demand[40]
England	369,487	11,173	141,666

3.8 As an alternative measure of constrained demand we have used data from the Regulated Mortgage Survey (RMS)[41] to identify the potential backlog of first time buyers who have been priced out of the market since quarter 1 2003. This suggests that there is a backlog of 270,000 potential first time buyers. This was during a period when lower quartile house prices rose from 5.23 in 2003 to 7.25 in 2007. Research findings C describes the methodology and the key findings.

[38] Constrained demand arising from sharing, concealed and overcrowded households.

[39] Only includes households temporarily housed in a Bed and Breakfast, hotel, hostel or refuge, and excludes households temporarily accommodated in the private rental sector or in local authority and registered social landlord stock.

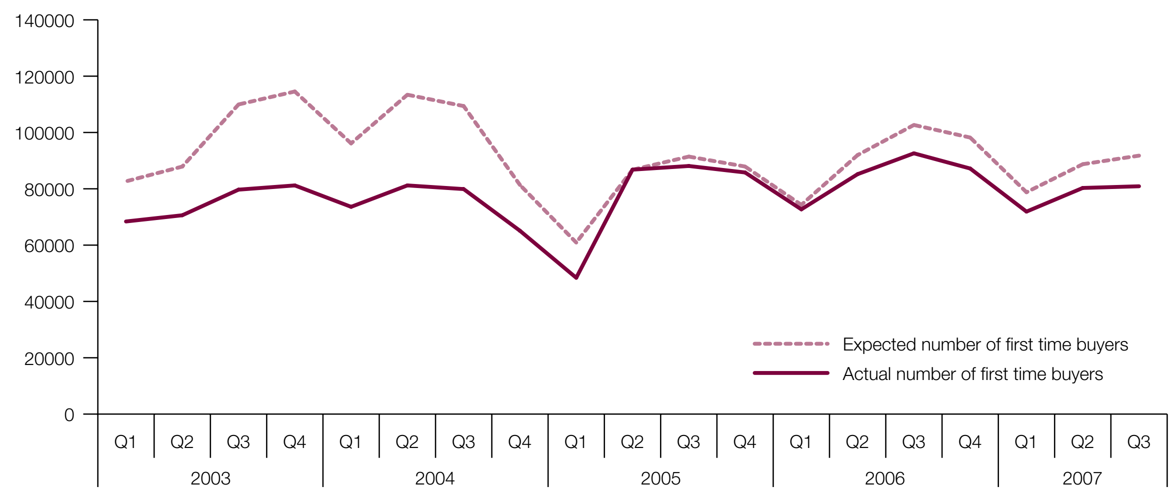
[40] Estimates the number of one person households yet to form due to affordability issues.

[41] CML Regulated Mortgage Survey.

Research findings C: Where have all the first time buyers gone?

From quarter 4 2002 there was a major decline in the proportion of mortgages going to first time buyers. It is possible to estimate the number of potential first time buyers priced out of the market by holding the proportion of home loans to first time buyers at the same level as that recorded in quarter 4 2002 and comparing this estimate to the actual number (see Figure C1).

Figure C1: Comparison of the expected number of first time buyers and the actual number of first time buyers, 2003–2007



Source:

The difference between the expected and actual number of first time buyers is greatest between quarter 1 2003 and quarter 4 2004, which suggests that this was the period in which the housing market really turned against the first time buyer. Over the whole period it is estimated that around 270,000 potential first time buyers in England had been priced out of the housing market.[1]

There are a number of reasons for the fall in first time buyers but a tightening in lenders loan-to-value (LTV) ratios, leading to the requirement of larger deposits, would appear to be one of the biggest factors. When deposits reached a high of almost 50 per cent of annual gross income in quarter 3 2004 the proportion of loans to first time buyers fell to 28 per cent.

[1] The Royal Institution of Chartered Surveyors (RICS), using a different methodology, estimated that as many as 500,000 potential first time buyers had been squeezed out of the housing market across the UK by the end of 2007. (See 2008 Housing forecast, RICS Economics, December 2008).

Income and earnings growth

3.9 A 1 per cent increase in income will cause house prices to increase by 2 per cent, all else being equal. Average household disposable income is forecast to increase by an average of 4.5 per cent per year until 2026, 2.3 per cent in real terms[42]. As individuals get richer they will demand bigger and better homes. This may be in the form of more space, more bedrooms, bigger gardens or access to green space.

3.10 Alternatively, existing households may wish to own additional dwellings as second homes or for investment purposes, creating an additional element of housing demand.

3.11 In 2006 second homes made up 1.1 per cent of housing stock in England, with 240,000 second homes across the nine Government Office Regions. As the population gets richer we can expect the demand for second homes to increase.

3.12 In recent years there has been an increase in owning housing as an investment – buy-to-let mortages have increased from 44,000 in 1999 to 350,000 during 2007. This has been fuelled by products made available in the credit markets, the relative weakness of equity markets in the early part of the century and a healthy demand in the private rental sector. NHPAU analysis[43] examines the impact of buy-to-let mortgages on house prices, Research Finding D summarises the key findings.

Interest rates

3.13 Interest rates influence the housing market, mainly through the cost of mortgage lending. We know that if there is a 1 percentage point increase in interest rates then house prices will fall by around 3 per cent, holding other influences constant.

3.14 Interest rates have recently been lower than they were in the late 1980s. The average building society interest rate was 13 per cent during the second half of the 1980s, considerably higher than the average of 5 per cent since the turn of the century. This fall in interest rates had a significant inflationary effect on house prices up until the early years of this decade.

3.15 In more recent times interest rates have been increasing, although they remain well below the levels of the 1990s. For example, Bank of England data show that the average interest rate for a 2 year fixed rate mortgage with a 25 per cent deposit has reached 6.27 per cent[44] . Analysts expect rates to remain around this level for the next few years.

[42] Experian UK Forecast, June 2008

[43] NHPAU Research Finding Number 1: Buy-to-let mortgage lending and the impact on UK house prices, NHPAU, February 2008.

[44] Bank of England, Data series IUMBV34, May 2008.

Research findings D: Buy-to-let mortgage lending and the impact on UK house prices

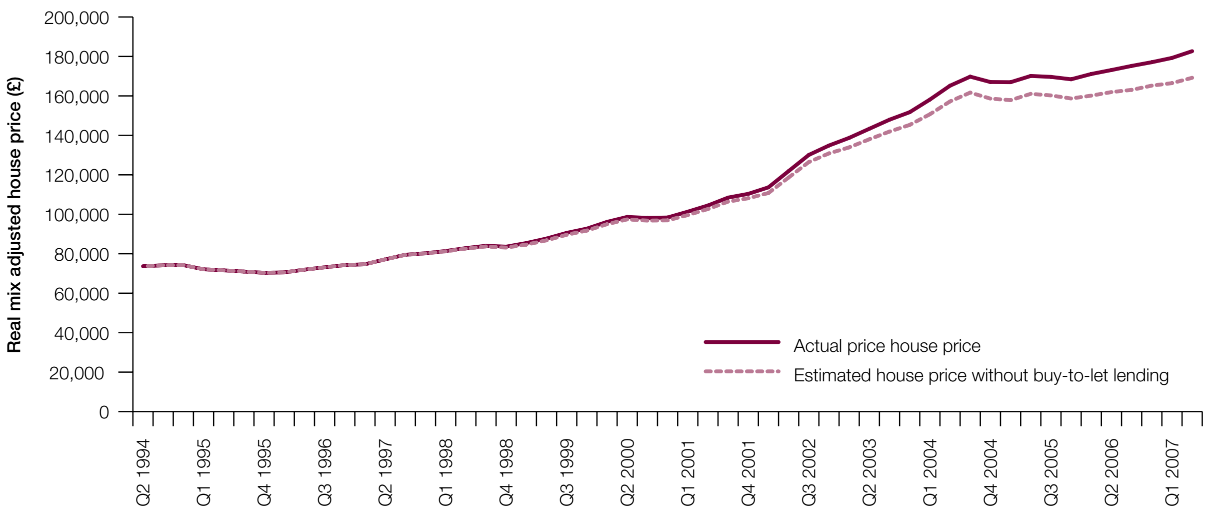
Recent research published by the NHPAU found that buy-to-let investment in the housing market has played a small part in the increase in house prices. It also affirmed that low and stable interest rates, rising incomes, household growth and limited supply were the biggest factors in the increase in house prices.

Figure D1 shows that over the last 8 years buy-to-let mortgage advances had increased from £1,600 million in the second half of 1999 to £24,100 million in the same period in 2007, as investors sought to capitalise on a buoyant rental market.

These investors with access to financing and capital have significant purchasing power and are often in competition with potential first time buyers in certain areas of the market.

Taking the last period that a comparison can be made in quarter 2 2007, the actual mix adjusted house price was then £183,000 and the estimated house price without buy-to-let lending was £169,000. This implies that buy-to-let lending had increased prices by up to £13,000 (or 7 per cent) over and above what they would otherwise have been.

Figure D1: Actual mix adjusted house prices and the estimated house price if there had been no Buy-to-let mortgage lending (Quarter 2 1994 – Quarter 2 2007)



Source: NHPAU Research Fundings No. 1

The growth of buy-to-let investment has impacted on mortgage costs, with buyers of the average priced home on a 100 per cent mortgage paying around £1,190 rather than £1,100 a month as a result of house prices being 7 per cent higher.

However, buy-to-let has also helped to increase the size of the private rented sector and helped to keep rents low. This has provided much needed affordable accommodation for those who do not wish or cannot afford to become homeowners.

Housing supply

Current housing delivery

3.16 For the past few years the number of new homes has been on an upward trend. Total net additions in England increased from 130,000 per year at the turn of the century to 200,000 during 2006/07.

3.17 Maintaining this level of supply will be very difficult during the next few years. The number of both starts and completions fell between 2007 and 2008. Between quarter 1 2007 and quarter 1 2008 starts fell by 24 per cent and completions by 18 per cent. Completions exceeded starts during 2007/8 for the first time since 1992/93.[45]

3.18 The current conditions in the mortgage and housing markets will impact on house builders. If potential buyers find it difficult to obtain mortgages for properties, particularly for new build properties, builders will find sales dropping and will therefore be less inclined to build out sites with planning permission.

3.19 A fall in the delivery of market housing will also result in a fall in the number of affordable dwellings delivered through section 106 arrangements.

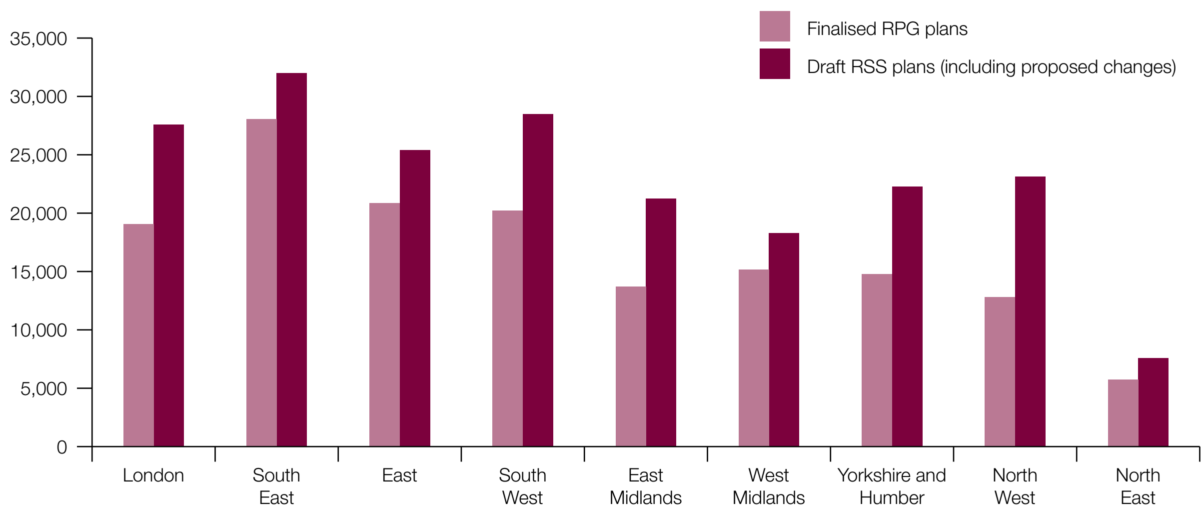
Emerging RSS plans

3.20 In June 2007 a total of 190,000 additional dwellings per year across England were reflected in emerging RSS plans (including proposed changes). Following a number of amendments to some of the plans a total of 205,000 additional dwellings per year is now reflected. A regional breakdown of this total is shown in Figure 8.

3.21 We have previously examined the impact of emerging RSS plans, and project that they would lead to a deterioration in the lower quartile house price to earnings ratio from 7.25 in 2007 to 8.6 in 2026[46].

3.22 To put this into context, the difference between stabilising affordability at the Government's PSA baseline level (7.25 in 2007) and the projected effect of regional plans would be to increase the mortgage and/or deposit required by first time buyers in 2026 by about £23,000 at today's prices.

Figure 8: Emerging RSS plans



Source: CLG

[45] House building: March quarter 2008, England. CLG, Housing statistical release, May 2008.

[46] Based on cautious assumptions about earnings growth and interest rates. See Meeting the housing requirement of an aspiring and growing nation: Taking the medium and long-term view, NHPAU, June 2008.

4. Improving the long-term affordability prospects

4.1 Planning Policy Statement 3 (PPS3) reflects the Government's commitment to improving the affordability of housing through a more responsive supply at a local level.

4.2 In addition, the Housing Green Paper, *Housing for the future: more affordable, more sustainable*, published in July 2007 set out the Government's aim to increase housing delivery above the level set out in emerging RSS plans.

4.3 A number of housing delivery targets were identified, including:

- Delivering 240,000 additional homes a year by 2016, 2 million homes by 2016 and 3 million by 2020;
- Creating 10 new eco-towns, a shortlist of 15 is currently being considered; and
- Delivering 45,000 new social homes a year by 2010-11, and an aspiration of 50,000 new social homes a year in the next spending review period.

4.4 It is important to note that the Callcutt Review[47] recently indicated confidence that the building industry could deliver the Government's housing supply targets, although sentiment and recent data on new build starts indicates a big test in the short run.

4.5 The Government's commitment to increasing supply is an important step towards stabilising affordability. But in considering the most up to date evidence, Regional Planning Authorities may want to go further.

Stabilising affordability in the long term

4.6 Despite common perceptions that people are against new development, 65 per cent think that the current housing build targets are either about right or too low.[48]

4.7 In June we issued our advice to the Government on the housing supply ranges to be tested in each of the English regions (and London) through future RSS reviews.[49] Our advice was based on the premise of stabilising affordability in all regions.

4.8 We have recognised the short-term outlook for the economy in general and the housing market in particular, but have not been distracted by these. Fundamentally our advice is based on available evidence about medium and long term affordability, demographic and economic trends.

4.9 For the purposes of proposing a supply range we have drawn on analysis of the results from two methodologies:

- The first utilises the Affordability Model, which integrates information about the labour and housing markets and demographic trends. The Model enables us to understand the effect of supply on affordability prospects.
- The second is a traditional demographic approach which draws on household projections and makes an allowance for constrained need and demand, vacancies in new supply and the demand for second homes.

[47] The Callcutt review of housebuilding delivery, November 2007.

[48] NHPAU YouGov Survey, 2955 respondents, May 2008

[49] Meeting the housing requirement of an aspiring and growing nation: Taking a medium and long-term view, NHPAU, June 2008.

4.10 We have worked closely with officials from the Regional Assemblies, Development Agencies and Government Offices in developing our advice. Taking into account their feedback, we have been cautious in our approach and with underpinning assumptions. For instance:

- When modelling the impact of housing supply on affordability we have been conservative in our assumptions about the key drivers of house price growth. Specifically for income we have assumed 1.5 per cent growth in real terms until 2026. For average mortgage interest rates we have assumed 6.25 per cent over the same period; and
- In our demographic analysis we have based our range on the latest official Revised 2004-based Household Projections – rather than uplifting for the increases implied by the 2006 based population projections.

4.11 Our analysis is not a target, it is a proposed supply range to be tested – we have provided the 'bookends'. These should provide sufficient flexibility for the Regional Planning Authorities to deal with a range of outcomes reflecting regional priorities and circumstances.

4.12 It should ensure a more transparent debate about the trade-offs being made between providing more homes and competing objectives. It should also provide the basis for a more consistent approach across the regions.

4.13 Table 3 shows our supply range advice. The Minister will consider our advice and issue guidance to the regions.

4.14 Our full advice and technical appendices can be found on our website.[50]

Table 3: NHPAU Recommended Supply Range for the period 2008-2026

	BOTTOM OF THE PROPOSED HOUSING SUPPLY RANGE				UPPER END OF THE PROPOSED HOUSING SUPPLY RANGE			
Region	Average annual net additions to 2026	Peak delivery point by 2016	Total net additions by 2016	Total net additions by 2020	Average annual net additions to 2026	Peak delivery point by 2016	Total net additions by 2016	Total net additions by 2020
North East	6,700	6,600	61,500	87,800	7,500	7,600	66,800	97,300
North West	26,600	27,600	228,900	339,300	29,500	31,300	247,700	373,000
Yorkshire & Humber	23,800	25,100	202,100	302,500	26,400	28,300	218,300	331,700
East Midlands	23,400	23,700	207,000	301,900	24,600	25,300	214,500	315,500
West Midlands	19,000	19,800	164,100	243,200	22,600	24,300	186,600	283,700
East of England	30,600	32,100	259,600	388,000	39,200	43,000	314,300	486,300
London	33,800	35,500	286,600	428,500	42,600	46,700	342,400	529,100
South East	37,800	38,700	331,500	486,200	49,700	53,800	407,200	622,500
South West	29,800	31,000	255,600	379,600	34,800	37,400	287,400	436,800
England	**231,500**	**240,100**	**1,996,900**	**2,957,000**	**276,900**	**297,700**	**2,285,200**	**3,475,900**

50 http://www.communities.gov.uk/nhpau/keypublications/

5. Our role looking forward

Engagement with the Regional Spatial Strategy process

5.1 After we have published our advice to the Government about the supply range to be tested in future RSS reviews the technical team will discuss in more detailed terms its full advice with regional partners and other stakeholders.

5.2 As Regional Planning Authorities move through the coming review process we can also work with them to help develop their own affordability analysis, for example understanding the impact of a more modest aspiration on long-term affordability, or to generate data beyond 2026 where these are required and feasible.

5.3 More formally we expect to engage with the future RSS review processes, for example in providing evidence to Examinations in Public, not only to explain our supply advice, but also to provide a view about the implications of emerging and preferred regional planning authority supply proposals as they move through the process.

Research

5.4 The NHPAU is committed to providing high quality, evidence-based advice to central, local and regional government and the research that we undertake is pivotal in enabling us to fulfil this role.

5.5 Work will continue on the research projects currently underway on second homes, data sources and the effect of infrastructure constraints on housing supply. Reports will be published shortly.

5.6 In addition to this, key to the Unit's programme this year will be its work to consider sub-regional housing markets. This will draw on the work being undertaken across the regions to identify sub-regional housing markets. Ultimately we hope this will lead to the Unit developing some practical tools to help practitioners and policy makers consider affordability at a more detailed spatial level.

5.7 The Unit has also recently commissioned a new project on the economic and social consequences of worsening affordability. The aim is to identify the impact of house price rises on issues such as labour mobility, inequalities in housing wealth and the impact that this can have on health, education and employment outcomes.

5.8 The Unit's main research agenda for the coming year will arise from its Research Innovation Fund, which called for proposals to further develop understanding of the issues that impact and influence market housing affordability. Our Research Innovation Fund will allow us to work with a wide range of expert organisations and stakeholders to produce rigorous research and analysis, with a clear focus on policy. We anticipate that the fund will draw out new and innovative research themes which will increase our knowledge and be of assistance to our stakeholders.

5.9 As well as the pieces of research that we commission externally we will continue to build on the research that we produce in-house. This research will help shape and strengthen the advice that the NHPAU continues to provide to policy makers and practitioners on the steps that can be taken to improve affordability.

Supporting regional partners

5.10 One of the key aims of the Unit is to provide assistance to the regional partners in developing a consistent methodological practice to assessing the implications for affordability of their house building plans.

5.11 Given that a key tool in achieving this is the CLG Affordability Model, we will deliver a series of training events for our regional partners. The events will disseminate expertise, and aid technical understanding and usage of the model and will cover affordability issues and measurement, and provide training on the CLG Affordability Model including a detailed explanation and some 'hands on' use of the model.

5.12 We plan to hold the affordability workshops in autumn 2008 and they will be open to representatives from the Government Offices, Regional Assemblies, Regional Development Agencies, Regional Observatories and other related bodies who are involved in housing planning, policy and strategy.

If you have any questions about this publication then please contact the unit:

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Appendix A: NHPAU Board Members

Stephen Nickell (Chair)

Currently Warden of Nuffield College, Oxford, and a Board Member of the UK Statistics Authority. Previously he has held Economics Professorships at both LSE (London School of Economics) and Oxford and was President of the Royal Economic Society from 2000 to 2003. He was a member of the Bank of England Monetary Policy Committee from 2000 to 2006, and during this time he made a number of speeches on the housing market. He is a fellow of both the Econometric Society and the British Academy as well as being a foreign honorary member of the American Economic Association and the American Academy of Arts and Sciences.

Prof Glen Bramley

Professor of Housing and Planning/ Urban Studies at Heriot – Watt University in Edinburgh since 1994 leading research on planning, housing and urban policy. Prior to this he lectured in Urban Studies at the University of Bristol specialising in local government finance, housing and economic aspects of public policy. He has published papers and extensive research analysing the economics around housing affordability and its relationship with planning and house building.

Glen is the linked Board member for the South West and North East regions.

Prof Paul Cheshire

Has been Professor of Economic Geography at the London School of Economics and Political Science since 1995. Prior to this he was Professor of Urban and Regional Economics at the University of Reading and has spent time at Washington University in the USA. He has written extensively and conducted research on applied urban and regional economics, particularly the economics of housing, land markets and land use regulation.

Paul is the linked Board member for London and the East Midlands region.

Max Steinberg

Has been Chief Executive of Elevate East Lancashire, a housing market renewal pathfinder since 2003, following 25 years at the Housing Corporation where his roles included, Director of Investment & Regeneration for the North and Regional Director of the North West and Merseyside. He is a leading UK practitioner in Urban Regeneration and Housing. Max is Chair of the Board of Liverpool John Moores University European Institute for Urban Affairs and the Chair of Governors at King David High School in Liverpool.

Max is the linked Board member for the Yorkshire and Humber region.

Bob Lane

Is involved in a range of consultancy and non-executive roles in housing, economic development and regeneration. Until April 2008 he was Chief Executive for North Northants Development Company responsible for housing growth and regeneration in the area. His previous roles include Chief Executive of Speke Garston Development Company, Liverpool, Assistant Chief Executive of the Merseyside Development Corporation and roles at Oldham and Lambeth Councils managing urban programmes. He is a specialist in the delivery of complex urban regeneration projects, with more than 25 years experience as a regeneration practitioner/manager.

Bob is the linked Board member for the East of England and the North West regions.

Dr Peter Williams

Is now an independent consultant on housing and mortgage markets. His clients include the Intermediary Mortgage Lenders Association and Acadametrics. He was previously Deputy Director General of the Council of Mortgage Lenders. Prior to that, he was Professor of Housing Management at Cardiff University, Deputy Director at the Chartered Institute of Housing and as an academic at the Australian National University and the University of Birmingham. He previously served on the Board of the Housing Corporation (1995 - 2002) and Housing for Wales (1989 to 1993). He is a Visiting Professor at the Centre for Housing Policy at the University of York.

Peter is the linked Board member for the West Midlands and South East regions.

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