9. Barriers to homeownership for young adults

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Key findings

- **The last 20 years have seen a substantial fall in homeownership among young adults.** In 2017, 35% of 25- to 34-year-olds were homeowners, down from 55% in 1997. The biggest falls have been among middle-income young adults. In terms of housing tenure, they now look much more like the poorest groups than their richer peers.

- **Since 1997, the average property price in England has risen by 173% after adjusting for inflation, and by 253% in London.** This compares with increases in real incomes of 25- to 34-year-olds of only 19% and in (real) rents of 38%. In most of the country, real house prices have not risen in the last decade; however, they have increased by 30% in London, 8% in the South East and 10% in the East of England since 2007. Rising house prices have benefited older generations at the expense of younger ones and increased intragenerational inequalities.

- **Increases in property prices relative to incomes have made it increasingly hard for young adults to raise a deposit.** The proportion of young adults who would need to spend more than six months' income on a 10% deposit for the median property in their area has increased from 33% to 78% in the last 20 years. Most of this increase occurred between 1996 and 2006. Over the last decade, stable or falling house prices outside London, the South East and the East of England have meant that raising a deposit has become slightly easier in most of the UK.

- **Even with a 10% deposit, many young adults are severely restricted in their ability to purchase a home.** Most mortgage lenders will not lend more than 4.5 times salary. In 1996, for almost all (93%) young adults, borrowing 4.5 times their salary would have been enough to cover the cost of one of the cheapest properties in their area assuming they had a 10% deposit. By 2016, this figure had fallen to three-in-five (61%) across England as a whole and around one-in-three (35%) in London.

- **Rates of homeownership amongst young adults could potentially be increased by recent policies to advantage young buyers over others (in particular over multiple-property owners) –** for example, by reducing stamp duty for the former and increasing it for the latter. But these policies risk increasing house prices or rents or both.

- **Increasing the supply of homes and the responsiveness (or elasticity) of supply to prices is crucial.** Planning restrictions make it hard for individuals and developers to build houses in response to demand. Easing these restrictions would reduce (or at least moderate) both property prices and rents, boosting homeownership and benefiting renters who may never own. Without greater elasticity of supply, policies to advantage young adults in the housing market will in part push up house prices and will not help (and could even harm) those young adults who will never own a home.

9.1 Introduction

The rate of homeownership amongst young adults has fallen substantially over the last 20 years. This change has not gone unnoticed: reversing the trend is a priority for both the government and the opposition. Philip Hammond's 2017 Autumn Budget stated that:

> The government is determined to fix the dysfunctional housing market, and restore the dream of home ownership for a new generation.[1]

The Shadow Secretary of State for Housing, John Healey MP, said in an interview in Autumn 2017:

> Since 2010, we've seen the number of under-45s owning their own home drop by 900,000 and now home ownership generally is at a 30-year low. Everyone knows someone who's affected, someone who can't get the home they need or aspire to.[2]

Successive governments have introduced (or revamped) a range of policies in an attempt to tackle low ownership rates. The Conservative government has introduced a stamp duty surcharge on the purchase of additional residential properties and cut the stamp duty paid by first-time buyers. Help to Buy and new Lifetime ISAs have topped up the savings and offset the mortgage costs of first-time buyers. Direct subsidies for housing construction and loan guarantees for housing providers are aimed at boosting housing supply. The variety of policies reflects what was called in the Budget a 'push on all fronts'.

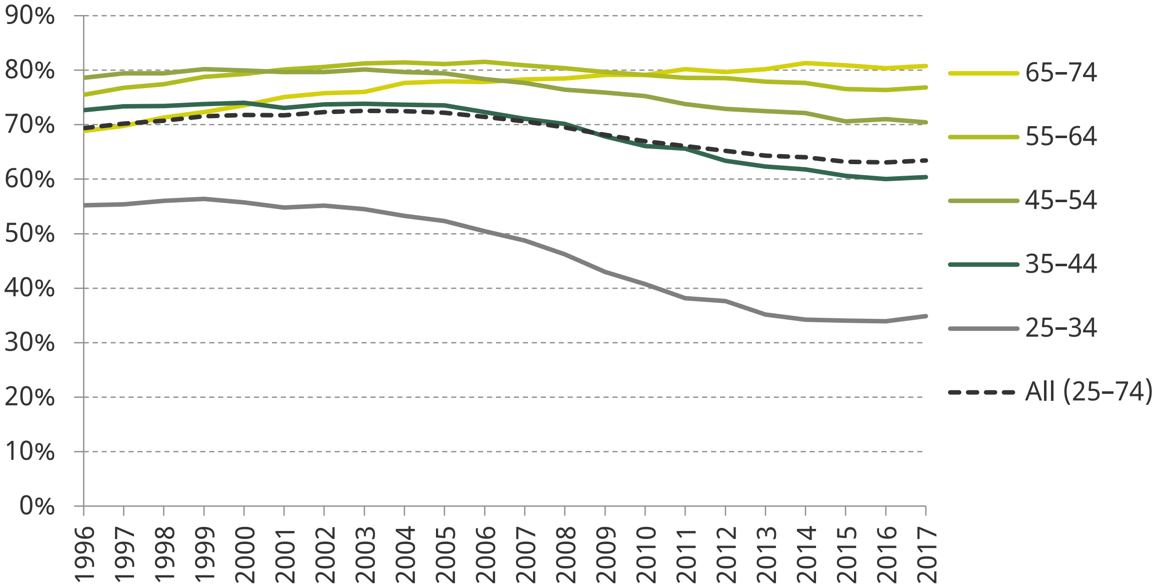
The headline trends in homeownership and housing costs that these policies respond to have been set out many times by analysts inside and outside of government.[3] Figure 9.1 shows how ownership rates of different age groups have changed since 1996: over a 20-year period, the proportion of young adults (aged 25–34) owning their own home fell by 20 percentage points (ppts) from 55% to 35%, with most of the change occurring between 2002 and 2013 and essentially no change since then. While there have been some falls in homeownership of older adults over the last 20 years, they have been much more modest than the falls among younger adults, and homeownership rates for those aged 65–74 have risen gradually. In this figure, as well as in the rest of this chapter, a person is counted as a homeowner if they or their cohabiting partner or spouse own the property in which they live (either with a mortgage or outright). But, for example, someone living with a homeowning parent is not counted as being a homeowner themselves.

1 Paragraph 5.1 of HM Treasury, *Autumn Budget 2017*, https://www.gov.uk/government/publications/autumn-budget-2017-documents.

2 Interview in the *New Statesman*, 4 September 2017, https://www.newstatesman.com/microsites/housing/2017/09/john-healey-labour-has-radical-and-deliverable-housing-plan-government.

3 See, for example: A. Corlett and L. Judge, *Home Affront: Housing across the Generations*, Resolution Foundation Intergenerational Commission, 2017, https://www.resolutionfoundation.org/app/uploads/2017/09/Home-Affront.pdf; Department for Communities and Local Government, *English Housing Survey: Headline Report, 2015–16*, 2017, https://www.gov.uk/government/statistics/english-housing-survey-2015-to-2016-headline-report; and J. Cribb, A. Hood and J. Hoyle, 'The decline of homeownership among young adults', IFS Briefing Note BN224, 2018, https://www.ifs.org.uk/uploads/publications/bns/BN224.pdf.

Figure 9.1. UK homeownership rates by age group, 1996–2017



Note: An individual is counted as a homeowner if they or their cohabiting partner or spouse own the property in which they live (either with a mortgage or outright).

Source: Authors' calculations using the Labour Force Survey 1996–2017.

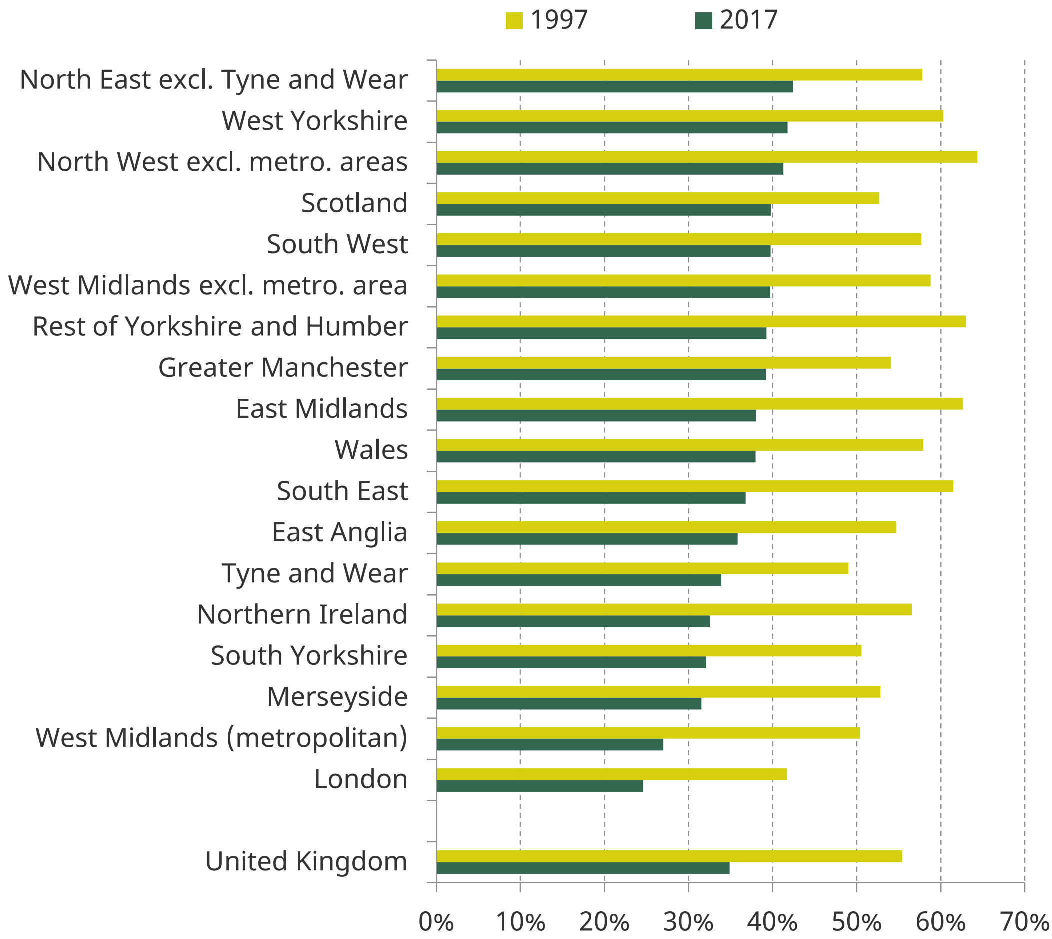
As Figure 9.2 illustrates, the substantial decline in young adults' homeownership has occurred across all regions and nations of the UK over the last 20 years, with the smallest falls in Scotland (13ppts) and the largest in the South East (25ppts). The share of young adults owning their own home is lowest in two sorts of areas: those with high house prices (such as London and the South East of England) and poorer, urban areas with lower wages and employment (such as the West Midlands metropolitan area and Merseyside).

These trends are well known, but discussion of why – or whether – they are cause for concern has in general been less precise. It is often taken for granted that lower homeownership is bad and that policies that boost homeownership must be good. In this chapter, we focus on how young adults interact with the housing market: the house prices and the rental prices that they face, the constraints they face when looking at purchasing a home, the consequences this has for homeownership and inequalities, and some of the potential policy options available to address these challenges.

Section 9.2 presents key information on changes in the housing market over the last 20 years. We focus on trends in house prices, mortgage interest rates and repayments, and rents in the private rental market to assess how the market facing young adults who are looking to rent or buy a property differs from that in the past.

Section 9.3 considers the economic reasons – related both to efficiency and to equity – why low homeownership rates amongst young adults might be a matter for public policy concern. There may also be political (or political economy) rationales for such concerns, particularly as voters frequently name housing as a top priority. For example, low homeownership could potentially increase disengagement of younger generations from the political process. We do not consider these political arguments in detail.

Figure 9.2. Homeownership rates of 25- to 34-year-olds across the UK



Source: Authors' calculations using the Labour Force Survey 1997 and 2017.

One particular feature of the housing market is that most people buying a first home will need access to credit (i.e. a mortgage) to purchase a property. There are various borrowing constraints in the mortgage market that limit the amount that people can borrow, with both minimum deposit requirements and caps on loan-to-income ratios. These constraints disproportionately affect the ability of younger prospective buyers compared with older people because they have had less time to save for a deposit and are more likely to have their peak earning years ahead. Moreover, rising house prices over the last 20 years mean that these constraints have become even more binding for young adults, at a time when rent increases – and falls in mortgage interest rates – have made owning appear cheaper compared with renting (when comparing mortgage interest payments and rents).

Section 9.4 analyses this issue in greater detail, quantifying how higher house prices compared with incomes have made the borrowing constraints faced by young adults much more important over the last two decades. Previous work in this area has focused on comparing average prices with average earnings or incomes. We build on this by looking at how the income distribution for young adults compares with the property prices in the housing market that they face in the area (local authority) in which they live.

Section 9.5 considers some of the broad policy options open to government. One potential approach is to dismantle the barriers on the mortgage market; however, there are good macroeconomic reasons not to, and even removing the restrictions entirely would still leave young adults at a disadvantage. We go on to consider the relative merits of three types of intervention: advantaging young adults in the buying process; disadvantaging other potential buyers; and increasing housing supply, and the responsiveness of supply to changes in property prices or demand.

Section 9.6 concludes.

9.2 The English housing market: changes in property prices, interest rates and rents

Property prices, mortgage interest rates and rents in the private rental market are three key factors that affect housing tenure decisions and housing costs. In this section, we set out the key trends for each over the last 20 years. We then explore briefly the links between these three factors, which can help us to understand what has happened in the housing market over the last 20 years. Due to data constraints, we restrict our attention to England only.

Trends in property prices

Over the last 20 years, average house prices have increased rapidly, even after accounting for overall inflation (excluding housing costs) and for the types of houses sold. Using Land Registry data for England, Figure 9.3 illustrates that between 1997 and 2017, the average house price in England increased from £86,000 to £234,000 (expressed in 2016–17 prices), a 173% increase. This compares with an increase in the mean net income of 25- to 34-year-olds of 19% (after adjusting for the same measure of inflation) between 1997–98 and 2016–17.

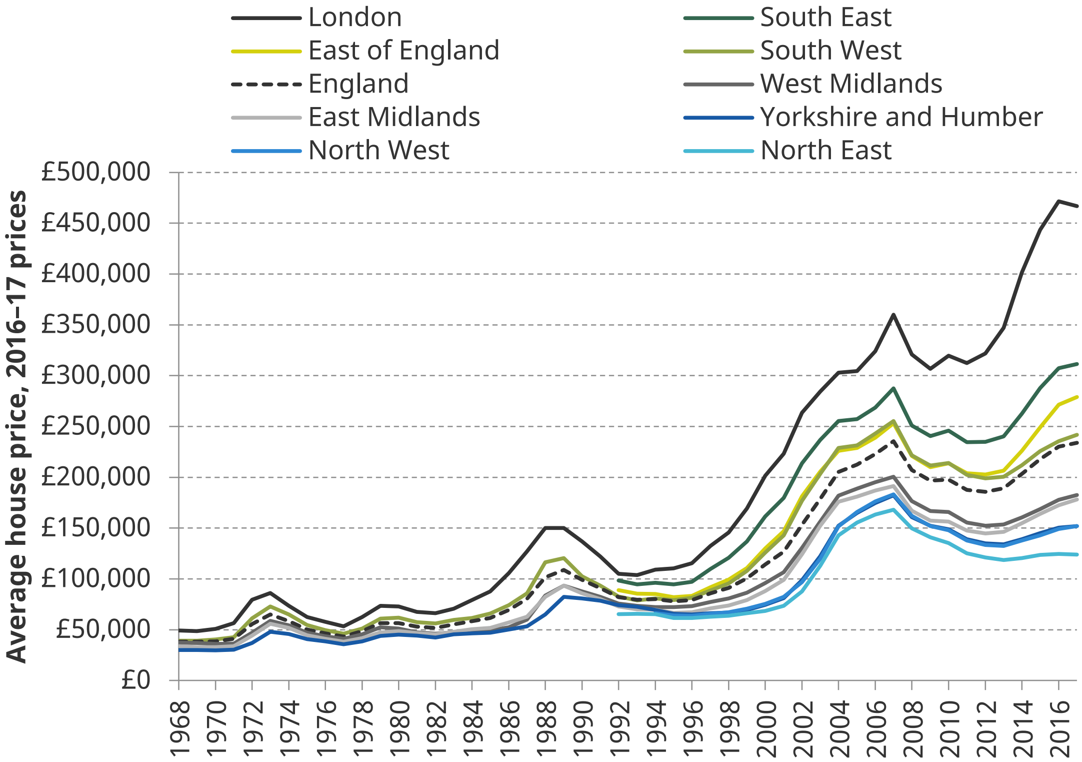
This house price growth is much higher than in other large developed economies. Data from the OECD (which use slightly different measures of both average house prices and inflation) show that between 1997 and 2017, real property prices in the UK as a whole grew by 150%, higher than for any other G7 country, with Canada (141% growth) and France (101%) being closest to the UK, and Germany (4%) and Japan (–23%) having the slowest growth.[4]

Some regions in England have experienced much faster growth – most notably London, where the average house price increased by over 250% in real terms (from £132,000 to £467,000) over the same period. It is also important to note that only in London, the South East and East of England are average house prices higher (in real terms) than their pre-crisis (2007) peak, although real house prices across the rest of England are still much higher than they were 20 years ago.

The Land Registry data used in Figure 9.3 are only complete up to 2017. More recent data from Nationwide suggest that in the year to the second quarter of 2018, average house

[4] https://data.oecd.org/hha/housing.htm.

Figure 9.3. Average (mean) real house prices by region of England, 1968–2017



Note: Land Registry methodology uses hedonic methods to adjust for changes in the composition of houses being sold over time. Data are not available for all regions before 1992. Prices expressed in 2016–17 prices, adjusting for inflation using the Consumer Prices Index (excluding housing costs).

Source: UK Land Registry House Price Index data for average prices at the regional level, 1968–2017.

prices fell by 0.2% after adjusting for CPI inflation, with falls in London of 4.3%.[5] Looking forward, there are some predictions of possible falls in house prices as a result of Brexit, particularly if the UK leaves the EU in a ‘disorderly’ way.[6] However, average house prices would need to fall by around two-thirds to take us back to the (real) prices seen two decades ago, and the experience since the financial crisis shows that, while house prices may drop significantly in the aftermath of a large macroeconomic shock, they may not necessarily stay at the depressed levels, at least in some regions such as London and the South East.

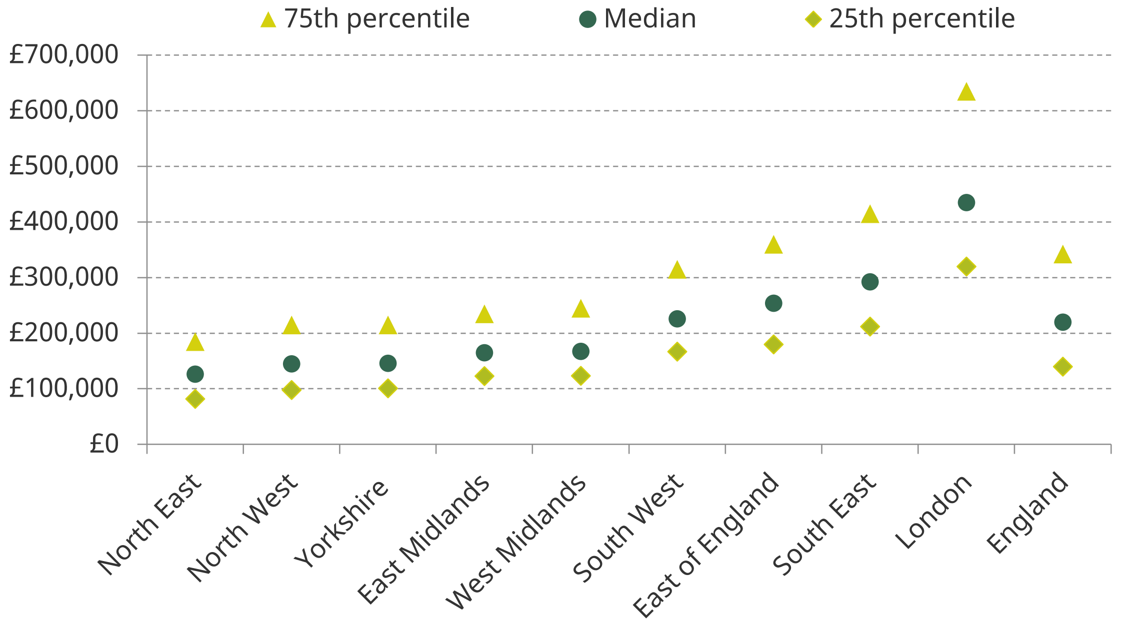
Differential trends in house prices over the last 20 years have opened up enormous differences in the distribution of house prices between regions. To see the distribution of house prices faced by young adults in 2016, Figure 9.4 shows the range of property prices in each English region. For comparison, we also show the variation in the net income of young adults by region in Figure 9.5.

Figure 9.4 confirms that the high house prices in London and the South East are found across the distribution as well as for the average. In practice, this means that the distribution of housing costs within each region is dwarfed by the much bigger differences

5 https://www.nationwide.co.uk/-/media/MainSite/documents/about/house-price-index/2018/Jun_Q2_2018.pdf.

6 https://www.ft.com/content/87b1f284-1452-11e7-80f4-13e067d5072c.

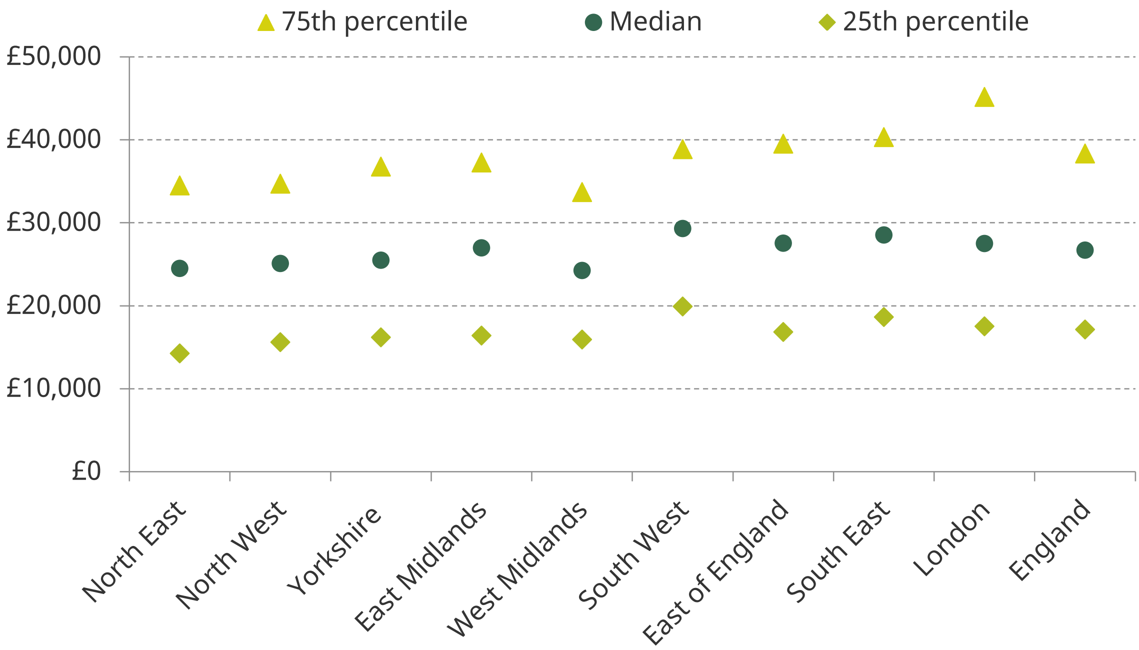
Figure 9.4. Distribution of English house prices by region (2016), 2016–17 prices



Note: Regions are ranked by median house prices.

Source: HM Land Registry price paid data 2016.

Figure 9.5. Distribution of annual net income for adults aged 25–34 by region (2015 and 2016 pooled), 2016–17 prices



Note: Regions are ranked by median property prices. Annual net income includes the income of the young adult and any cohabiting partner. Incomes are not equivalised. Incomes are expressed in 2016–17 prices, adjusting for inflation using the Consumer Prices Index excluding housing costs.

Source: Authors' calculations using Family Resources Survey 2015 and 2016. Based on pooled data for 2015 and 2016.

across the country. For example, the 25th percentile (the property costing more than 25% of properties) house price in the East of England (£180,000) is similar to the 75th percentile (higher than 75% of properties) in the North East of England (£185,000). London is so exceptional that the 25th percentile of house prices there is higher than the median in the next most expensive region – the South East.

Regional differences in net income (that is, after direct taxes are paid and any benefits received) for young adults are small in comparison, as shown in Figure 9.5. The median young adult in England had a net income (including the income of their cohabiting spouse or partner if they have one) of £27,000. Across regions, this figure only varied from £24,000 in the West Midlands to £29,000 in the South West. The differences in the 75th percentile of young household incomes are somewhat larger, ranging from £34,000 in the West Midlands to £45,000 in London.[7]

The differences between income and house prices shown here are important. Previous IFS research found that all of the fall in the homeownership of 25- to 34-year-olds between 1995–96 and 2015–16 could be accounted for by increases in average regional house prices compared with young adults' after-tax incomes.[8]

Trends in interest rates and mortgage repayments

While house prices are far higher than they were 20 years ago, mortgage interest rates have fallen significantly. Figure 9.6 shows data from the Bank of England on how the average interest rate on a variable (or 'tracker') mortgage has fallen over the last 20 years. It shows a gradual decline in mortgage interest rates since the mid 1990s, falling from around 8% in 1995 to reach 5% in the mid 2000s. Mortgage rates fell again as the Monetary Policy Committee of the Bank of England cut the Base Rate in 2008 (though by less than the Base Rate fell), and continued to fall to reach around 2% in 2016. With CPI inflation still above 2%, *real* interest rates on mortgages are close to zero. Having said that, Bank of England statistics show that mortgage interest rates have not fallen as much on higher loan-to-value mortgages such as those that first-time buyers frequently have, meaning many younger mortgagors will not have benefited as much from falling interest rates.[9]

Falling mortgage interest rates and higher property prices mean that young adults who do purchase a home face a very different structure of mortgage repayments from what was typical in the mid 1990s. Our analysis from the Family Resources Survey (FRS) shows this in clear detail:

- The average (mean) monthly mortgage repayment (which includes both the interest and capital repayments) for young homeowners rose by 120% after adjusting for inflation between 1996–97 and 2007–08, driven by rapidly growing house prices and higher interest rates in the run-up to the financial crisis. Since then, falls in interest rates

7 One reason for these small geographical differences is that the region with the highest wages (London) also has the highest proportion of people living without a partner, which suppresses average income there.

8 J. Cribb, A. Hood and J. Hoyle, 'The decline of homeownership among young adults', IFS Briefing Note BN224, 2018, https://www.ifs.org.uk/uploads/publications/bns/BN224.pdf.

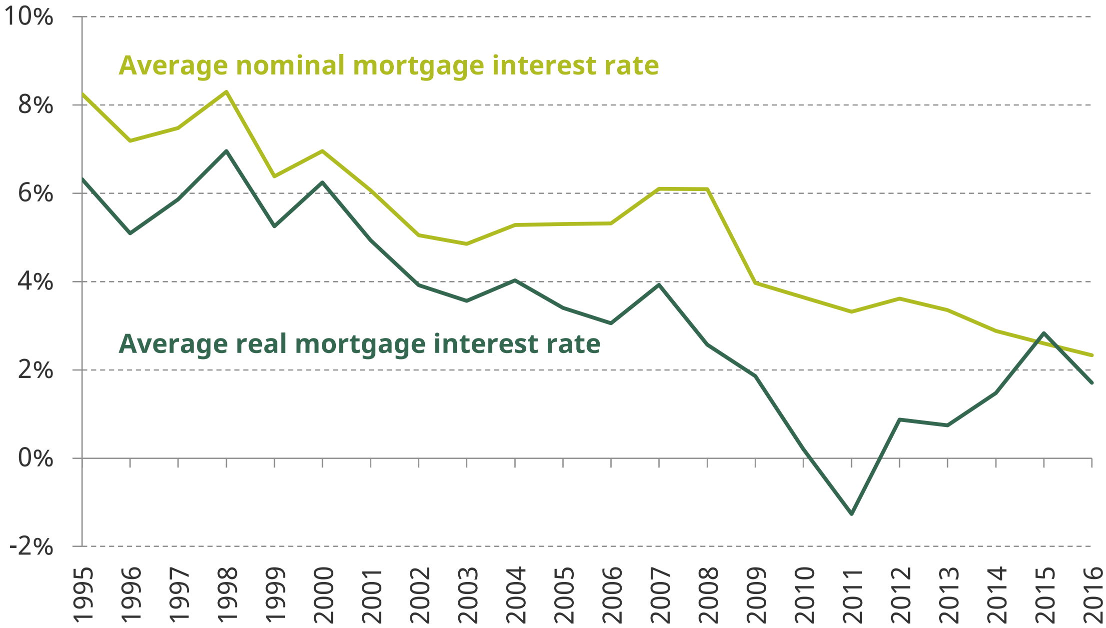
9 See chart E in H. Phaup, 'Historical sources of mortgage interest rate statistics', Bank of England, 2015, https://www.bankofengland.co.uk/-/media/boe/files/statistics/bankstats-articles/2015/historical-sources-of-mortgage-interest-rate-statistics---bankstats-article.pdf?la=en&hash=79EEA48DAD7C48817355A5C8CFDC73E458951772.

and more moderate changes in average house prices mean that the average mortgage repayment has fallen back, but it is still 76% higher in real terms in 2016–17 than in 1996–97. This compares with average (mean) real income growth of young adults of 25% over the same period.

- The average amount that young homeowners paid on mortgage interest payments (i.e. ignoring the capital repayment) also rose substantially between 1996–97 and 2007–08, by 82% in real terms, again driven by rising house prices and increases in interest rates between 2003 and 2007. But the falls in interest rates since then mean that mean interest payments by young homeowners in 2016–17 were 1% below their 1996–97 level. This means that, over the last 20 years, young homeowners pay similar amounts of interest but much higher capital repayments.[10]

- The average mortgage term (the number of years over which a mortgage is repaid) for homeowners aged 25–34 has increased by four years from 2003–04 to 2016–17, from around 23½ years to 27½ years. This means that young homeowners are now spreading the cost of their mortgage over a longer period. This may have been one way that young adults responded to the increased financial undertaking resulting from higher property prices, as borrowing over a longer period, all else equal, reduces the average monthly repayment (though it increases the total amount paid over the full course of the mortgage).

Figure 9.6. Average nominal and real mortgage interest rates on variable mortgages, 1995–2016



Note: Real mortgage interest rate is after adjusting for CPI inflation (excluding housing costs).

Source: Bank of England, 'A millennium of macroeconomic data', data set available at https://www.bankofengland.co.uk/statistics/research-datasets.

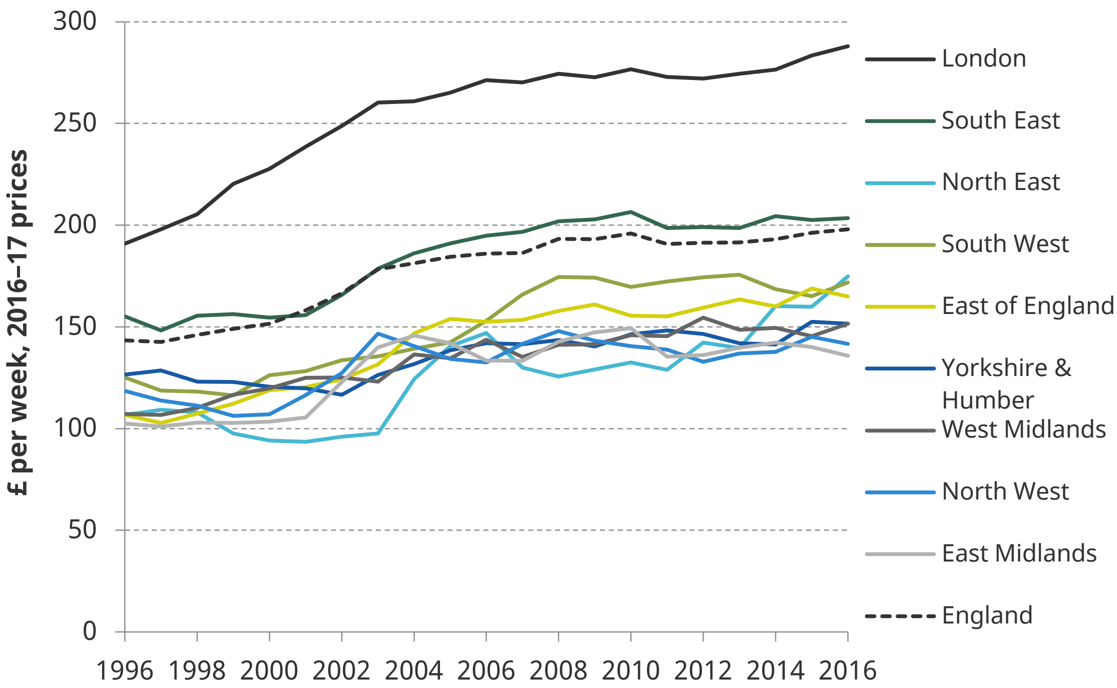
[10] Note that these figures also include very small amounts for water rates, council water charges, structural insurance premiums and ground rents or service charges, but these are typically not significant compared with mortgage interest payments.

Trends in the private rental market

This analysis so far has focused on the cost of purchasing a property: both the price of the property itself and the interest rates and repayments on mortgages. But there is another key price in the housing market: the price of privately renting a home. Private renting is becoming increasingly common as homeownership has fallen (as has the proportion of younger adults living in social housing). Figure 9.7 shows the average (mean) real cost of renting for private renters in England since the mid 1990s.[11] It shows that private rental costs have increased by around 40% in real terms, from around £140 per week to around £200 per week on average. Crucially, this is faster than real income growth for young adults (which has grown by around 20% since 1997). However, rents have grown much more slowly than the 190% increase in house prices (see Figure 9.3). As with house prices, most of the increase occurred prior to the financial crisis. Between 2007 and 2016, there were only modest changes in rents.

Moreover, like the differences in property prices, there are vast regional differences in private rental prices. The average private rental cost in London is £290 per week, 45% higher than the average for England, and the South East is easily the next most expensive region, with average rents in every other region of England below the English average. London has also seen bigger increases in rental prices since 1996–97 (51%) than the average for England (38%). Of course, this is still small compared with the increase in property prices in the capital, in part because rental prices in London have risen a lot less quickly than property prices in London since 2011.

Figure 9.7. Average (mean) real private rental costs by English region, 1996–2016



Note: Years are financial years. Data refer to a three-year rolling average ending in the stated year and are adjusted for inflation using the Consumer Prices Index (excluding housing costs).

Source: Authors' calculations using the Family Resources Survey 1996–2016.

[11] The figures are the average cost for renting private rental properties. They are not adjusted for the number of people in the family (or the number of adults) or for the size or quality of the property.

This analysis shows that rental prices across the country have risen in real terms, and compared with young adults' incomes, over the last 20 years. Higher rents compared with incomes not only reduce the purchasing power of young adults' incomes; they also make it harder for those living in private rental properties to save for a deposit for a home. London is a particular outlier, with rents and prices rising much faster than in the country on average. However, rents have not increased at anywhere near the same rate as property prices.

The difference in pattern between property prices and private rents has attracted the attention of some economists and commentators as a way to explain what is driving changes in the UK housing market. Among others, Ian Mulheirn and Simon Wren-Lewis have separately argued that low interest rates are driving increases in UK prices, rather than a lack of housing supply.[12] Before we move on, it is worth considering this argument.

The argument goes something like this: when interest rates fall, the demand for owning housing increases, in part because the return on saving in savings accounts or bonds has fallen, and so housing becomes a relatively more attractive asset to hold.[13] This higher demand pushes up house prices and means that the rental yield (i.e. the rent compared with the property price) falls. As a result, the expected return on housing as an asset falls until – after adjusting for risk – it is the same as the return on cash or bonds.[14]

This is true, but only because the supply of housing in the UK does not respond much to higher demand and higher prices (economists therefore say that housing supply is price 'inelastic').

Instead, imagine that housing supply were price *elastic*, with individuals and developers swiftly responding to higher prices from increased demand by building more properties. In this case, demand for owning property still increases when interest rates fall. But that demand is met by an expansion of housing supply, meaning that more houses are built, and so property prices do not rise that much. In this scenario, more houses have been built and are now owned by people who want to rent them out. There is a resulting increase in supply to the private rental market, which pushes down rents. Therefore the yield in the rental market falls too.

The key implication of this is that the more elastic the supply of housing, the smaller the rise in property prices and the larger the fall in rents as a result of lower interest rates. This means that, even if it is true that much of the increase in *demand* for property over the last 20 years has been driven by lower interest rates, the extent to which *supply* is responsive to property prices has still played a crucial role in determining the overall impact on both house prices and rents. Most importantly, if housing supply were more elastic, then higher demand would have led to more homes being built and smaller increases in property prices. Of course, even if housing supply were more elastic than it

[12] I. Mulheirn, 'Parrots, housing and redistribution', 2017, https://medium.com/@ian.mulheirn/parrots-housing-and-redistribution-419b36a72e52; S. Wren-Lewis, 'House prices and rents in the UK', 2018, https://mainlymacro.blogspot.com/2018/02/house-prices-and-rents-in-uk.html.

[13] Demand for owning property also rises when interest rates fall, as the cost of borrowing to purchase a house has fallen.

[14] The expected return on housing that is rented out is the anticipated income from rental payments plus the expected capital gain (or loss) as a result of a change in the value (price) of the property.

currently is, house prices may still have risen over the last 20 years to some extent, due to increasing demand for property.

9.3 Should policymakers be concerned about the low homeownership rates of young adults?

The large falls in homeownership among young adults are stark. But are there good economic reasons for the government to be particularly concerned about low rates of homeownership specifically? Or is this just one aspect of a broader issue of very high land and property prices?[15]

There is an argument on 'efficiency' grounds for supporting more homeownership. For example, there is some evidence that owner-occupiers do more to take care of their home and their local neighbourhood, which benefits wider society rather than just the individual homeowner.[16] On the other hand, homeowners are likely to be less geographically mobile than renters, which could have costs in terms of reducing labour market efficiency.[17]

There is also a public finance rationale for policymakers to care about low rates of homeownership. In the longer run, if increasingly large numbers of people reach retirement without owning their own home, they might end up struggling to pay rent on a lower retirement income and/or could fall back on housing benefit and therefore place additional pressures on the public finances.

Other concerns about low levels of homeownership might actually reflect concerns about the quality and security associated with private renting itself. To address these concerns, policy might be better aimed at dealing with those issues directly rather than at increasing levels of homeownership. Of course, this would need to be done with careful consideration of the upwards pressure on rents that such interventions might risk.

However, the key economic rationale for concerns over falling levels of homeownership appears to be equity – both equity between generations and equity within the younger generation.

Inequities between different generations: Higher house prices and the resulting falls in homeownership make the current generation of young adults worse off in two ways compared with older generations. First, older generations benefited from the increase in house prices (which are generally untaxed, in particular as there is no capital gains tax on wealth held in primary residences), greatly increasing their wealth. At the same time, higher house prices mean a higher cost of homeownership for young adults.

[15] For evidence of the similarity of land and property prices, see P. Cheshire, 'Urban containment, housing affordability and price stability – irreconcilable goals', Spatial Economics Research Centre (SERC), Policy Paper 4, 2009, http://www.spatialeconomics.ac.uk/textonly/SERC/publications/download/sercpp004.pdf.

[16] D. DiPasquale and E. Glaeser, 'Incentives and social capital: are homeowners better citizens?', *Journal of Urban Economics*, 1999, 45, 354–84; N. E. Coulson and H. Li, 'Measuring the external benefits of homeownership', *Journal of Urban Economics*, 2013, 77, 57–67.

[17] See A. Oswald, 'A conjecture on the explanation for high unemployment in the industrialised nations: part 1', University of Warwick Economic Research Paper 475, 1996, http://wrap.warwick.ac.uk/1664/1/WRAP_Oswald_475_twerp_475.pdf.

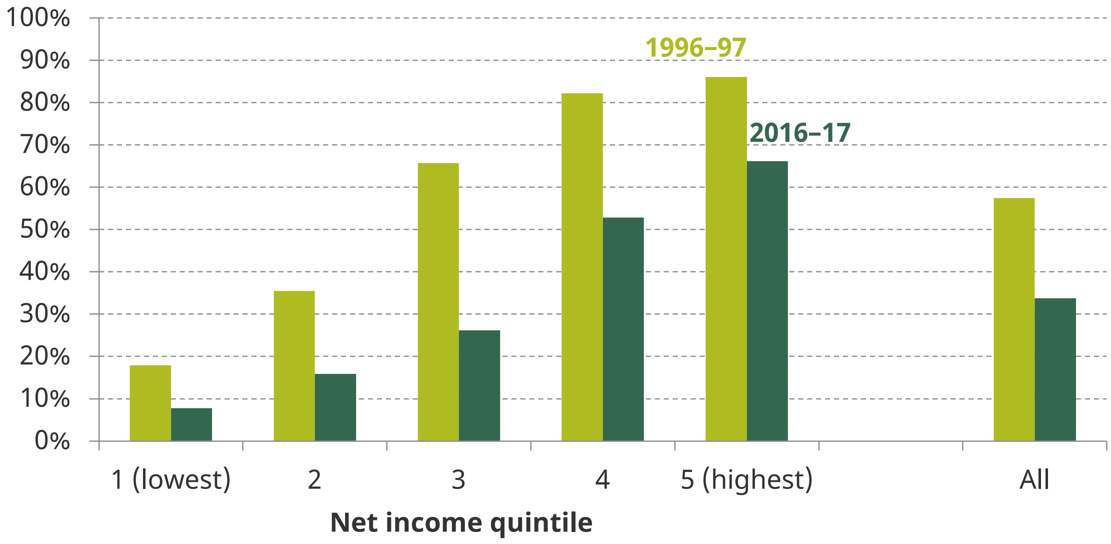
Second, higher house prices mean larger deposits and mortgages are needed to purchase a home. Since young adults typically have less liquid wealth, lower salaries relative to their lifetime earnings, and shorter credit histories than their older counterparts, they might particularly struggle to meet the up-front costs of buying as house prices rise.

Inequities within the younger generation: Some young adults will be able to access funds from their parents, creating an additional inequality between those who have access to family wealth and those who do not. By providing their children with a deposit for a home, wealthier parents may be able to help their children get around borrowing constraints in a way that people from less affluent backgrounds cannot.

However, evidence suggests that – at least so far – these effects are not large. After taking into account young adults' own earnings, occupation and family situation, those from high socio-economic backgrounds are only a little (3 percentage points) more likely to own a home than those from low socio-economic backgrounds.[18] Having said this, differences in parental wealth may affect homeownership in other ways, such as those from wealthier backgrounds living in larger properties or more desirable areas.

Second, the decreases in homeownership have already affected different types of young adults in different ways. Over the last 20 years, the biggest falls in owner-occupation have been among those with middle incomes. Figure 9.8 shows how homeownership has changed across the income distribution since the mid 1990s. For middle-income young adults, the homeownership rate has fallen from around two-thirds (66%) to around one-quarter (26%) between the mid 1990s and the mid 2010s. This fall is larger than for those with the lowest incomes (a fall from 18% to 8%) or for those with the highest incomes

Figure 9.8. Homeownership rates for those aged 25–34, by net income quintile



Note: Quintiles use the net income of the individual plus the net income of any cohabiting partner.

Source: Authors' calculations using the Family Resources Survey 1996–97 and 2016–17.

[18] J. Cribb, A. Hood and J. Hoyle, 'The decline of homeownership among young adults', IFS Briefing Note BN224, 2018, https://www.ifs.org.uk/uploads/publications/bns/BN224.pdf.

(from 86% to 66%). In terms of homeownership, middle-income young adults now look more similar to poor young adults than to their better-off peers.

Finally, if the huge increases in property prices (particularly in London and the South East of England) are sustained, then it is increasingly likely that some people will receive very large inheritances (probably towards the end of their working life), whereas others will not. It has always been the case that some people receive inheritances and others do not. But the fact that property prices are so much higher than 20 years ago, and relatively few people draw down on their property wealth in retirement, means that there are likely to be growing differences in the size of the inheritances received by people from different socio-economic backgrounds, and from different parts of the UK.

9.4 Quantifying the borrowing constraints faced by young adults

This section seeks to better understand why young adults are increasingly unable to purchase their first home in the face of rising prices and borrowing constraints. In particular, we look at how these constraints have evolved at a local, not just a national, level.

Mortgage borrowing constraints

Our analysis focuses on two borrowing constraints: the 'loan-to-value ratio' and the 'loan-to-income ratio'.

The **loan-to-value ratio** refers to the maximum amount a person or couple can borrow relative to the price of the house they wish to buy and how much they need as a cash deposit. It is therefore also known as a **deposit requirement**. Requiring a deposit helps to prevent buyers from going into negative equity, which is when the value of their house falls below the value of their outstanding mortgage debt.

The **loan-to-income ratio** refers to the maximum amount a person or couple can borrow relative to their annual gross (pre-tax) salary (not relative to their post-tax income, despite the name). Restrictions on this ratio are aimed at preventing buyers from taking out mortgages on which they cannot afford to make the repayments.

As well as protecting households from changes in house prices or income, these borrowing constraints help to minimise the risk of widespread mortgage defaults coinciding with falls in house prices. The specific level of each constraint is determined partly by banks or mortgage lenders themselves, and partly by regulation that seeks to preserve the financial stability of the banking sector and economy as a whole.

In order to see how much of a challenge these constraints pose to young prospective homeowners, we use data from the Family Resources Survey on the incomes, household structure and local authority of residence of a representative group of young adults aged 25–34. We define incomes to include those of individuals plus any cohabiting partner or spouse. This means that the incomes of a couple that live apart are not combined (even if they plan to move in with each other). We also include both homeowners and renters (and those living with their parents) in our sample. We combine the FRS with information about the distribution of house prices at the local authority level, calculated using Land Registry data, which cover all properties sold in England between 1996 and 2016.[19]

Using these data, we can therefore answer two key questions:

- If a young adult wanted to buy the average-priced home in their area, how much would a 10% deposit be relative to their annual income? What if they were looking to buy one of the cheapest homes in their area?
- Assuming a young adult had already saved a 10% deposit, would borrowing 4.5 times their annual earnings cover the remaining cost of purchasing a home, both for an average property in their area and for a cheap property in their area?[20]

Separately considering the two different challenges young adults face when trying to get a mortgage helps us to understand how trends in property prices have affected young adults and which constraint appears more binding, and it can also help to guide policy responses.

Maximum loan-to-value ratio (deposit requirement)

A maximum loan-to-value ratio requires that prospective buyers have a deposit for a portion of the value of the house.

Figure 9.9 shows that around 9% of mortgages have a deposit of less than 10%, and since 2008 essentially no mortgages are approved with less than a 5% deposit. The figure also shows that, despite an increase in the last few years, the proportion of people who have a deposit of less than 10% is still well below where it was prior to the financial crisis. The increasing scarcity of high loan-to-value mortgages reflects changes in risk perception or attitudes of lenders, rather than specific government regulation in this area. Regardless, it is safe to assume that the majority of prospective homeowners need at least a 10% deposit in order to get a mortgage. By definition, they are not able to use traditional credit markets – such as mortgage lenders – to help them pull this together; instead, deposits are usually based on savings (sometimes the result of a gift from parents or other family members).[21]

In order to see how the deposit requirement affects young adults, we ask: 'If a young adult wanted to buy the median-priced property in their local area, how much would a 10% deposit be as a share of their annual net (post-tax) income (including the income of their cohabiting partner or spouse, if they have one)?'.

Figure 9.10 shows that in 2016, four-in-ten (41%) young adults would have needed to save more than a year's net income for a 10% deposit on the median house in their area. This

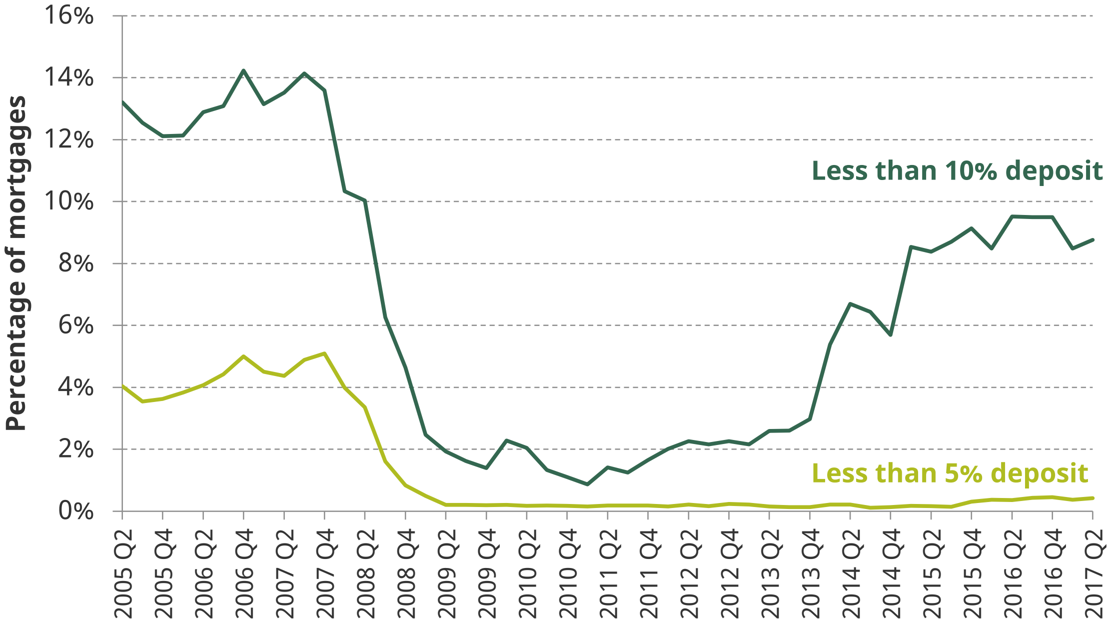
[19] We only look at information up to and including the 2016 calendar year, to exclude the increase in second (and subsequent) property purchases in the first quarter of 2017 that occurred before increases in stamp duty for these transactions in April 2017.

[20] Holding the loan-to-value and loan-to-income restrictions themselves fixed (rather than reflecting the changes that actually occurred over time and are seen in Figures 9.9 and 9.10) allows us to isolate the impact of changes in incomes and property prices on the ability to save for a deposit and borrow enough to purchase a home.

[21] According to the English Housing Survey, 81% of first-time buyers in 2015–16 reported using savings as a source of their deposit; 29% had help from friends or family.

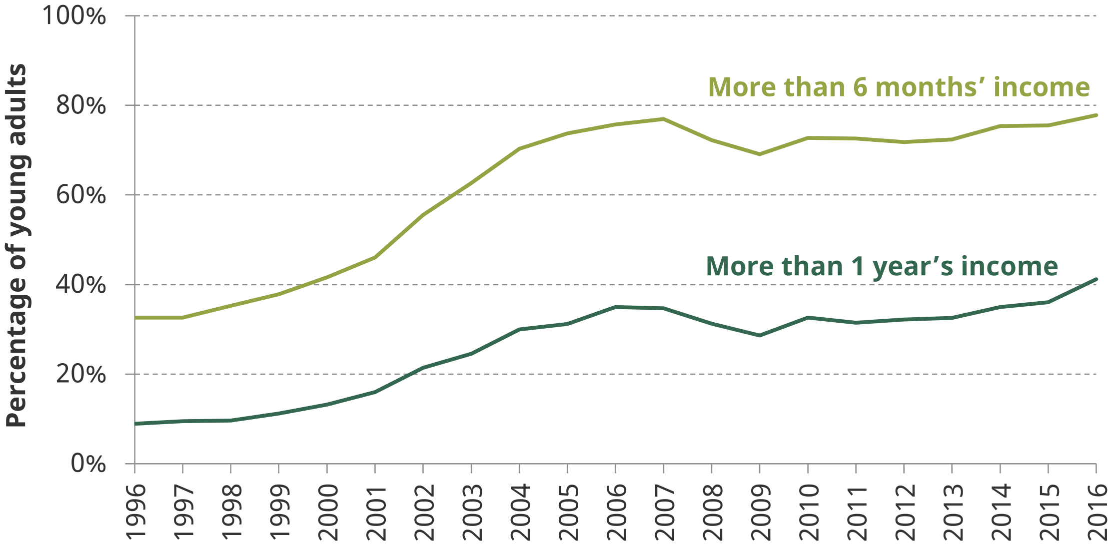
has risen dramatically since the mid 1990s, when only one-in-ten (9%) would have needed to do so. Moreover, by 2016, for the majority (78%) of young adults, a 10% deposit was more than six months' income, up from 33% in 1996. On both measures, it became much

Figure 9.9. Percentage of mortgages with less than a 5% deposit and less than a 10% deposit, 2005–17



Source: Authors' calculations using table 3.3 of Financial Conduct Authority product sales data, https://www.fca.org.uk/publication/data/psd-mortgages-2017.xlsx.

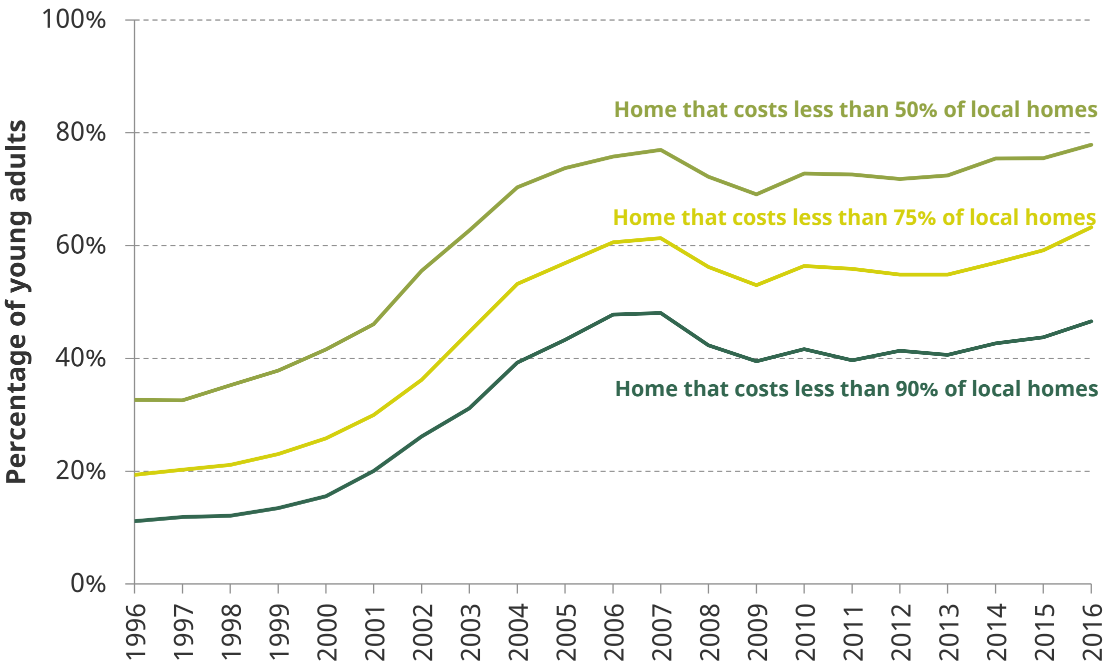
Figure 9.10. Percentage of 25- to 34-year-olds for whom a 10% deposit on the median property in their area is more than six months or a year of their net annual income



Note: Net annual income includes the income of the young adult and any cohabiting partner. It does not include the income of any parents or friends who they may reside with. 'Their area' is defined as the local authority district that they currently reside in. Individuals who report zero net income are excluded. England only.

Source: HM Land Registry price paid data and Family Resources Survey, both 1996–2016.

Figure 9.11. Percentage of 25- to 34-year-olds for whom a 10% deposit is more than six months of their net annual income, by position in local house price distribution



Note: Net annual income includes the income of the young adult and any cohabiting partner. It does not include the income of any parents or friends who they may reside with. 'Their area' is defined as the local authority district that they currently reside in. Individuals who report zero net income are excluded. England only.

Source: HM Land Registry price paid data and Family Resources Survey, both 1996–2016.

harder to raise a deposit between 1996 and the financial crisis, since when there has been relatively little change on these measures.

Figure 9.10 showed the challenge for young adults of saving a deposit for an average-priced property in their area. Figure 9.11 takes the top (light green) line from that figure (the proportion for whom a deposit is more than six months' income) and adds two further lines to analyse the extent to which it is easier to save for a deposit on a cheaper local property.

In 2016, 78% of young adults needed to save more than six months of their annual net income to have a 10% deposit on the median property. For a house at the 25th percentile (one cheaper than three-quarters of homes in their area), this proportion falls to 63%, and it is 47%for the very cheapest homes (a home cheaper than 90% of homes in the area). In other words, around half of young adults would need to save more than six months of income to raise a deposit on one of the cheapest properties in their area.

Differences in the savings required to buy relatively cheap versus averagely priced houses are held down by two factors. First, much of the variation in house prices is across, rather than within, local areas. Second, any given difference in house price translates to a much smaller difference in deposit (in pounds). In 2016, it would on average cost a young person a little over £50,000 more for the median property than for a property cheaper than three-quarters of local homes, but this increases the required (10%) deposit by only around £5,000.

Figure 9.12. Percentage of 25- to 34-year-olds for whom a 10% deposit on the median property is more than six months of net annual income, by region

Note: Net annual income includes the income of young adults and any cohabiting partners. It does not include the income of any parents or friends who they may reside with. 'Their area' is defined as the local authority district that they currently reside in. Individuals who report zero net income are excluded. England only.

Source: HM Land Registry price paid data and Family Resources Survey, both 1996–2016.

Figure 9.12 shows the variation in difficulty of raising a deposit for young adults in different regions. As outlined in Section 9.2, young adults in London face much higher prices than their peers in the rest of the country, but their average household incomes are broadly in line with other regions. It is therefore not surprising that, compared with their incomes, young adults in London need the largest deposits. In 2016, a 10% deposit on the average property in their area would be equivalent to more than six months of net income for 95% of 25- to 34-year-old Londoners. The proportion is almost as high in the South East (91%), East of England (86%) and South West (84%), but much lower (50–60%) in the East Midlands and regions in the North of England.

In all regions, saving for a 10% deposit became a much bigger undertaking in the 10 years between 1996 and 2006. The proportion of young adults for whom a 10% deposit on an average local home is more than six months' income rose by 43 percentage points on average, ranging from a 34ppt increase in the North East to a 50ppt increase in the South West.

After 2006, it continued to become more difficult to save for a deposit in three regions – London, the South East and the East of England. As Figure 9.3 showed, these are the only regions in which the average real house price was higher in 2016 than prior to the financial crisis. In these three areas combined, the proportion of young adults for whom a deposit is more than six months' income was 41% in 1996, 83% in 2006 and 92% by 2016. Elsewhere in England, the ease of raising a deposit has either stayed the same or improved since the mid 2000s. On average in the rest of England, the proportion for whom a deposit is more than six months' income actually fell to 65% by 2016 (having risen from 26% to 69% between 1996 and 2006).

Overall, this analysis shows how difficult it has become for most young adults to save enough for a 10% deposit. Twenty years ago, only one-third of young adults needed more than six months' income for a 10% deposit on the average home in their area. By 2016, this proportion had risen to almost 80% of young adults in England, and to 91% in the South East and 95% in London. Even if they aim to purchase one of the lowest-priced homes in their area, half of young adults in England would need to save six months' income for a 10% deposit. In many areas of the country, there have been small improvements in the ease of raising a deposit since the financial crisis. But in three regions – London, the South East and the East of England – deposits have continued to rise relative to incomes. This shows how the combination of high house prices and relative stagnation in incomes of young adults has made it harder for young adults to accumulate enough savings to purchase a home in their local area without financial assistance from elsewhere.

Maximum loan-to-income ratio

There has been considerable interest in the challenges young adults face in saving for a deposit. But for young adults who do manage to save the 10% deposit, the next consideration is the size of the mortgage that they will be able to get. We therefore consider the following question: 'Assuming they have a 10% deposit, for what proportion of houses in their local area could a young adult get a mortgage large enough to cover the remaining 90% of the (pre-deposit) price?'.

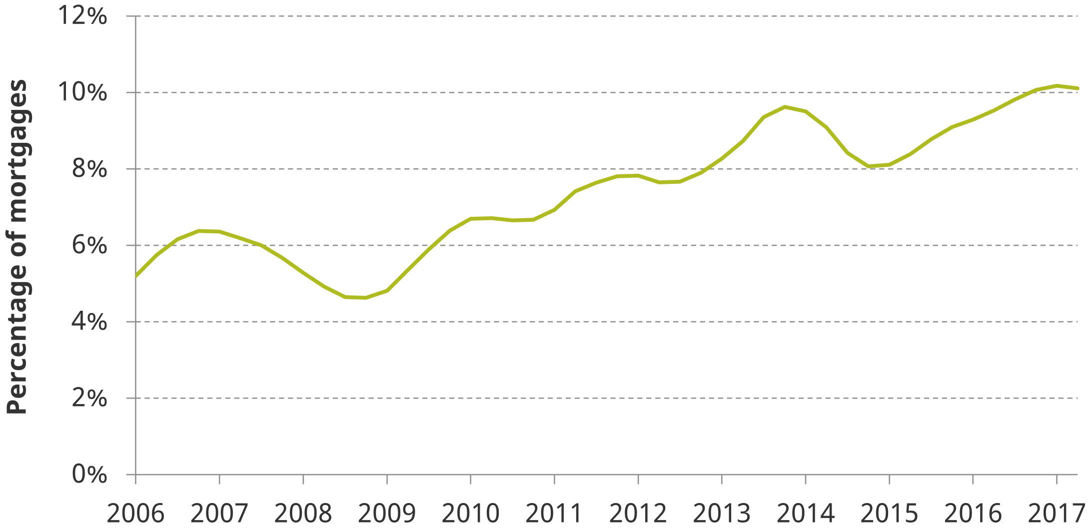
Following a recommendation by the Financial Policy Committee of the Bank of England, the Financial Conduct Authority (which regulates the financial sector in the UK) has set out an expectation that all FCA-authorised mortgage lenders 'limit the number of mortgage loans made at, or greater than, 4.5 times loan-to-income ratio to no more than 15% of their new mortgage loans'.[22] Indeed, Figure 9.13 shows that, in 2017, only around 10% of new mortgages had a loan-to-income ratio of 4.5 or above – although that has increased from around 6% in 2007. While deposit constraints remain stricter than before the financial crisis, loan-to-income ratios appear to be more generous, presumably reflecting lower long-term interest rates and hence lower mortgage costs for any given debt.

Using the same data set described above, we take each young adult aged 25–34 in the FRS and use the gross (pre-tax) annual salaries of them and their cohabiting partner (if they have one) to work out what percentage of homes in their local area recently sold for less than 4.5 times their salary (including their partner's) plus a 10% deposit.

Figure 9.14 shows that, in 1996, 83% of young adults would have been able to borrow enough to purchase the average-priced home in their local area with a 10% deposit and a mortgage of 4.5 times their earnings. The vast majority (93%) of young adults who work and/or whose cohabiting partner (if they have one) works had sufficiently high earnings to cover the very cheapest homes in their area (those cheaper than 90% of local properties). This means that 20 years ago, if credit conditions had been the same as today, pulling together a deposit would have been the main barrier for young adults looking to get on the housing ladder.

[22] https://www.fca.org.uk/publication/finalised-guidance/fg17-02.pdf.

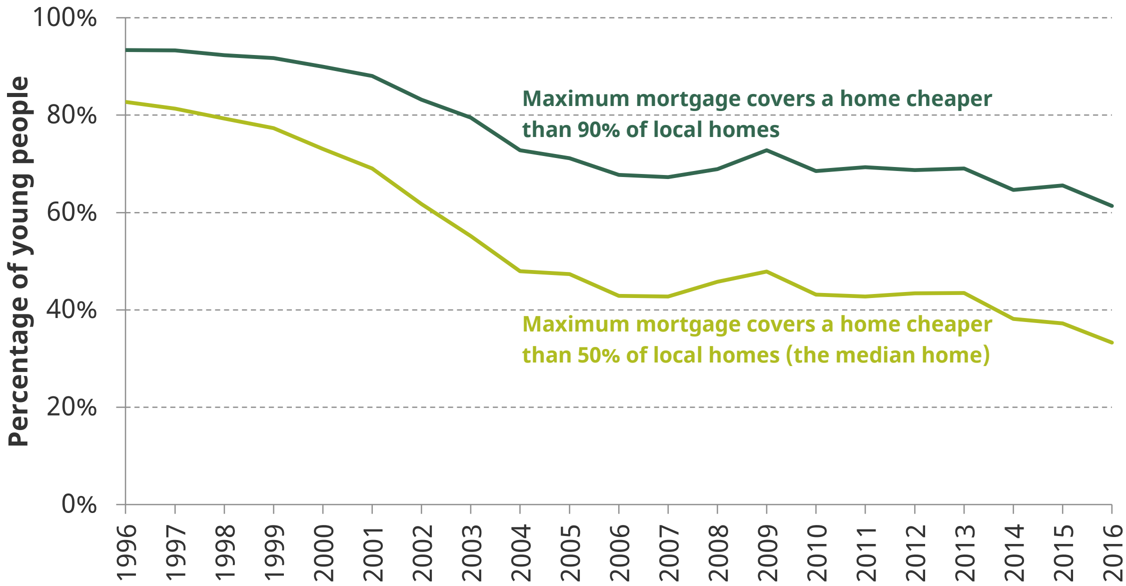
Figure 9.13. Percentage of new owner-occupied mortgages extended at loan-to-income ratio of 4.5 or above



Note: Data are shown as a four-quarter moving average.

Source: Chart A.9 of Bank of England, *Financial Stability Report*, June 2018, https://www.bankofengland.co.uk/financial-stability-report/2018/june-2018.

Figure 9.14. Percentage of 25- to 34-year-olds who can purchase homes in their area with a mortgage at a loan-to-income ratio of 4.5, assuming they have a 10% deposit



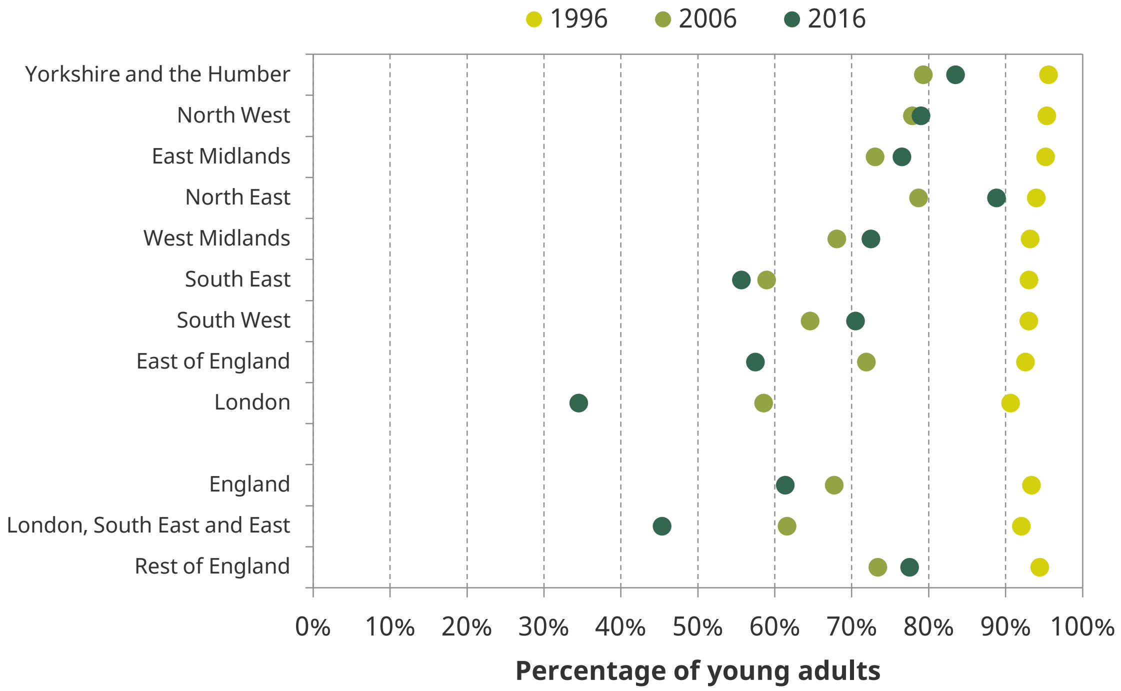
Note: 'Income' includes the annual salary of the young adult and any cohabiting partner. It does not include the annual salary of any parents or friends who they may reside with. 'Their area' is defined as the local authority district that they currently reside in. Individuals who report zero net income are excluded. England only.

Source: HM Land Registry price paid data and Family Resources Survey, both 1996–2016.

The figure also shows how much this situation has changed in the last two decades. In 2006, for only 43% of young adults would a mortgage of 4.5 times their earnings cover the median property in their area even if they had a 10% deposit, a fall of 40ppts. For only 68% would it cover the very cheapest properties (those cheaper than 90% of homes in the area), down 26ppts. Since then, these proportions have fallen further, albeit at a slower pace. In 2016, even if they had managed to save for a 10% deposit, only three-in-five (61%) 25- to 34-year-olds earned enough that borrowing 4.5 times their annual earnings (including their partner's) would cover even one of the cheapest homes in their area; only one-third (33%) could borrow enough to purchase the average property in their area (again assuming they had a deposit of 10%).

Figure 9.15 shows the same information broken down by English region, focusing on the proportion who can borrow enough to purchase one of the cheapest properties in their area (i.e. one cheaper than 90% of local homes). Between 1996 and 2006, the regional trends mirrored the national picture shown in Figure 9.14. In 1996, it was rare in all regions of England for 4.5 times the earnings of a young person not to cover the remaining cost of the cheapest homes in their area after putting down a 10% deposit. Across the country, the proportion able to borrow enough on this measure decreased steadily between 1996 and 2006 – ranging from a 15ppt decline in the North East to much larger drops in London (32ppts) and the South East (34ppts).

Figure 9.15. Percentage of 25- to 34-year-olds for whom a mortgage with a loan-to-income ratio of 4.5 would cover the cheapest properties in their area, assuming they have a 10% deposit, by region



Note: 'Income' includes the annual earnings of young adults and any cohabiting partners. It does not include the annual earnings of any parents or friends who they may reside with. 'Their area' is defined as the local authority district that they currently reside in. Individuals who report zero net income are excluded. England only. 'Cheapest properties' is defined as a property at the 10th percentile, meaning the property that is cheaper than 90% of properties in their local authority.

Source: HM Land Registry price paid data and Family Resources Survey, both 1996–2016.

Over the subsequent 10 years from 2006 to 2016, the trend continued in London, the South East and East of England – the proportion who could buy a cheap local property in these three regions combined fell from 92% in 1996, to 62% in 2006 and 45% in 2016, meaning that the proportion essentially halved over 20 years. However, in the rest of England, the situation for young adults has improved since 2006 – the proportion able to borrow enough increased by 4ppts on average (ranging from a 1ppt increase in the North West to a 10ppt rise in the North East).

The trend in London is particularly dramatic. In 1996, if they had a 10% deposit, 91% of young adults in London would have been able to buy the 10th percentile property in their local authority if they could borrow 4.5 times their gross earnings. This proportion fell to 59% in 2006 and 35% in 2016. Only a third of young Londoners could, in the latter year, borrow enough to buy the cheapest homes in their area even if they managed to save for a 10% deposit.

If they are determined to buy, these households must find a way to increase their deposit to fill the gap, such as turning to family members for help with a larger deposit (meaning they need to borrow less) or purchasing a home in a cheaper area. From the perspective of meeting the purchase price on a house, saving for a deposit is slow: a £1,000 gift from family increases the buyer's purchasing power by £1,000. An extra £1,000 in earnings increases the amount that can be borrowed by £4,500 under the loan-to-income constraint, and on top of that these extra earnings (which, post-tax, would be £680 for an employee paying basic-rate income tax and employee National Insurance contributions) could be used to save for a larger deposit.

While much of policymakers' attention has been focused on helping individuals saving towards a deposit, this analysis shows that, on their own, policies to boost deposits are not enough, as many cannot borrow enough even with one. It also shows why high house prices in London (and to a slightly lesser extent the South East and East of England) make it so difficult for young adults to purchase a home. Even if they have a 10% deposit, in these regions only 45% could get a mortgage to buy one of the cheapest properties in their area; in London only one-third could.

However, if young adults were able to borrow more, it is not clear they would; committing to service and repay the large mortgage implied by high prices may not be feasible or desirable for many young adults. Indeed, as was shown in Section 9.2, even for those who do get onto the property ladder, average total mortgage repayments are far higher than they were 20 years ago. There is evidence (from the same section) that young adults are increasing their mortgage terms to stretch out repayments over a longer period, potentially because committing to higher monthly repayments would be a difficult financial undertaking.

9.5 Policy responses to low homeownership among young adults

This section considers potential policy responses to low homeownership rates among young adults. We discuss four broad groups of policy options that have been or could be used.

First, the most direct response to borrowing constraints would be for policymakers to relax the regulation on banks and mortgage lenders that restricts residential lending. Second, the government could enact policies to advantage young adults when purchasing a home or, third, to disadvantage purchasers of second homes or buy-to-let properties. Fourth, the government could enact policies that directly increase the number of homes that are built, or reforms that allow supply to increase more flexibly as property prices rise. We assess each of these options in turn – looking at how they may affect the housing market, and who will benefit most from different policies.

Fewer restrictions on mortgage lending

One response to the borrowing constraints that we have outlined would simply be to allow people to borrow more or to put lower deposits on their houses.

However, this sort of policy might not actually be effective in boosting homeownership among the young. Property prices are so high, particularly in south-eastern England, that many young adults may not be able to afford to borrow more even if they were allowed to. Moreover, unless the supply of housing increases in response to the extra demand from people who could now borrow more, relaxing lending rules will just push up house prices further,[23] benefiting those who already own property and meaning that prospective buyers face even higher prices.

In addition, relaxing lending restrictions could pose serious risks to borrowers, the financial sector and society more generally, particularly if banks believe that they would be bailed out if there were large-scale defaults.[24] Given these concerns, it would be prudent to be very cautious before loosening lending regulations, while there are other policy alternatives to help boost homeownership.

Giving young first-time buyers a financial advantage in the market

Another set of potential policies try to give young adults a financial advantage relative to other potential property buyers when purchasing a home, either by topping up their savings or by reducing the effective cost of buying a house. The coalition and Conservative governments have introduced several of these policies in recent years, including:

- **Lifetime ISA**: This is a new type of savings account that can be opened by 18- to 40-year-olds and paid into until age 50. The government provides a 25% top-up to saving made each year, with a maximum annual bonus of £1,000, on the condition that the funds are subsequently used towards a deposit on a first home (as long as it costs £450,000 or less and is bought with a mortgage), or not withdrawn until after age 60. The Lifetime ISA is similar in many ways to the Help to Buy ISA, which is being phased out in late 2019 (though it has slightly different restrictions). In 2017–18, 166,000 Lifetime ISAs were opened, less than 2% of all ISAs opened that year.[25]

[23] Y. Chu, 'Credit constraints, inelastic supply, and the housing boom', *Review of Economic Dynamics*, 2014, 17, 52–69.

[24] L. Dam and M. Koetter, 'Bank bailouts and moral hazard: evidence from Germany', *Review of Financial Studies*, 2012, 25, 2343–80.

[25] Source: Table 9.4 of HMRC Individual Savings Account Statistics, https://www.gov.uk/government/statistics/number-of-individual-savings-accounts-isas-amounts-subscribed-to-each-component-and-average-subscription. As ISAs need to be registered for annually, this includes anyone who paid into an ISA in 2017–18. However, it is important to note that there were few Lifetime ISA

- **Cuts to stamp duty for first-time buyers**: As announced at the Autumn Budget 2017, the government has created an exemption from stamp duty land tax for all first-time buyers who purchase a residential property worth £300,000 or less. The government has also introduced a cut of up to £5,000 to stamp duty for first-time buyers purchasing a property of between £300,000 and £500,000 – though for any property above this price, there are no discounts available.

- **Help to Buy**: Introduced in April 2013 by the coalition government, Help to Buy (equity loan) is a policy under which the government will provide a low-interest loan worth up to 20% of the value of the property (40% in London) for prospective buyers of new-build homes with a maximum price of £600,000. The buyer needs at least a 5% deposit themselves and a mortgage for the rest. Only prospective owner-occupiers are eligible – properties bought through Help to Buy cannot be sublet or rented out. By March 2018, 170,000 properties had been bought through the scheme, with government loans of £8.9 billion: this works out at an average of just over £50,000 of government loan per property purchased. Although it is not required by the scheme, four in every five property purchases have been by first-time buyers, of which 83% had a deposit of less than 10%.[26] The policy is set to continue until March 2021.

In Section 9.4, we discussed the two different borrowing constraints that young adults face – saving for a deposit, and a maximum loan-to-income ratio. The three policies outlined above help ease these constraints in different ways. The top-ups in the Lifetime ISA can help young adults save for a deposit more quickly, either by speeding up the time taken to save a certain deposit or by increasing the size of a deposit such that the mortgage needed is lower. Similarly, cuts to stamp duty mean most first-time buyers will pay little or none of this tax on their purchase. Since mortgages do not cover stamp duty, this also effectively reduces the amount that young adults need to save to cover the up-front costs of buying a house. Help to Buy tackles both constraints – prospective buyers only need to save for a 5% deposit and they do not need to apply for such a large mortgage.

In general, policies such as these that make it easier to buy a house will increase demand, in turn (to the extent to which supply is inelastic) pushing up house prices. If these policies were extended to anyone purchasing a property in the UK, it is therefore unlikely that they would increase homeownership; instead, prices would rise in line with the subsidy. However, by restricting eligibility to a certain group, they offer younger first-time buyers an advantage relative to other purchasers (such as older people buying second homes or buy-to-let property). This means that these policies may push up the share of properties that are owner-occupied by young adults and reduce the share of properties owned as second (or subsequent) homes.

However, there are a number of downsides to this type of policy.

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products on offer when the policy launched in April 2017 (https://www.ft.com/content/a487303e-fe6f-11e6-96f8-3700c5664d30).

[26] Source: Ministry of Housing, Communities and Local Government, 'Help to Buy (Equity Loan scheme) and Help to Buy: NewBuy statistics: data to 31 March 2018, England', 2018, https://www.gov.uk/government/statistics/help-to-buy-equity-loan-scheme-and-help-to-buy-newbuy-statistics-april-2013-to-31-march-2018.

First, they could cause house prices to increase, although this may not be by the full amount of the subsidy since eligibility is restricted to only a subset of potential home buyers. A second concern is that policies such as these can be difficult to target. They benefit some young first-time buyers who were already able and planning to purchase a home (either with or without parental help), so they may have significant 'deadweight', offering payments to people for things they would have done anyway. A third potential concern is that these policies benefit young adults who are, on average, much better off than their peers.

Finally, from a public finance perspective, Help to Buy adds risk to the government balance sheet. In particular, the government could face losses if property prices fall and borrowers default on their loans at the same time, as the value of the property may not cover the outstanding balance of the loan. As the Office for Budget Responsibility (OBR) points out in its 2017 Fiscal Risks Report, housing-sector-related risks are 'mostly likely to crystallise alongside other economy-related risks' – in other words, at a time when the public finances are already under pressure. However, the OBR also notes that, relative to the overall effect that changes in the housing market could have on the public finances, the contribution from loan- or guarantee-based schemes such as Help to Buy that the government offers to various players in the housing market is small.[27]

Disadvantaging other buyers in the housing market

The government could also seek to increase homeownership among young adults by disadvantaging other prospective buyers in the housing market. For example, it could make it more costly to own, or seek to own, multiple properties – this should reduce demand for housing from these buyers, exerting downwards pressure on property prices with potential benefits for young buyers.

Policies of this type will mainly affect older generations. Around 14% of those born between 1950 and 1954 own a home in addition to their primary residence.[28] In addition, most private landlords are older people; the Council of Mortgage Lenders Landlord Survey 2016 found that 61% of landlords surveyed were aged 55 or above, and 81% were 45 or older.

There are a number of examples of current government policies in this area:

- **Higher rates of stamp duty on second homes**: In April 2016, the government introduced an extra levy of 3% of the purchase price, on top of the normal stamp duty, for buyers who already own a home. This affects both those purchasing a second home for their own consumption (such as a holiday home) and those purchasing a home to let out.

- **Reduction of buy-to-let mortgage interest tax relief**: By April 2020, private landlords will not be able to deduct the cost of mortgage interest from their rental income at their marginal rate. They will have to pay tax on rental payments gross (rather than net) of interest payments, and will instead receive a 20% income tax credit. This means that

[27] Paragraphs 7.39 and 7.40 of Office for Budget Responsibility, *Fiscal Risks Report: July 2017*, 2017, http://obr.uk/frr/fiscal-risk-report-july-2017/.

[28] R. Crawford, 'The use of wealth in retirement', IFS Briefing Note BN237, 2018, https://www.ifs.org.uk/uploads/publications/bns/BN237.pdf.

landlords with mortgages on their rented property who are also higher-rate (or additional-rate) income tax payers will see (potentially large) increases in their tax bills (landlords who pay only the basic rate of tax, and those who own their second property mortgage-free, will in practice see no change in their tax liability). Companies and landlords of furnished holiday lettings will be unaffected by the change.

- More broadly, additional **regulation of the private rental market** could, if it reduces the profitability of being a landlord, reduce demand from buy-to-let buyers in the property market.

These policies may well help to drive down house prices and increase homeownership amongst young adults. However, there are some distinct disadvantages to these kinds of policies that make them very much 'second best' from an efficiency point of view. The current tax system already favours owner-occupation over renting. By increasing landlords' costs (for example, through additional stamp duty levies or reduced mortgage interest relief), these policies might decrease the supply of property to the private rented sector for a given rental price. This would likely lead to *increased* private rents, making those who rent privately – the majority of young adults – worse off.

Influencing housing supply

The final broad set of policies we consider are those aimed at increasing the supply of housing and the responsiveness of supply to changes in house prices.

In his 2017 Autumn Budget speech, Mr Hammond set out the government's ambition to boost the net increase in housing supply to 300,000 homes (including conversions as well as new builds) per year by the mid 2020s. By historical standards, this would be high. Even in the 1960s, when the public sector funded the construction of a large number of homes, once demolitions are factored in, net additional dwellings averaged 222,000 per year in England.[29] The figure is also high by current standards: in 2016–17, the English dwelling stock increased by 217,000.[30]

To achieve a higher rate of housing supply, there are broadly two sorts of reforms the government could consider. It can either act to increase the supply of homes directly, or act indirectly by increasing the 'elasticity of supply' (the responsiveness of supply to an increase in prices).

Directly increasing the supply of housing

In England, most construction of new homes is funded by private developers who borrow to build, in anticipation of recouping their investment by selling the new builds on the open market. One way for the government to increase housing supply is to directly cover the costs of constructing new homes.

In the past, local authorities used local tax revenues and capital grants from central government to fund the construction of council housing. For most of the 1960s and 1970s, publicly funded development accounted for around half of new builds. These homes

[29] Average annual increase in the dwelling stock in England between 1 April 1961 and 31 December 1969 calculated from table 104 of Ministry of Housing, Communities and Local Government, live tables on dwelling stock, https://www.gov.uk/government/statistical-data-sets/live-tables-on-dwelling-stock-including-vacants.

[30] Table 120 of MHCLG live tables on dwelling stock.

remained the property of the state (at least until Right to Buy was introduced), and were typically let at below-market rents. In the early 1980s, there was a large decline in the number of homes built each year with public funds. Most building of social housing that did take place was done by housing associations, funded by a combination of capital grants from government and borrowing from the private sector.[31] Housing associations are not classified as part of the public sector, so these homes are not owned by the state, but the process by which they allocate homes and the rents they charge are heavily regulated.

The current central government vehicle for providing capital funding for social rental and shared ownership housing is the **Shared Ownership and Affordable Homes Programme**. The scheme has a budget of £4.7 billion between 2016 and 2021, which in annual terms is much less than was available 10 years ago through similar programmes.[32] The funding is explicitly targeted at building homes for shared ownership – expected to make up 88% of houses built through the programme – rather than homes for social rent. In a shared ownership arrangement, a portion of the property is sold on the open market, whilst a portion is retained (normally by a housing association). For the tenant, this means paying a mortgage on the share that they own, and rent on the remaining share.[33]

Within a fixed capital budget, there is a trade-off between building homes for social rent and increasing the supply for shared ownership. The mix of tenures chosen will have different implications for homeownership and housing outcomes more generally. When social housing is built to be rented, it can only increase homeownership amongst young adults indirectly. An increase in social housing stock would result in a subset of poorer families switching from the private rental sector into the social rented sector, which offers greater stability and security. Lower demand in the private rental sector would be likely to lead to lower rents in that sector. And, as rents fall relative to prices, demand for buy-to-let properties would fall too. All else equal, this would be likely to reduce house prices and potentially boost homeownership as house prices fall.[34]

By contrast, the expansion of shared ownership could have a direct impact on homeownership amongst young adults. Allowing prospective owner-occupiers to buy only a share of the house they live in means that they are able to invest some of their money in housing (they share in any increases in the price of the house), even if they cannot save enough, or borrow enough, to cover the full value of a property where they would like to live. In principle, if they are able to save from their remaining income, and if their earnings grow over time, they may eventually be able to purchase the house in its entirety (though

[31] Housing associations are currently not classified as public sector bodies, so their borrowing does not count towards the public sector total. This was not the case between 2008 and 2017.

[32] For more information about social housing and changes in funding under the coalition government, see S. Adam, D. Chandler, A. Hood and R. Joyce, 'Social housing in England: a survey', IFS Briefing Note BN178, 2015, https://www.ifs.org.uk/uploads/publications/bns/BN178.pdf.

[33] In addition, in September 2018, Prime Minister Theresa May announced a supplementary £2 billion of funding for homes for social rent. This is spread over 10 years so does not represent a large increase in the annual budget. At the Conservative party conference in October 2018, the Prime Minster also announced the removal of caps on the borrowing local authorities can make within their housing revenue accounts (their budget for investment and maintenance of council housing stock).

[34] This analysis assumes that the land for building social housing would not otherwise have been used for building houses to be sold for their market value – which would have led to a direct increase in the supply of homes available for purchase.

the speed at which they can build up savings will be affected by the rent due on the remaining portion of the property).

However, focusing government funding on homes for shared ownership will not help people for whom owning a property will never be possible (such as many low-income social or private renters). If construction of social housing does not keep up with sales through Right to Buy and Right to Acquire, housing costs for this group could increase over time, as more people would live in the (higher-cost) private rental sector.

Increasing the elasticity of supply

In addition to (or instead of) funding the construction of homes itself, the government could choose to help remove barriers to private sector construction of houses to be sold at market prices.

The planning system poses a substantial barrier to construction. Local authorities place restrictions on development in their area: in order to build on a particular plot of land, developers must apply for permission, which – if granted – can be conditional on meeting certain ‘planning obligations’. A well-known feature of the planning system is the existence of designated green-belt areas, which cover 13% of land area in England, preventing development around London, metropolitan parts of the Midlands and northern England, Bristol, Oxford, Cambridge and Bournemouth.[35]

There are reasons to think that some restrictions on development are beneficial. For example, an unregulated market may not take into account the value of public goods, such as parkland, so some regulations could help prevent ‘overdevelopment’.

However, the green belt places restrictions on building around the areas with the highest productivity and earnings, especially in southern England. The South East (including London) has the most stringent planning restrictions, as well as the highest demand for housing due to its wealth and productivity. This combination drives the extremely high prices shown earlier in the chapter and has made it increasingly hard for young adults to purchase a home in these areas. A previous study, published in the *Economic Journal*, concludes that, if the planning regulations in the South East were relaxed to match those in the North East, house prices in the South East would have been around 25% lower in 2008 than they were.[36]

More generally, by increasing the uncertainty and administrative burden of development, planning systems make development less responsive to house prices – in other words, they make supply more inelastic. Over the longer term, this could contribute to systematically lower housing supply, leading to higher property prices and rents.

As well as affecting housing supply over the longer term, strict planning constraints also compromise the effectiveness of policies that increase housing demand, such as transfers to younger generations seeking to buy homes. With price-inelastic supply, higher demand

[35] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642684/Green_Belt_Statistics_England_2016-17.pdf.

[36] C. Hilber and W. Vermeulen, ‘The impact of supply constraints on house prices in England’, *Economic Journal*, 2016, 126, 358–405.

due to these policies would push up house prices, rather than deliver substantial increases in homeownership.

The coalition and Conservative governments have introduced a series of policies that seek to make the planning system easier to navigate, in order to help make supply more responsive to price:

- **'Reforming the planning system'**: Changes implemented in recent years have included measures to increase certainty for developers, by: requiring planning authorities to publish more information about their intentions for new home building in their area; reducing the amount of negotiation in the planning process; and introducing permitted development rights. In London, 'fast-track' planning has been introduced whereby permission is (in principle) given by default if certain criteria are met.

- **New Homes Bonus**: This provides local councils with an incentive to permit housing developments by matching the increased council tax revenues on new-build properties for four years.

The reforms that have been introduced are sensibly aimed at loosening some supply restrictions. But the planning system remains one fundamentally based on case-by-case discretion, with elements of developer–planner negotiation and of unavoidable local politics. Even with greater guidance and information put out by planning authorities, the reforms made so far are more likely to deliver incremental improvements in the system than to create radical change in the approach to development taken by local planning authorities.

Finally, there are many other ways in which the government is trying to increase the elasticity of housing supply by making it easier to access the land and funding that make development possible. There is a wide range of current government policies that fall into this category (reflecting the wide range of potential barriers), primarily aimed at helping developers in the earliest stages to secure land and prepare sites. Some examples include:

- **Building on public sector land**: There have been various pushes for the public sector to sell its land for development. One of the roles of Homes England is to coordinate making public sector land available to private developers for housing construction.[37]

- **Home Building Fund**: The government provides loans of between £250,000 and £250 million to private sector organisations to fund development costs of building homes or the costs of site preparation. A total of £4.5 billion of loans are available over six years.

- **Housing Infrastructure Fund**: This provides central government money to local authorities in order to build infrastructure needed to allow the building of new homes or to accompany new homes. A total of £5 billion of grant funding is available over six years.

In all three of these cases, the underlying rationale is that there are profitable projects that are prevented from moving forwards due to market failures. Potential market failures

[37] See Chapter 6 for more details.

that create barriers to profitable projects include developers finding it hard to raise credit to fund even profitable developments, and the existence of public goods (such as new link roads) that need to be provided alongside the development, but which will benefit a wider population than will live in the new homes.

By intervening with targeted assistance, the government hopes to overcome these barriers and use a relatively small amount of money to 'enable' large amounts of development. Whether it is effective in practice will hinge on targeting – is the government able to identify those cases in which private developers really do have a profitable project but are constrained by a market failure? Without good targeting, these policies could have a significant amount of deadweight and make little impact on housing supply.

The current and past governments have pursued a range of policies to help directly boost, and increase the elasticity of, housing supply in England. Many of these policies seem to have potential attractions, but with so many modest changes being made at the same time it is difficult to predict how they will interact, and in the future it will be challenging to look back and unpick the contribution of any individual policy to any changes we may see in housing supply. It remains to be seen whether their cumulative effect will be enough to significantly boost housing supply and limit property price growth.

Summary

Overall, with firms and individuals[38] unable to build many more houses in response to demand, the result of higher demand has been higher prices over time (even after adjusting for inflation). There are many reasons that demand for property has increased over time, particularly in London and the South East, including a growing population, higher incomes and lower interest rates. However, as we set out in Section 9.2 with regard to falling interest rates, the extent to which higher demand (for whatever reason) leads to higher property prices depends on the elasticity of supply.

Indeed, over the longer run, it will be hard to achieve sustained levels of higher homeownership without greater increases in the supply of homes. Over time, the demand for housing (and space to live in) tends to go up (although higher interest rates might moderate some demand for housing). This is not just as a result of population growth, but also because housing is a 'normal' good: as incomes rise, people want more space to live in. Indeed, housing is almost certainly 'income elastic': as incomes grow, demand for housing increases more rapidly than incomes.[39] This means that, as the country (hopefully) gets richer over time, demand for housing will continue to grow strongly.

If the country continues to have a planning system that restricts the ability to build more homes in the areas where prices rise, this higher demand is likely to lead to increasingly higher property prices. Higher property prices reduce the ability of younger adults to

[38] Although not many properties are built by individuals (independently of developers) in the UK at the moment, in other European countries, such as Belgium and France, it is much more common. See https://www.sheffield.ac.uk/news/nr/home-building-architecture-development-grand-designs-custom-build-europe-1.560893.

[39] See, for example: G. Meen, 'Homeownership for future generations in the UK', *Urban Studies*, 2013, 50, 637–56; and P. Cheshire and S. Sheppard, 'Estimating the demand for housing, land, and neighbourhood characteristics', *Oxford Bulletin of Economics and Statistics*, 1998, 60, 357–82.

purchase homes, and restrictions on the supply of homes also lead to higher rental prices for those who do not own a home.

If, on the other hand, increased demand led to higher supply and construction of homes (for example, if planning constraints on green-belt areas were relaxed), particularly in south-eastern England, then prices would be likely to moderate. More young adults would be able to purchase homes, and private renters would face lower private rental costs.

9.6 Conclusion

This chapter has examined barriers to homeownership and policies that might be used to address the falls in homeownership among younger adults over the last 20 years. Property prices in the UK grew faster than incomes, rents and the price of other goods and services between the mid 1990s and the financial crisis. Over this period, house prices in south-eastern England (including London) grew the fastest and, after small declines, they have continued to increase over the last decade. Elsewhere, they remain below their 2007 peak. The huge increases in property prices are the key reason for declining homeownership among young adults, partly because they are unable to buy and partly because they are unwilling to do so at prevailing prices.

There are a number of economic reasons to be concerned about low homeownership for young adults; for example, higher homeownership could have positive spillover effects onto society as a whole. The most unambiguous of these reasons is that high property prices, and the resulting low homeownership rates, increase inequalities both between generations (as older generations benefit from higher property prices at the expense of young ones) and within the younger generation (as those with greater parental wealth will see increasingly large benefits compared with others in their generation).

In policy commentary, there has been a lot of focus on the difficulty prospective first-time buyers have in saving enough for a 10% deposit on a home. It has indeed become harder to save for a 10% deposit over the last 20 years: the proportion who need to save an amount equivalent to their total annual net income in order to buy an average-priced home in their local area has increased more than fourfold, from 9% to 41%. Over the last 10 years, it has become harder to save for a deposit in the South East, East of England and London. Elsewhere in England, it has become slightly easier, reflecting differential trends in house prices.

A key additional constraint is that even when young adults have a 10% deposit, they might not be able to borrow enough to purchase a home. Twenty years ago this was rare, but now almost four-in-ten young adults with a 10% deposit cannot borrow enough to purchase even one of the cheapest properties in their local area, and almost two-in-three cannot in London. Even if they could borrow more, it is not clear they would, as committing to service and repay the large mortgage implied by high prices may not be something that many young adults want to do.

The key to increasing homeownership is lower property prices, at least relative to young families' incomes. In the medium to long term, the way to achieve this is a greater, and more price-responsive (or elastic), supply of housing. Property prices are highest in south-eastern England (including London) not only because it is the richest area of the country, but also because the planning regime is far more restrictive there than in the Midlands and northern England.

A system that makes it easier for individuals and developers to build new homes in response to growing demand has four key benefits. First, a greater supply of homes would push down (or at least moderate) property prices, meaning more young adults are able to purchase a home. Second, more supply also puts downward pressure on private rents, benefiting the (on average poorer) section of society who will remain in private rented accommodation. Third, it would allow areas that face higher demand (for example, as a result of new job opportunities) to expand more easily, preventing localised increases in property prices. Fourth, it makes any other form of policy aimed at benefiting younger generations less likely to lead to increases in house prices. Without more elastic supply, policies to advantage first-time buyers, such as the Lifetime ISA or cuts to stamp duty – whatever their other merits – will risk increasing property prices further still.

As many others have acknowledged, it is not just how many homes are built, but where they are built. This chapter has also highlighted a clear geographic pattern to trends in prices and homeownership. The most productive and wealthiest parts of England are also those with the largest price increases and most restrictive planning constraints. As well as influencing the ability of young adults to buy, this has implications for a variety of other important issues not discussed in this chapter, including economic productivity, time spent commuting and inequality in access to job opportunities, all of which should be considered as part of the government’s approach to housing supply.