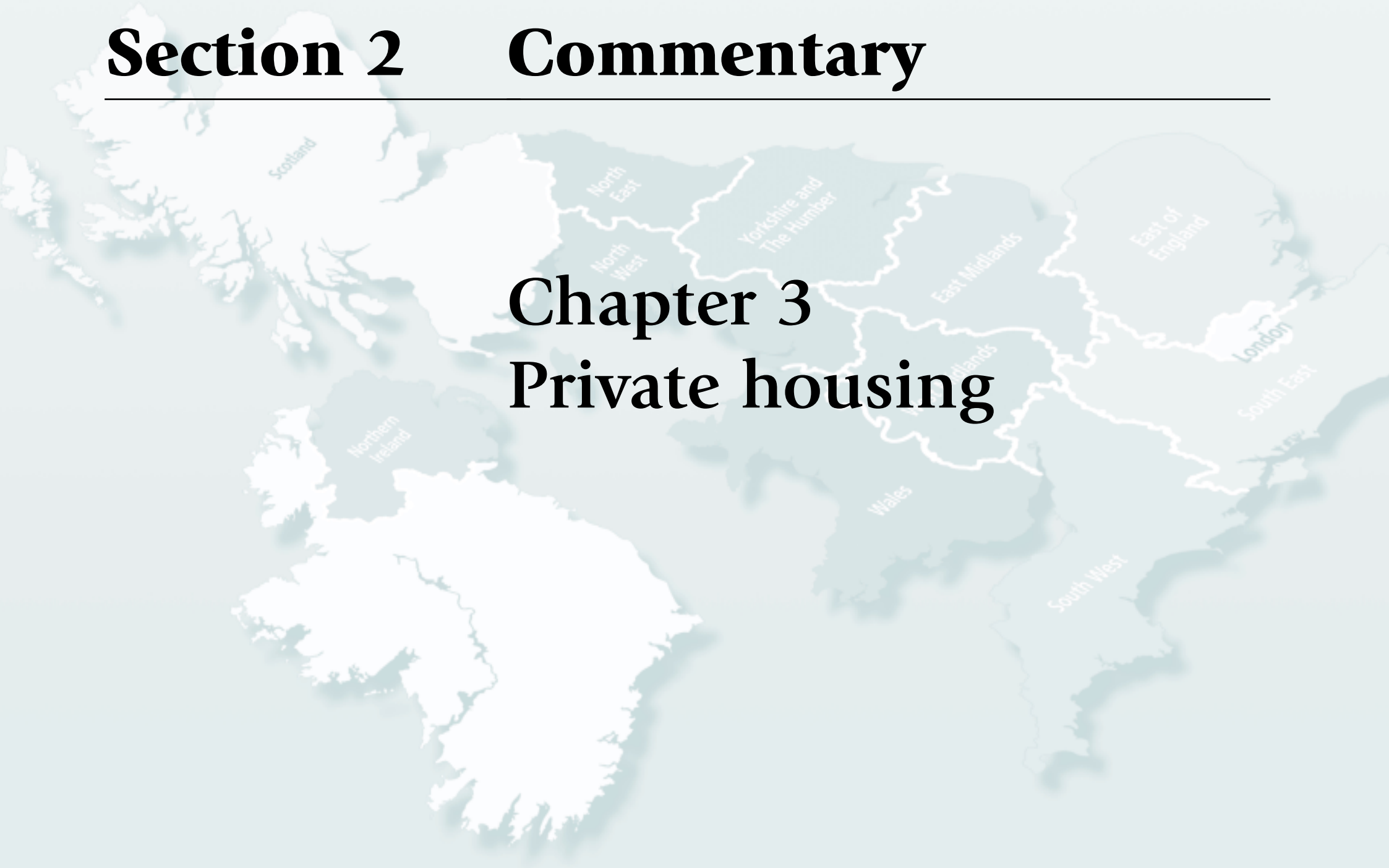
Section 2 Commentary



Chapter 3
Private housing

House price rises

In overall terms house prices in the UK rose an average 22 per cent in the UK in 2003 (Compendium Table 47a), in response to continuing economic growth and a further falls in interest rates. This rise reflects the change in the mix of properties being sold over the year, and in particular the sharp decline in the numbers of first-time buyers (from 527,000 in 2002 to just 359,000 in 2003), and the proportion of first-time buyers relative to purchases by existing owner-occupiers (Compendium Table 42).

On a mix adjusted basis (i.e. prices based on a standardised mix of properties in terms of type and size) house prices rose 16 per cent in 2003 (Compendium Table 47b). However, the average price paid by first-time buyers in the market rose by just 5.4 per cent in the year.

While the numbers of first-time buyers fell dramatically in 2003 this was largely offset by a sharp rise in the numbers of buy to let purchasers during the year (of which more below). Nonetheless there was a slight fall in the total number of property transactions in 2003 (Compendium Table 39a).

The Bank of England increased base rates five times in less than twelve months, in quarter point steps from 3.5 per cent in October 2003 to 4.75 per cent in August 2004.

The string of five quarter point increases in interest rates is likely to be reflected in an easing back of house price rises in the coming year. The possibility of a sharper market reaction, especially if there are further rate rises, and its implications for the wider economy, have already been discussed in Commentary Chapter 1. This modest rise in house prices for first-time buyers nonetheless saw average mortgage cost to income ratios for first-time buyers rise in 2003, to just under 19.6 per cent (Compendium Table 42a). While interest rates fell in 2003, the average incomes of first-time buyers in 2003 were nearly 10 per cent lower than 2002 (but still higher than in 2001).

The average first-time buyer deposit rose in cash terms to £26,783 in 2003, but remained virtually unchanged as a proportion of the average purchase price at 22.5 per cent. Nonetheless cash levels of average deposits have now risen fivefold since 1996, and the Survey of English Housing suggests that one in five first-time buyers rely on gifts or loans from families or friends to fund their house purchase. Indeed, a recent MORI survey found that almost a half of current home-owning parents expected to have to provide financial support to enable their children to enter the housing market. The average level of support parents envisaged providing was £17,000 (MORI, 2004).

A new affordability index

While the measures of house prices (and mortgage costs) against the incomes of first-time buyers are important market indicators they are not entirely satisfactory as measures of the relative difficulty of access to the home-owner market over time. There is a circularity in the data, in that it measures the incomes of those households that have succeeded in entering the market each year, rather than the incomes of those households that might wish to enter the market.

The costs of mortgages over time also reflect variations in the average levels of deposits over the years, as well as variations in interest rates. Yet the requirement for higher deposits is potentially just as much of a barrier to gaining access to the home-ownership market as increases in mortgage costs.

To overcome these constraints the editor has compiled a new housing market affordability index to be published each year in the *Review*, and also in ROOF, the Shelter housing magazine. The index shows the ratio of house purchase costs to incomes, and in that sense is comparable with Compendium Table 43a. There are, however, two critical differences.

The first is that while the new index is based on the same first-time buyer house prices it assumes a constant 15 per cent deposit (for all regions and the UK as a whole) over time. This is roundly based on the average UK level of first-time buyer deposits over the last decade. The consequence of this change is that the new index fully reflects from year to year the impact of changing house prices.

The second change is that the new index is based on the average gross household incomes of working households in each region, and not the incomes of

the households that succeed in purchasing in any particular year.

The income data has been specially commissioned from the Expenditure and Food Survey (previously known as the Family Expenditure Survey). To avoid erratic variations at the regional level the income data for each year is smoothed over three years. That is, each year's income figure is an average of the year in question, and the preceding and following years.

In the first instance it has only been possible to obtain income data from 1994, and consequently the new index, set out in Table 2.3.1 also commences in 1994. This shows how much more difficult house purchase has become over the years since 1994, although access was marginally easier in 2003 than 2002.

The mortgage cost to income ratios on which the index is based are set out in Table 2.3.2. One of the most striking results of the new index is that it shows that by 2003 access to home-ownership had become most difficult in the South West of England, where 19.7 per cent of average household earnings would be required to access the sector, compared to 19.1 per cent in the South East and 19.0 per cent in London. This is not because house prices are highest in the South West, but rather because incomes in the South West are that much lower.

Next year's edition of the *Review* will extend the new index backwards to the beginning of the 1980s.

Table 2.3.1 **Affordability index**

Based on first-time buyer house prices and average incomes for all working households

Country/Region	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
United Kingdom	**100.0**	**94.4**	**87.2**	**99.2**	**109.6**	**113.6**	**121.6**	**109.6**	**131.2**	**128.8**
North East	**100.0**	**92.9**	**88.9**	**92.9**	**111.1**	**112.1**	**117.2**	**97.0**	**99.0**	**98.0**
North West	**100.0**	**94.8**	**84.5**	**95.7**	**100.9**	**100.9**	**112.9**	**100.9**	**113.8**	**104.3**
Yorkshire & The Humber	**100.0**	**95.6**	**85.8**	**95.6**	**107.1**	**108.0**	**115.0**	**95.6**	**114.2**	**112.4**
East Midlands	**100.0**	**95.5**	**86.4**	**102.7**	**108.2**	**110.0**	**116.4**	**103.6**	**124.5**	**128.2**
West Midlands	**100.0**	**93.1**	**82.3**	**88.5**	**92.3**	**96.2**	**102.3**	**96.9**	**116.9**	**111.5**
East	**100.0**	**94.7**	**87.8**	**101.5**	**106.9**	**110.7**	**124.4**	**120.6**	**145.0**	**142.7**
London	**100.0**	**103.8**	**94.0**	**109.0**	**122.6**	**136.8**	**141.4**	**131.6**	**148.9**	**142.9**
South East	**100.0**	**91.5**	**83.8**	**94.4**	**107.0**	**108.5**	**121.8**	**115.5**	**138.0**	**134.5**
South West	**100.0**	**94.1**	**85.9**	**101.5**	**111.1**	**117.0**	**127.4**	**121.5**	**145.2**	**145.9**
England	**100.0**	**93.1**	**84.6**	**97.7**	**106.9**	**111.5**	**118.5**	**111.5**	**131.5**	**130.0**
Wales	**100.0**	**89.1**	**84.0**	**90.8**	**105.0**	**107.6**	**111.8**	**105.9**	**117.6**	**106.7**
Scotland	**100.0**	**98.9**	**94.6**	**103.2**	**128.0**	**134.4**	**130.1**	**117.2**	**125.8**	**115.1**
Northern Ireland	**100.0**	**115.5**	**109.5**	**131.0**	**154.8**	**158.3**	**167.9**	**148.8**	**164.3**	**146.4**

Source: Calculated from Survey of Mortgage Lenders and Expenditure and Food Survey data.

Table 2.3.2 **Mortgage cost to income ratios**

Based on first-time buyer house prices and average incomes for all working households

Country/Region	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
United Kingdom	**12.5**	**11.8**	**10.9**	**12.4**	**13.7**	**14.2**	**15.2**	**13.7**	**16.4**	**16.1**
North East	**9.9**	**9.2**	**8.8**	**9.2**	**11.0**	**11.1**	**11.6**	**9.6**	**9.8**	**9.7**
North West	**11.6**	**11.0**	**9.8**	**11.1**	**11.7**	**11.7**	**13.1**	**11.7**	**13.2**	**12.1**
Yorkshire & The Humber	**11.3**	**10.8**	**9.7**	**10.8**	**12.1**	**12.2**	**13.0**	**10.8**	**12.9**	**12.7**
East Midlands	**11.0**	**10.5**	**9.5**	**11.3**	**11.9**	**12.1**	**12.8**	**11.4**	**13.7**	**14.1**
West Midlands	**13.0**	**12.1**	**10.7**	**11.5**	**12.0**	**12.5**	**13.3**	**12.6**	**15.2**	**14.5**
East	**13.1**	**12.4**	**11.5**	**13.3**	**14.0**	**14.5**	**16.3**	**15.8**	**19.0**	**18.7**
London	**13.3**	**13.8**	**12.5**	**14.5**	**16.3**	**18.2**	**18.8**	**17.5**	**19.8**	**19.0**
South East	**14.2**	**13.0**	**11.9**	**13.4**	**15.2**	**15.4**	**17.3**	**16.4**	**19.6**	**19.1**
South West	**13.5**	**12.7**	**11.6**	**13.7**	**15.0**	**15.8**	**17.2**	**16.4**	**19.6**	**19.7**
England	**13.0**	**12.1**	**11.0**	**12.7**	**13.9**	**14.5**	**15.4**	**14.5**	**17.1**	**16.9**
Wales	**11.9**	**10.6**	**10.0**	**10.8**	**12.5**	**12.8**	**13.3**	**12.6**	**14.0**	**12.7**
Scotland	**9.3**	**9.2**	**8.8**	**9.6**	**11.9**	**12.5**	**12.1**	**10.9**	**11.7**	**10.7**
Northern Ireland	**8.4**	**9.7**	**9.2**	**11.0**	**13.0**	**13.3**	**14.1**	**12.5**	**13.8**	**12.3**

Source: As Table 2.3.1.

However, in the interim it has been estimated that the mortgage cost to income ratios in 2003 remain rather lower than during the last housing market boom. An initial analysis using household income data from another source suggests that the average UK ratio in 1990 would have been about 20 per cent.

While the further house price rises in 2004, and the higher level of interest rates, will clearly result in higher mortgage cost to income ratios they still look set to remain some way below the peak 1990 levels.

Buy to let

The continuing growth in the market for 'buy to let' mortgages can be seen in Compendium Table 55. Some 188,000 new buy to let mortgages were advanced in 2003, and there were over 400,000 buy to let mortgages outstanding at the end of 2003. Altogether, buy to let purchasers represented about a third of the new entrants to the housing market in the year; as the numbers of first-time buyers (with mortgages) fell to just under 360,000.

Despite the dramatic rise in the numbers of buy to let mortgages, there were still no signs of any significant growth in the overall size of the private rented sector by 2002/03 (Compendium Table 54). While the Survey of English Housing data suggest that the numbers of private lettings did rise by some 70,000 in 2002/03 this simply offset the decline in the previous year. Overall, the numbers of private lettings in 2002/03 still remained lower than the levels found in the mid 1990s, before the emergence of the buy to let phenomena.

However, the provisional results from the 2003/04 Survey of English Housing do suggest a substantial rise in the numbers of private lettings compared to 2002/03, and that the continuing rise in buy to let investment has now begun to have a significant impact on supply.

Landlords with buy to let mortgages are now a substantial part of the sector, accounting for more than a quarter of all assured (including assured shorthold) tenancies in the market. Surveys in the mid 1990s found that at that time only one in eight landlords had acquired their properties with loans (Kemp, 2004).

With house price rises now set to moderate (if not fall) it is likely that the numbers of new buy to let mortgages will also fall. However, a recent survey found that most buy to let landlords see their investment as relatively long-term (and often as part of their pension planning), and that most are therefore likely to stay in the market even if house prices do begin to fall (Rhodes and Bevan, 2004).

The more problematic issue for buy to let landlords is the recent rounds of interest rate rises, which will significantly increase their operating costs, without an equivalent increase in potential rental incomes. In some cases this will result in landlords making short-term operating losses, and they may then need to exit the market.

References

P. Kemp, *Private renting in transition*, Chartered Institute of Housing, 2004.

MORI, *Homeowners: Sons and Daughters, a survey of parents who are owner-occupiers*, Joseph Rowntree Foundation, 2004.

D. Rhodes and M. Bevan, *Private landlords and buy to let*, Centre for Housing Policy, University of York, 2003.

Key Reading

Housing Finance, Quarterly Journal of the Council of Mortgage Lenders.

Compendium of Housing Finance Statistics, Council of Mortgage Lenders, 1997.