Chapter 3
Private housing

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Boom but no bust?

The private housing market has received much media attention during 2021, because of both the continued price boom and the on-going cladding and fire safety scandal that dominates the lives of many of those living in flats. We discuss the latter in Commentary Chapter 2. Here our focus is upon the housing market itself, both rental and owned, with renting discussed in detail in Contemporary Issues Chapter 2.

Last year we reflected on the difficulties of forecasting outcomes given the pandemic. Although in 2021 the market remained open (with lessons having been learned), it was far from a 'normal' year with uncertainty abounding (see Commentary Chapter 1 on economic prospects) alongside evolving policy changes. The market proved far more buoyant than had been forecast in late 2020, and indeed by mid-2021 price expectations for the year were revised upwards by a significant margin, for example, by Savills from four per cent to nine per cent. The Scottish Fiscal Commission in its 2021 *Economic and Fiscal Forecasts* commented:[1]

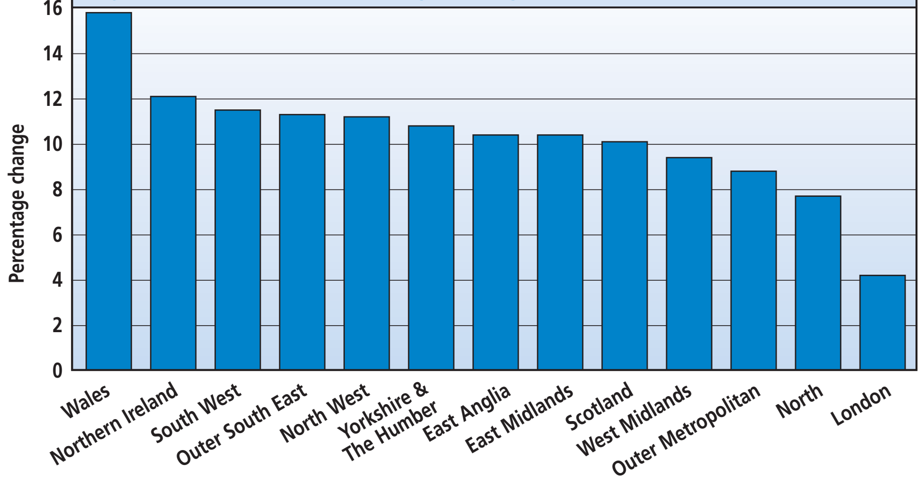
> *'Because the price growth in 2020-21 was far larger than we have seen in recent years, it's difficult to judge whether this is a permanent rise in the average house price, or simply driven by changes in the housing market because of the pandemic. This is the most significant source of uncertainty in our [general] forecast.'*

What is also striking in that report is how this strong house-price effect impacts on other aspects of the Scottish forecast. Depending upon the index used, 2021 ended with UK house prices up by over ten per cent on an annual basis – with Nationwide noting it was the largest annual increase since 2006.[2] Later we return to the 2022 outlook.

Prices, transactions, mortgages and rents

Figure 2.3.1 shows Nationwide's national/regional indices for the fourth quarter of 2021 with the Welsh market performing very strongly – prices up on an annual basis by nearly 16 per cent – followed by Northern Ireland at 12 per cent. Nationwide noted that this was the first time Wales had topped their index in 48 years. London, by contrast, had the weakest market. As we go on to argue, these figures partly reflect the reworking of the housing market that has been underway throughout the pandemic, as well as the impact of the transaction tax holidays across the UK.

Figure 2.3.1 **Annual percentage change in house prices, Q4 2021**



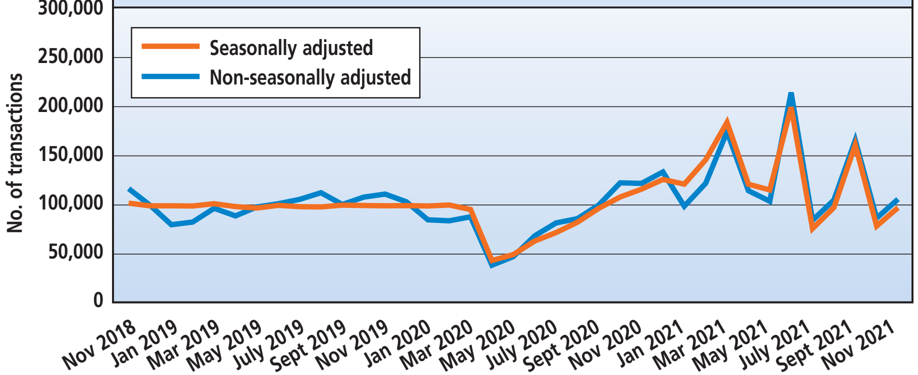
Source: Nationwide Building Society.

Transactions

Figure 2.3.2 shows both seasonally and non-seasonally adjusted transactions data for the UK over the three years to November 2021. Transactions in 2021 have been on something of a roller coaster with peaks and troughs reflecting the phasing of and changes to the transaction tax regime in different countries, though it should be clear that it is the position in England which is driving the numbers overall. Data are provisional given the backlog to be processed, but there is clear evidence of transactions being brought forward to beat the ending of the tax holidays in September. Unsurprisingly in October 2021 residential sales halved but this was followed by a slight bounce back in November.

Transactions in 2021 were at their highest since 2007 with roughly one in 16 privately owned homes changing hands.3 As Bob Pannell notes, existing homeowners moving home were big users of the tax holiday scheme with some 489,000 moving in the year to September with a mortgage (plus of course there would have been cash buyers).[4] Buy to let landlords were also active in this period buying more than 110,000 homes, notably in the most pressured areas of Southern England.

Figure 2.3.2 **Seasonally and non-seasonally adjusted UK residential property transactions, 2018-2021**



Source: HMRC.

Mortgages

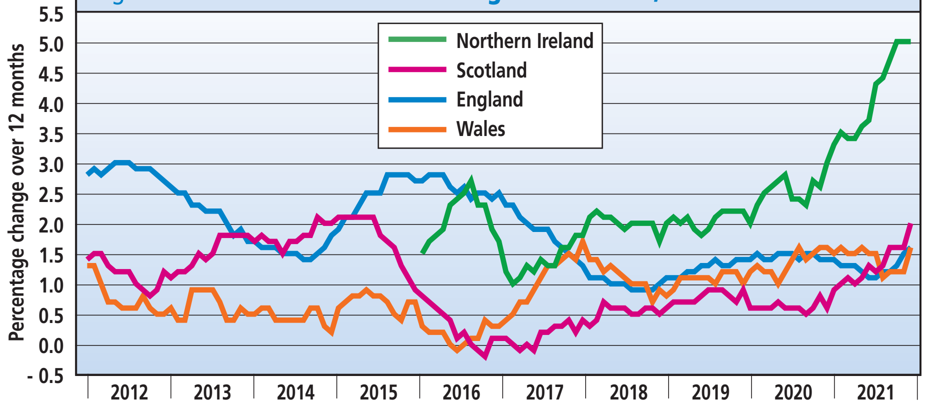
2021 saw the mortgage market growing with gross advances estimated by UK Finance at £316 billion, the highest nominal level since the peak year of 2007 (£363 billion); however, the 2021 figure was still some £200 billion below the 2007 value in real terms. Mortgage approvals followed the same pattern as transactions but were trending downwards towards the end of the year. Mortgage rates fell during the year, driven by competition and the continued low base-rate. For example, the charge on a variable rate 90 per cent loan-to-value (LTV) loan fell from an average quoted rate of 3.63 per cent in January to 2.02 per cent in November; while 95 per cent LTV loans became markedly more competitive dropping from 4.16 per cent on a two-year fixed rate to 2.91 per cent in the same period, according to the Bank of England (BoE) database. There was then a slight uptick in December following the BoE rate rise (more within the lower LTV bands), though it is important to note that around three-quarters of borrowers are on fixed-rate mortgages. Such was the demand for mortgages (as well as the challenges of remote working and Covid-19) that some lenders struggled to maintain service levels. The number of mortgage products increased sharply in 2021 to over 5,000 in December thus recovering the ground lost after the market contraction in 2020, not least at 95 per cent LTV where the government's short-term mortgage guarantee scheme has also had an impact.

Private rents

As Figure 2.3.3 details, the ONS experimental index suggests that private rents in Northern Ireland have been rising fastest over the last 12 months and in something of a contrast to flatter trends in England and Wales, at least until recently. Scotland's rents have also been increasing more quickly and in 2021 rose slightly faster than in England after a longer-term slowdown in rental growth. However, industry commentary elsewhere from various sources[5] would give a somewhat more qualified view, noting that at a UK level rental growth in the third quarter was strong – running at 4.6 per cent (6.0 per cent if London at 1.6 per cent were to be excluded). Paragon noted the reduction in buy to let mortgages and the overall shrinkage in the PRS stock – down from 20.3 per cent in 2016/17 to 18.7 per cent in 2019/20 in England, although with uncertainty about the data.[6] Hamptons highlighted a sustained though slowing exit by landlords, a view backed by a Centre for Housing Policy report on the lower end of the English PRS.[7] This highlighted the many and varied reasons for landlord exits from this market segment while suggesting that in fact only a small minority will choose to do so.

All this indicates how varied the PRS is by type of home, tenant, area and landlord motivation and all arguing for a far more sophisticated understanding of this diverse and changing market. The apparent contraction may reflect policies in

Figure 2.3.3 **Index of Private Housing Rental Prices, 2012-2021**

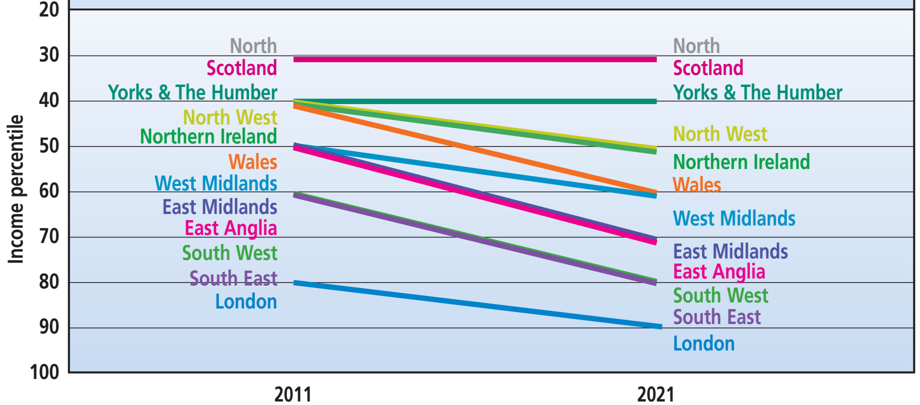


Source: ONS Index of Private Housing Rental different parts of the UK where efforts are being made to improve the quality and performance of the sector. Despite this there is some evidence that an increasing number of middle-age and older households are opting to rent rather than own.[8] With tight supply and strong demand, rental markets including that of inner London are bouncing back – a view supported by the RICS in its November release.[9] It predicted a four per cent rise in rents over the next twelve months with this trend being sustained in the medium term.

Affordability

The *UK Housing Review's* annual Affordability Index (Compendium Table 45a) shows the long-term trends by region and country (since 1994), the deterioration in affordability in the run up to the 2007/08 crisis and subsequent improvements before the market strengthened again in recent years. Nationwide Building Society's recent report on affordability and its Q4 house price index highlight the gaps in affordability by country and region, with worsening conditions in most parts of the UK.[10] Figure 2.3.4 looks at where on the income spectrum the typical buyer of a home at the average price for first-time buyers (FTBs) in each country/region would have been in 2011 compared with 2021.[11] In East Anglia and the East Midlands, the typical buyer has moved up from the 50th income percentile to the 70th since 2011 and in London, the South West and South East into the 80th income percentile, up from the 60th ten years previously. Scotland and the North remain at the same level but Northern Ireland and Wales both show a deterioration. Little wonder that both income multiples and deposits for FTBs have been rising.

Figure 2.3.4 **Income percentile of typical buyer by country/region 2011 and 2021**



Source: Nationwide Building Society.

However, looked at on a mortgage-cost-to-income basis (Table 45b in the Compendium), we can see that the ratios have generally improved over the decade or more since the global financial crisis – even in London. Thomas refers to this as the mortgage-affordability paradox:[12] that alongside a record national high in terms of the house-price-earnings ratio (in June 2021 at 8.8) we then have these relatively low cost-to-income ratios – a product of falling interest rates – which in turn have helped fuel record house prices.

First-time buyers

Yorkshire BS recently estimated[13] the number of FTB house-purchase loans for the full year 2021 at 408,379, up from 303,000 in 2020 – a 35 per cent increase and topping the 2006 figure of 400,900 (but well below the 531,800 in 2002). Given the affordability challenges highlighted above this would seem to be a product of both the greater availability and reduced cost of higher LTV loans through the year, together with the transaction tax holidays as well as accumulated savings during the pandemic lockdown. In addition, as the Yorkshire release reminds us, some 60 per cent of FTBs are in the top 40 per cent of the income distribution, where the improvement in household finances was strongest. And there is the Bank of Mum and Dad (BOMAD) with Savills suggesting that in 2021 there will be a record 'payout' of £10 billion of gifts and loans supporting almost half of FTB transactions.[14]

The changing geography of demand and the structure of homeownership

Housing markets across the UK are undergoing something of a reset as a consequence of the on-going pandemic and the related reworking of the labour market, including the relationship between home and work. The initial 'race for space' focused on moves out of smaller, more centrally located homes in urban centres, often flats, with households relocating to outer suburbs or indeed much further away. With the restructuring of the working week around no or few days in the office some households found it possible to buy bigger and better and further away at no extra cost other than a longer, more expensive and less frequent commute. As the economist Andrew Oswald comments in the latest *FT Economists* survey:[15] 'The search by well-off people for rural properties (with plenty of land) is likely to become intense. Pandemics make humans buy space.'

Evidence is still fragmentary and the process is still unfolding. Anecdotally there is some evidence of a 'return to the city' as some employers and employees rethink the arrangements. The FT survey reports Hamptons suggesting that 2021 will mark the largest out-migration from London for at least 20 years. Their research indicates that some 113,000 homes were bought outside the capital by London residents – a 62 per cent rise on 2020 – spending some £55 billion in the process. It indicates that 57 per cent of these buyers were existing owners moving out of the capital while a further 24 per cent were FTBs – making up some 38 per cent of all London FTBs. Overall, the movers sold London property worth around £34 billion and traded an estimated 239,000 bedrooms in London for 275,000 bedrooms elsewhere!

Of course, this has consequences and, for example, the surge in prices in Wales must partly be a product of such moves, but the same story is repeated in smaller cities, towns and villages across the UK as households migrate, putting further pressure on local markets and people. Some migrants will also retain their London (or other city) property as a rental (and as a safeguard for the future), thus shrinking the supply of cheaper homes for purchase in the capital or elsewhere.

Reflecting on the market more generally, Compendium Table 30a highlights the steady rise in outright homeownership in England over the decades since 1990. However, Hamptons suggest this is likely to start falling, as older outright owners die and are replaced by mortgaged younger owners.[16] This is significant because the scale of outright ownership does cushion the housing market to some extent, whether in terms of BOMAD support, remortgaging or reducing the impact of rate rises. If households carry mortgages further into later life – which they will, given older age of entry and longer mortgage terms – the market becomes more constrained and may put the current level of homeownership under more pressure. Much turns on the inheritance process and who will benefit from it.

The changing shape of the PRS

We have already noted the shrinkage of the PRS since 2016/17 in England, with a similar trend in Scotland, and according to a range of official sources the number of households in the sector was down a further 2.6 per cent in GB over the twelve months from March 2020,[17] though as noted earlier the latest figures should be treated with caution. Alongside tenants taking advantage of the tax holiday to buy their own homes, there were also moves out of the PRS by young adults who could move back to the parental home and more space. At the same time there was evidence of a reduction in turnover because of greater uncertainty, resulting in some households choosing to hold off decisions about buying and/or moving; many landlords chose to reduce rents in order to help tenants and reduce instability. Some landlords also took full advantage of the transaction tax holidays to buy more homes as noted above and to refocus their portfolios on single family dwellings.[18] So, as this suggests, a number of contradictory trends were evident.

At the same time the still nascent build to rent (BTR) sector has continued to gather momentum. A second report on who lives in build to rent in London highlighted the similarities and differences between it and mainstream PRS – more sharers and more 25-34 year olds in BTR and more middle-income earners – though for much else the two have much in common.[19] The British Property Federation (BPF) 3rd Quarter 2020 survey highlighted continued growth with 205,525 build to rent homes in the UK of which 63,950 are complete, 42,032 under construction and 99,543 at planning stage. London dominates with a total of 88,893 units of all categories. However, as is clear from the data, most homes are still not complete and of course the market context has been changing.

Little wonder that the BTR industry has been calling for the government to exclude it from the residential developer property tax proposals published in September 2021.[20] The government has exempted registered non-profit providers from this tax and clarified that where BTR was developed and held by the same company no tax would be payable. However, as the BPF argues, this would leave quite a lot of the BTR sector still in scope.[21]

Policy interventions and the Bank of England's FPC recommendations

Extensive mention has already been made of the changes to transaction taxes across the UK. The Office of Tax Simplification undertook a review of both inheritance tax and capital gains tax in relation to private residences in 2020/21,[22] but in the end the chancellor accepted only relatively minor adjustments to the two regimes,[23] although the changes will have significant implications for landlords,[24] reducing incentives to take on that role.

The Bacon Review into self-build housing[25] was published in 2021 and resulted in the government moving ahead with the introduction of its new Help to Build equity-loan scheme. Modelled on the outgoing Help to Buy scheme, it provides equity loans for up to 20 per cent (up to 40 per cent in London) of the total estimated cost of the new home (which cannot be more than £600,000 including the cost of the land and no more than £400,000 on the building cost). £150 million has been set aside for the scheme to deliver up to 30-40,000 homes each year. It is hoped this will trigger the creation of a strong self-build sector as seen in other parts of the UK, for example Scotland, as well as elsewhere in Europe, making an important contribution to housing supply.

Over a year ago the BoE announced a review of its Financial Policy Committee's (FPC) macro-prudential controls on mortgage lending, introduced in 2014. The report and its conclusions were issued in December 2021.[26] Noting the contraction in the proportion of younger households who own their own home, down from around two-thirds of 25-34 year-olds in 1991 to around two-fifths now, the report examines the causes of this decline and possible explanations.

Perhaps unsurprisingly the Bank argues that the controls – the affordability test (a three per cent rate increase within five years) and the flow limit – have had only a marginal impact on access. Instead, it argues that the main driver of the fall has been rising house prices relative to incomes, and the need for ever-bigger deposits. This thorough report does accept that the controls have had some impact and that these have been most significant in the most pressured markets. The BoE recommends that it drops its affordability test but keeps the flow limit (limiting loans with a loan-to-income ratio above 4.5 to no more than 15 per cent of the book), alongside the existing FCA mortgage conduct of business regulations around affordability. Decisions about these recommendations will be taken during 2022 but if implemented they would seem likely to trigger increased demand and further house-price rises.

Where next?

As might be expected we go into 2022 with a range of views as to how the market might perform. Many analysts assume there will be a flattening in price rises as the impact of the tax holidays fades away.[27] The latest (December 2021) HM Treasury comparison of independent forecasts for the UK economy[28] gives a Q4 2021 to Q4 2022 house-price forecast from some 12 organisations. The range is from +5.6 per cent to -0.6 per cent with a median of +2 per cent. The OBR's own forecast is 1.3 per cent. This highlights both agreement that house-price inflation will come down, and wide disagreement as to where it might settle. Across lenders, estate agents and property websites the spectrum of house-price forecasts is of increases from around 2-5 per cent by December 2022 but with considerable variations by area and market. Considerable uncertainty evidently still exists.

Expectations for transactions are also lower, probably around 1.2 million compared to 1.5 million in 2021. In passing we should note how wrong the forecasts for 2021 proved to be – as can be seen from the 2021 *Review* (p.64) industry expectations were for 855,000 transactions in 2021 with declines also in gross and net mortgage lending. The reality was very different, so any figures should be treated with caution. If more property is released onto the market in 2022 by existing owners, then this will increase downward pressure on prices but much will turn on how the pandemic progresses, the degree of consumer confidence and the scale of any continued appetite to adjust living spaces triggered by Covid-19 (but also downsizing baby-boomers). Alongside these factors is the forward trajectory for interest rates and wages – a cocktail of factors which may take the market in largely unanticipated directions.

Similar debates surround rents and the private rented sector. Different agencies anticipate stronger or weaker growth in rents, partly dependent on their view of the likelihood of supply tightening if more landlords exit the sector. 2022 will see the publication of the government's white paper on the PRS in England, the so-called Renters' Reform Bill. This could usher in important legislation to remove 'no fault' section 21 evictions from the Housing Act 1988 and replacing them with a more comprehensive section 8. It may also bring in lifetime tenant deposits aimed at reducing the cost of moving between rental properties, and finally make the database of rogue landlords and letting agents more accessible and transparent. The new regime would come into force in 2023 or later. This plus new requirements on energy efficiency, changes in corporation tax for companies and in some areas increased regulation will reduce profits and increase costs. All this will lead some landlords to consider their future. However, the PRS continues to offer attractive returns compared to most other assets and the scale of transactions activity by landlords noted earlier suggests there is still a considerable appetite to invest in the sector.

Notes and references

1 Scottish Fiscal Commission (2021) *Economic and Fiscal Forecasts*, December. Edinburgh: SFC.

2 Nationwide House price Index, December 2021 (see www.nationwidehousepriceindex.co.uk/reports/uk-house-prices-end-the-year-at-a-record-high-with-annual-price-growth-in-double-digits).

3 See www.zoopla.co.uk/discover/property-news/one-in-every-16-homes-to-change-hands-in-2021/

4 Pannell, B (2021) *Market Briefing*, December 2021, IMLA, London

5 See https://advantage.zpg.co.uk/wp-content/uploads/2021/11/UK-Rental-Market-Q3-FINAL-2.pdf; www.hometrack.com/uk/insight/rental-market-report/q3-2021-rental-market-report/; www.paragonbankinggroup.co.uk/news/insights/prs-facing-supply-crisis; www.hamptons.co.uk/research/articles/sizing-up-the-second-home-surcharge#/

6 The *English Housing Survey Quality Report* highlights a number of problems, notably around the PRS reporting.

7 See www.york.ac.uk/media/chp/documents/Sustainable-Private-Rented-Sector.pdf

8 See an ONS study in 2020 (www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/ageing/articles/livinglonger/changesinhousingtenureovertime).

9 See www.hamptons.co.uk/research/articles/inner-london-rental-growth-turns-positive-for-the-first-time-since-the-pandemic-began#/; www.rics.org/uk/news-insight/latest-news/press/press-releases/supply-drought-causing-grief-for-growing-numbers-of-future-house-buyers/

10 See www.nationwidehousepriceindex.co.uk/reports/uk-house-prices-end-the-year-at-a-record-high-with-annual-price-growth-in-double-digits and www.nationwidehousepriceindex.co.uk/reports/affordability-special-report-raising-a-deposit-still-the-biggest-hurdle-for-first-time-buyers-despite-affordability-becoming-more-stretched

11 Using ASHE data the calculation is based on individual adult full-time workers with an 80% LTV loan on a home priced at the FTB average for that region

12 Thomas, R. (2021) *The mortgage affordability paradox.* London: IMLA.

13 Yorkshire BS (2022) *Number of First Time Buyers hits 20 year high*, press release, 4 January.

14 Savills (2021) *Bank of Mum and Dad to hit record high in 2021 with a £10 billion handout*, Savills News, 23 December.

15 See www.ft.com/content/001d12df-4420-4cf2-8198-0cbe3532f6bd

16 *Financial Times* (2021) 'Growth in outright home ownership predicted to stall', Personal Finance, 2 December.

17 See https://www.shawbrook.co.uk/media/4170/b2b-btlreport-20210820.pdf

18 CBRE Residential (2021) *Safe as houses: Why investors are Heading for the Suburbs*. London: CBRE.

19 See https://bpf.org.uk/media/3605/who-lives-in-build-to-rent-1.pdf

20 See www.gov.uk/government/publications/residential-property-developer-tax-draft-legislation

21 See https://bpf.org.uk/our-work/consultation-responses/

22 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935073/Capital_Gains_Tax_stage_1_report_-_Nov_2020_-_web_copy.pdf and subsequent final report

23 See www.gov.uk/government/publications/chancellor-responds-to-ots-reports-on-inheritance-tax-and-capital-gains-tax

24 See www.nrla.org.uk/research/special-reports/LSE-report-taxation; the report usefully covers the latest changes and also those over recent years.

25 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1013928/Bacon_Review.pdf

26 See www.bankofengland.co.uk/financial-stability-report/2021/december-2021

27 See Thomas, R. (2022) for the most up to date view (www.imla.org.uk/resources/publications/the-new-normal-prospects-for-2022-and-2023.pdf).

28 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040871/Forecomp_December_2021.pdf