

Affordability - are parents helping?

- Affordability continues to be stretched, particularly for younger households. But despite this, numbers of first-time buyers have been surprisingly resilient.
- Demographic factors mean that there will be increasing numbers of young households forming over the coming years. This should help numbers of first-time buyers to hold up relatively well.
- Over the past decade first-time buyers appear to be relying more and more on parents and others to help with their deposit. We estimate that 38% of first-time buyers under 30 – roughly 80,000 in number – got such financial assistance in 2006.
- There is significant regional variation in the extent to which young adults rely on such help, reflecting the severity of the affordability challenge faced. The need is most pronounced in Northern Ireland and the south of England.
- London is unusual in combining strong first-time buyer activity and heavy dependence on financial help, with assisted first-time buyers representing a fifth of all house purchases for owner-occupation.
- Assisted and unassisted first-time buyers have different risk profiles. Assisted buyers have low LTVs because they can put down substantial deposits, but borrow more in relation to their income. In contrast unassisted buyers have higher LTVs but lower income multiples.
- Where there are specific risks, there is some evidence that borrowers mitigate these through greater use of products such as fixed rates and flexible mortgages.
- The dilemma inherent in parents using their housing equity to help their children become home-owners, as for government initiatives to increase home-ownership, is that the aggregate impact may be to render home-ownership less affordable for others. This emphasises the crucial importance of expanding the longer-term supply of housing.

Introduction

As house prices have moved inexorably upwards and the prospect of home-ownership accelerated away from the grasp of young adults, the issue of housing affordability has demanded the attention of lenders, financial advisers, policy-makers and the media. The latest *Housing Market Report* affordability numbers amply demonstrate the severity of the pressures facing would-be first-time buyers. These show that a typical two-income British couple buying their first property in Q4 2006 would have had to commit 34% of their take home pay to meet their initial mortgage payments, the highest level since 1990.

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In the UK's property-owning democracy, the status of home-ownership serves as something of a totem for the health of the nation. The home-ownership rate in the UK was 70% in 2005, the latest year for which data are available. Pannell (2007) indicates that the desire for home-ownership in the UK is at near-record levels, with 78% of adults aspiring to be owner-occupiers in two years' time and 84% in ten years' time.

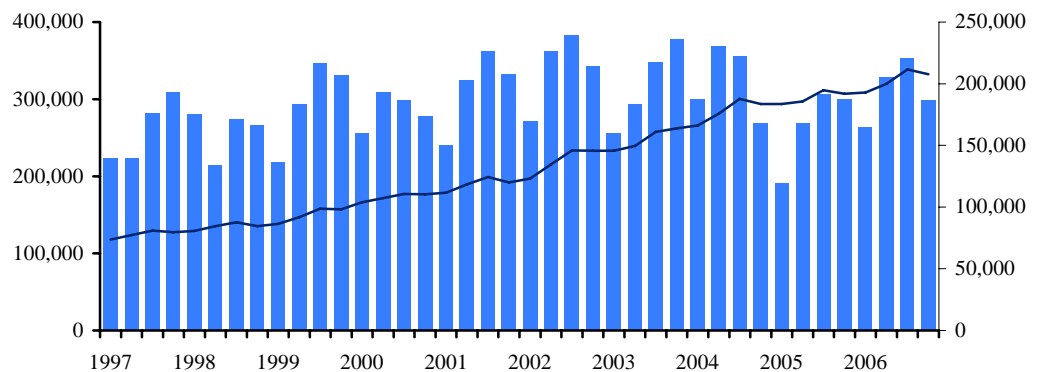
Williams (2007) looks at the many challenges facing the government if it is to meet its objectives of increasing home-ownership by one million households by 2010 and moving towards 75% home-ownership over the longer-term. But enabling large numbers of young households to enter into home-ownership for the first time represents a crucial element to achieving this. There are of course substantial affordability problems facing this group, and that is the focus of this paper.

But there is something of a puzzle here, because the number of first-time buyers has in fact been surprisingly resilient. This article tries to reconcile these findings by exploring the changing profile of those fortunate enough to be able to enter home-ownership. It then goes on to look at the credit risk features of first-time buyers, before assessing the prospects for future affordability and home-ownership. But we begin by describing recent market developments.

Background

Anyone looking quickly at the housing market might be forgiven for concluding that conditions are relatively favourable. When house price increases cooled in 2005, many commentators predicted that the housing market "bubble" would burst, aggravating the weakness of the wider economy. But these fears have proved unfounded. The wider economy has picked up and house prices have revived over the past year.

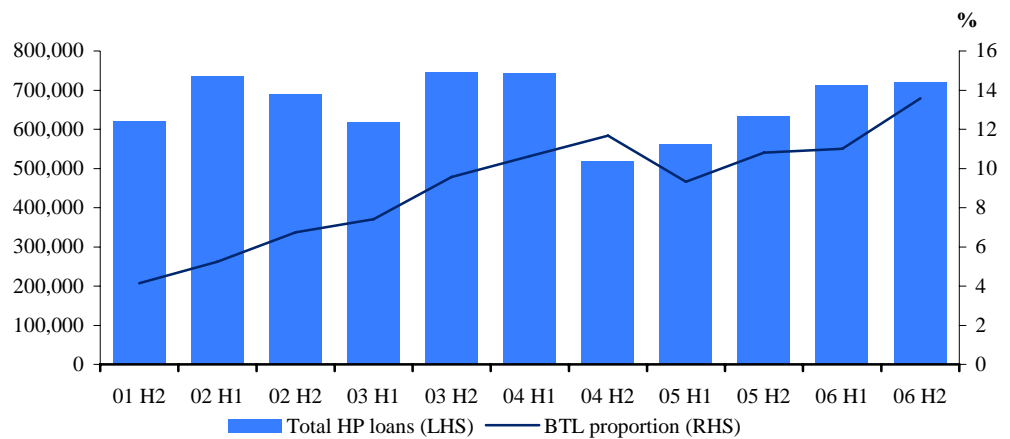
Chart 1: House prices and transactions, England and Wales



Source: HM Land Registry

But the overall numbers do not tell the whole picture. Last year's revival in the popularity of buy-to-let activity undoubtedly helped to support the housing market recovery. Buy-to-let lending grew by 57% to £38.4 billion in 2006. Although a substantial slice of this lending now represents refinancing, we estimate that buy-to-let investors bought more than 170,000 additional properties last year. This represented over 12% of total house purchases, up from around 10% in 2005 and just 4% five years ago.

Chart 2: Approvals for house purchase loans and buy-to-let house purchase completions

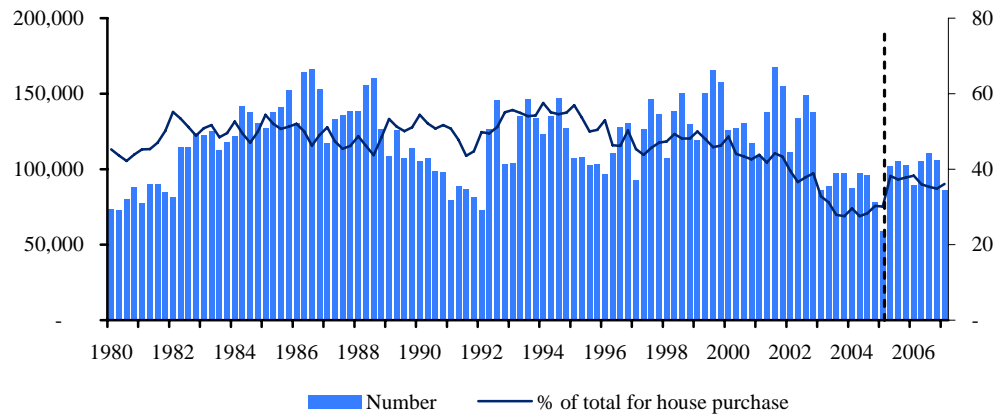


Source: Bank of England, CML, Research
 Notes: Bank of England figures for approvals include BTL purchases, but do not identify them separately. Approvals and completions figures are not always comparable due to timing issues. However on a half-yearly basis approvals and completions may be assumed to be broadly equivalent.

Despite greater buy-to-let activity, the number of house purchases for owner-occupation also grew last year.

A change in data sources in 2005 from the now discontinued Survey of Mortgage Lenders (SML) to the new Regulated Mortgage Survey (RMS) means that there is a degree of uncertainty about the recent behaviour of first-time buyers. Tatch (2006a) explains why estimates of lending to first-time buyers based on the RMS are materially different from earlier ones drawn from the SML. Reassuringly, the RMS-based estimates appear to be much closer to updated first-time buyer numbers based on Holmans (2005) and drawn principally from data in the Survey of English Housing. But while precise comparisons are not possible, we can at the very least be confident that since 2004 there has not been a decline in first-time buyer activity as a proportion of house purchase lending.

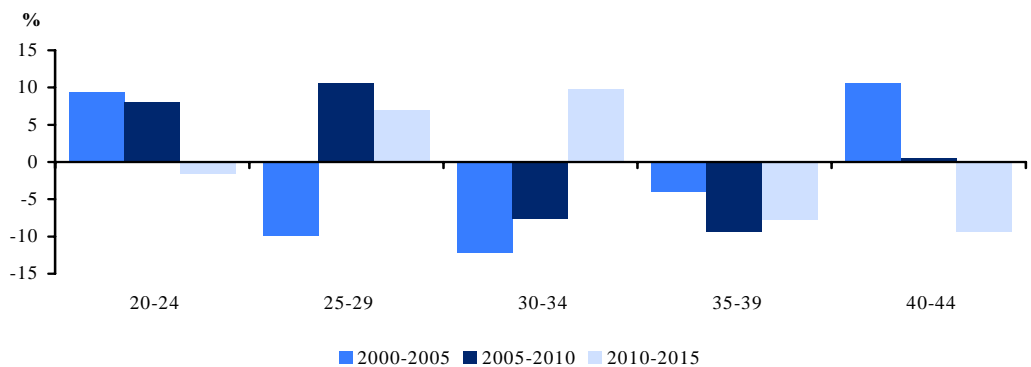
Chart 3: Number and proportion of first-time buyers



Source: Survey of Mortgage Lenders, Regulated Mortgage Survey, CML/BankSearch
 Notes: Absolute numbers pre April 2005 are not strictly comparable with those after that point

It is important to take into account demographic factors in order to better understand first-time buyer trends. The propensity to become a first-time buyer is highest among 18-34 year olds, but there has been significant change in this age group. The adult population aged under 35 peaked in 1991 at a shade below 15 million, but then subsequently fell by 11% to 13.3 million by 2004. In exploring the links between first-time buyer activity, demographics and economic and social factors, Smith (2005) finds that since the late 1990s the propensity to become a first-time buyer has fallen away sharply among younger households. Other things being equal, one might expect that these factors have combined to depress the number of first-time buyers and contribute to an upwards movement in their typical age.

Chart 4: UK population change by age cohort



Source: Government Actuary's Department
 Note: 2004-based projections

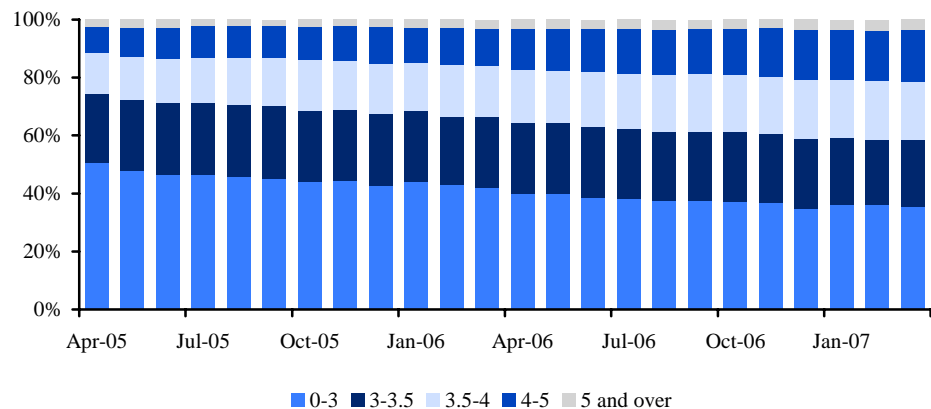
But 2004 marked the low point for the numbers in the 18-34 age group, and this is set to increase once more over the next decade or so. It seems reasonable to think that some of the apparent

resilience of first-time buyer numbers in the past couple of years reflects this changing age profile.

Income multiples

Since 2004 first-time buyer activity has (at worst) remained stable, but at the same time affordability has become increasingly stretched (see Chart 5), with the typical income multiple for a first-time buyer standing at 3.3 in Q1 2007. Whilst 3.3 times income is not a worryingly large amount to borrow, whether on a single or joint income basis, what is more telling is the upward trend (this was 3.13 in December 2005, but has risen steadily since). And an overall average figure masks the fact that some loans are taken out at significantly above (and below) this amount in each period. In April 2005, 11% of loans to first-time buyers were taken out at over four times income, but by March 2007 this had risen to 21%.

Chart 5: Income multiples, first-time buyers



Source: Regulated Mortgage Survey, CML/BankSearch

Loan to valuation ratios

Of course, lenders take more than just income multiples into account when assessing a loan application, and will often be prepared to lend more to a borrower with a larger deposit, all other things being equal. In 2006 the typical first-time buyer took out a loan at 90% of the property value and in fact this has been broadly static since the late 1990s. As with income multiples there is substantial variation around the average loan-to-value ratio, with many borrowers providing quite substantial deposits. In 2006 over one in five first-time buyers provided a deposit of more than their reported annual income, and one in ten provided a deposit of more than twice their income.

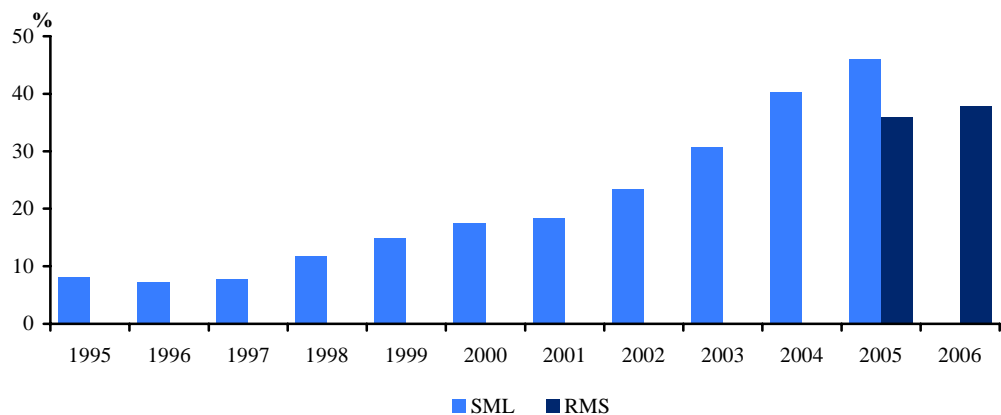
Not all first-time buyers are the same

We know that there are several different types of buyer present within reported first-time buyer numbers. Holmans (2005) presents evidence from the Survey of English Housing (SEH), indicating that about a fifth of reported first-time buyers are actually returning owner-occupiers. Such "returners" are captured in first-time buyer numbers if they did not own a property at the time of their current purchase, and will for example include some individuals who have been working abroad for a period or those leaving a failed relationship where a property was jointly owned.

"Returners" tend to be older than true first-time buyers, which is unsurprising given they have already owned a property before. For the most part, they are also likely to be able to put down substantial deposits from the proceeds of the sale of a previous property. Because of these marked differences in their profile, analyses of overall first-time buyer data can be distorted by the presence of this group. But SEH data indicates that there are few returners under the age of 30. As young households tend to be the ones hardest hit by affordability pressures, because they have had less time to increase their salary or make significant savings, it makes sense to focus on this group when looking at sources of deposits.

Tatch (2006b) estimates that in 2005, 46% of first-time buyers under the age of 30 were likely to be getting substantial financial help (from parents and other relatives) to raise a deposit, a proportion which had steadily risen over the past decade from around 10% in 1995.

Chart 6: Proportion of first-time buyers under 30 receiving assistance



Source: Survey of Mortgage Lenders (CML) and Regulated Mortgage Survey, CML/BankSearch
 Notes: SML figures show material differences from more comprehensive RMS data, and should be treated with caution

But these estimates were based on SML data. Using the same methodology outlined in Tatch (2006b), the newer RMS data for 2005 indicates a lower proportion - 36% - receiving assistance. But as we touched on above, RMS estimates higher absolute numbers of first-time buyers than

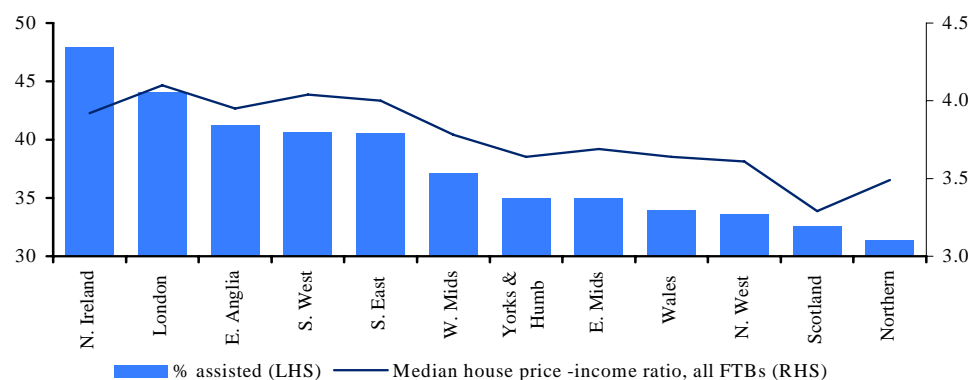
the earlier survey, so that the two sources do in fact indicate similar overall numbers - around 70,000 - of first-time buyers under 30 receiving assistance in 2005. RMS data suggests that last year this had risen to 80,000, or 38% of first-time buyers under 30.

The discontinuities between the old SML and the RMS data are unfortunate, but we are confident that the overall picture is one of a dramatic increase over the past decade in young people requiring parental help. This certainly chimes with the prevailing public view that it is either very difficult or the hardest it has ever been for young people to buy their first home (CML 2006).

On a positive note, the newer RMS data means that for the first time we are able to look at the profile of assisted and unassisted buyers in more detail.

As one might expect, there is considerable regional variation in the proportion of first-time buyers receiving assistance. Northern Ireland has the highest proportion of first-time buyers receiving assistance (48%). Elsewhere there is a higher incidence of assistance in the south of England and particularly in London (44%), where affordability is most stretched. Chart 7 shows clearly that the extent to which young buyers rely on financial help from their family is closely tied to the severity of the affordability challenge they face.

Chart 7: Assistance for first-time buyers under 30 vs. house-price earnings ratio, UK regions, 2006



Source: Regulated Mortgage Survey, CML/BankSearch

Generally speaking, areas with a high incidence of assistance also have the lowest first-time buyer activity, which is unsurprising given they are also the most stretched in terms of affordability. The exception to this is London where, despite the considerable affordability pressures, first-time activity is strong, as is the incidence of assistance. In London, assisted first-time buyers represent fully one fifth of all house purchases where a mortgage is required.

Research by Alliance and Leicester indicates that, when help was given, the size of first-time buyer assistance averaged £18,000 in 2006. Funds of this size substantially enhance the total available to a prospective homebuyer, both in adding this to the overall pot, and because they may also be able to borrow to a higher income multiple given this larger deposit.

Tatch (2006b) shows the affordability profile of assisted first-time buyers is radically different from unassisted buyers, and RMS data confirm this for 2006 (Tables 1 and 2). Unassisted first-time buyers have higher incomes than assisted buyers and take out larger mortgages at higher LTVs. Assisted buyers purchase more expensive properties than those buying without assistance, and have substantially higher income multiples. This means unassisted buyers are more at risk if house prices fall, but assisted buyers are potentially more exposed to interest rate increases.

These differences hold for every region of the UK, but the most striking finding is the difference between the first-time buyer market in London and elsewhere. The typical deposit for an assisted first-time buyer in London in 2006 was £57,000, over twice the amount in any other region except the South East. In comparison, the typical unassisted buyer in London put down a deposit of just £12,500. Such sizeable deposits clearly put the assisted first-time buyer at a considerable advantage in the London housing market.

Table 1: Assisted first-time buyers under 30 affordability characteristics, 2006

Region	Property Value (£)	Advance (£)	Income (£)	Deposit (£)	LTV (£)	Income multiple
Northern	100,000	78,000	23,500	12,900	83	3.36
Yorkshire and Humberside	110,000	84,000	24,384	17,000	81	3.42
East Midlands	116,000	87,723	25,000	18,000	82	3.47
East Anglia	130,000	100,000	27,708	23,936	80	3.60
Greater London	220,000	150,000	40,350	57,000	75	3.68
South East	159,000	115,000	31,500	34,950	77	3.61
South West	142,950	106,500	28,503	28,000	79	3.67
West Midlands	120,000	90,231	25,787	20,000	80	3.46
North West	115,000	85,000	24,851	19,000	81	3.40
Wales	115,000	86,000	25,000	20,000	80	3.45
Scotland	98,000	71,415	22,500	16,424	80	3.21
Northern Ireland	132,000	90,499	26,594	30,000	73	3.33
UK	135,000	99,500	28,000	26,000	79	3.51

Source: Regulated Mortgage Survey

Notes: Figures shown are medians of individual affordability calculations, and therefore will not cross calculate

Table 2: Unassisted first-time buyers under 30 affordability characteristics, 2006

Region	Property Value (£)	Advance (£)	Income (£)	Deposit (£)	LTV (£)	Income multiple
Northern	90,500	85,500	29,338	5,350	95	3.03
Yorkshire and Humberside	100,000	94,952	30,778	5,750	95	3.14
East Midlands	109,950	102,125	32,203	6,000	95	3.18
East Anglia	124,000	115,650	34,703	7,000	95	3.37
Greater London	200,000	185,250	54,500	12,500	92	3.43
South East	150,000	140,650	41,620	8,750	95	3.41
South West	134,500	125,000	37,000	7,857	95	3.42
West Midlands	115,000	107,000	33,000	6,125	95	3.25
North West	105,000	98,153	32,000	6,000	95	3.11
Wales	104,000	97,845	31,332	5,750	95	3.14
Scotland	85,000	77,915	29,000	6,000	95	2.78
Northern Ireland	120,000	113,402	35,075	6,500	95	3.24
UK	120,000	112,500	35,205	7,000	95	3.23

Source: Regulated Mortgage Survey

Notes: Figures shown are medians of individual affordability calculations, and therefore will not cross calculate.

Risk mitigation

Assisted and unassisted buyers face different risk factors, as described above. The mortgage market offers a wide range of products and options which can help mitigate these risks. Fixed rate products, for example, provide insurance against interest rate shocks and could be particularly useful to assisted first-time buyers, given that they typically have high income multiples and are more vulnerable to interest rate rises on variable rate mortgages. For unassisted buyers, high LTV ratios mean they have relatively little room to manoeuvre in the early years of the mortgage, should circumstances change and meeting mortgage payments becomes difficult. But equally, unassisted buyers have relatively high incomes and low income multiples. So flexible mortgages, which give borrowers the option of making over and underpayments, may be particularly useful to these borrowers, allowing them to build up a safety cushion when they have surplus income and make reduced payments when income is scarce.

Of course, these and other mortgage features can be of value to all types of borrower, but it is relevant here to see whether first-time buyers are choosing products that enable them to mitigate the risks relevant to their own circumstances. Encouragingly, it appears that unassisted first-time buyers are significantly more likely to choose mortgages with flexible features than other first-time buyers – and in fact more likely than all other types of borrower. In 2006 49% of unassisted first-time buyers took out mortgages with flexible features, compared with around 40% for both

first-time buyers as a whole and for home movers. Of course, this does not tell us whether they subsequently use these flexible features, but it is reassuring nonetheless that they are more likely to have these features available.

Looking at interest rate products, it does not appear that assisted first-time buyers are any more likely to choose fixed rate mortgages than other types of first-time buyer. However first-time buyers as a whole are much more likely than other borrowers to choose fixed rates, with 80% of all first-time buyers opting for fixed rates in 2006, compared with 62% of home movers and 63% of remortgagors.

Prospects

Notwithstanding a growing appetite on the part of young people to rent privately, the demographic impact of rising numbers of young people should be positive for first-time buyer activity. Recent rate rises, and expectations of another one to come, may temporarily bear down on actual numbers.

Affordability continues to be highly pressured, but the growing tendency of parents and relatives to help young people become home-owners has helped to sustain overall volumes of first-time buyers. In the absence of adverse economic shocks affecting incomes and employment, this looks likely to remain the case for the foreseeable future.

But such assistance entails the housing equity of mature owner-occupiers being recycled back to new entrants. The implications of this for the wider health of the housing market are potentially complex and far-reaching. To the extent that such activity pushes up house prices further, this will have positive wealth effects for those already in home-ownership, and may make older home-owners more able and willing to provide assistance to their children. It is not clear whether there are natural limits to how far this can support overall prices and activity. But for as long as it persists, it also represents something of a vicious circle. The more parents help their children get onto the housing market, the greater house prices will be and the greater the assistance that the next cohort of young would-be buyers will need. Over time, the housing market could also become increasingly polarised, with the children of parents who are themselves home-owners accounting for a progressively larger proportion of first-time buyers.

This is similar to the dilemma facing the government with its Homebuy and other schemes to help people become home-owners. Measures to assist specific groups of first-time buyers are likely to drive up prices further, and make home-ownership less attainable for another cohort of households, unless they are complemented by supply-side initiatives at the same time. The key importance of delivering greater supply of housing longer-term lies at the heart of the Barker

review proposals, and was recognised by Gordon Brown in his recent announcement to build new eco-towns.

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