Report 9

Has the private rented sector grown because people want to rent, or because they cannot afford to buy?

Image: Andersastphoto | Dreamstime

TDS Charitable Foundation
Funded project

About this report

This report has been created thanks to the support of the TDS Charitable Foundation. The Foundation *"works to advance education about housing rights and obligations in general".*

In particular, the charity focuses on:

- Best practice in the management of private rented housing;
- Legal rights and obligations of those involved in the provision or management of private rented housing;
- Using alternative dispute resolution for more efficient and effective resolution of disputes between landlords and tenants.

The charity has provided a grant to Kate Faulkner who runs Designs on Property Ltd (designsonproperty.co.uk), to produce a series of reports and surveys on the private rented sector which are designed to increase knowledge on the private rented sector in England and to promote best practice.

Opinions expressed in this report are those of Kate Faulkner and do not necessarily reflect the views of Tenancy Deposit Scheme (TDS) or The TDS Foundation.

TDS Charitable Foundation
Funded project

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About the authors

Kate Faulkner Bsc (Econ) MBA CIM DipM was originally a consumer in the residential property market, buying, selling, renovating and renting property for many years. At that time she was a sales and marketing professional working with major brands such as PG Tips.

Having enjoyed working in her spare time in residential property, she went on to set up one of the UK's first property portals prior to the advent of Rightmove, then used her experience to help create on- and off-line tools designed to take the stress out of corporate relocations for employees.

From here she moved to set up the Self-Build and Renovation Centre in Swindon, and subsequently helped build and professionalise a part exchange business. Kate was also a Future Homes Commissioner for RIBA.

After gaining so much experience across the property market, Kate embarked on a mission to improve the way people carry out property projects, especially within the private rented sector. So whether it is banishing cowboy builders and rogue landlords, or helping the public approach a property project as simple as hanging a door or as complex as letting or building their own home, Kate is always on hand, either via her consumer website at propertychecklists.co.uk or at the property clinics she runs around the UK, to help landlords, tenants, first-time buyer, self-builders, renovators and investors carry out their property projects in the right way, using qualified people and industry experts.

Kate's consultancy, Designs on Property Ltd, provides help and support to companies and organisations that want to communicate better to the public, or to introduce new products and services which help people carry out their property projects successfully, first time around.

She is fanatical that property facts and figures such as prices and rents should be reported correctly in the media, by the industry, and by organisations and policy-makers involved in the property market.

Kate regularly appears in the national and local media, and comments on TV, radio and in regional and national newspapers on property news items of the day. In this way she continues to pursue her chief objective, which is to help ensure the public get an independent, honest view of what's happening in the residential property market.

This report is part of a series of reports and surveys that Kate will be producing thanks to the support of the TDS Charitable Foundation.

The aim of the research provided is to improve the understanding of the private rented sector and to make recommendations on changes which will impact positively on the experience of landlords and tenants.

Sarah Walker is a freelance writer and editor with extensive knowledge of the property investment industry. A former estate agent and television presenter, Sarah has spent the last decade writing for industry publications and leading UK property companies, producing a wide range of marketing and PR content, including consumer guides, newsletters, website copy, articles and reports.

She has ghostwritten several property investment books, edited a number of others on property, business and branding, and continues to work with entrepreneurs to produce literature that supports their business enterprises.

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Has the private rented sector grown because people want to rent, or because they cannot afford to buy?

Introduction

The growth in the private rented sector has been considerable over the last 15 years, having more than doubled in size since 2002. In 2012-13, the PRS overtook the social rented sector for the first time and it has remained larger ever since. According to the government's English Housing Survey, the PRS accounted for 20% of households (4.7 million) in 2016-17 and, over the last decade, the number of households with dependent children in the private sector has increased from 30% to 38%.

Of those currently renting privately, 60% of those surveyed by the government expected to buy a property at some point in the future, a percentage point higher than the year before.

The key questions being asked and discussed in this report are:

- What factors have contributed to the growth of the PRS?
- Of those currently renting, how many are doing so because it suits them and how many because they genuinely can't afford a deposit or mortgage yet?
- What are the affordability challenges facing (primarily) young people today and how can they be tackled?

The 2018 PRSim LSL Tenant Survey revealed that 66% of tenants are happy with renting privately, certainly for the time being. They value the flexibility it allows them and appreciate the good standard of living it offers.

While satisfaction levels were broadly stable among the various groups of tenants categorised for the survey – ranging from 63% to 72% – it was the group dubbed 'Budgeting Families' who were the least satisfied (63%), possibly because they are juggling rent with higher costs, such as family expenses including childcare.

This report aims to dig deeper into why so many people are renting today, considering whether affordability to buy is the key driver or if renting is actually the right thing for them at this time in their lives.

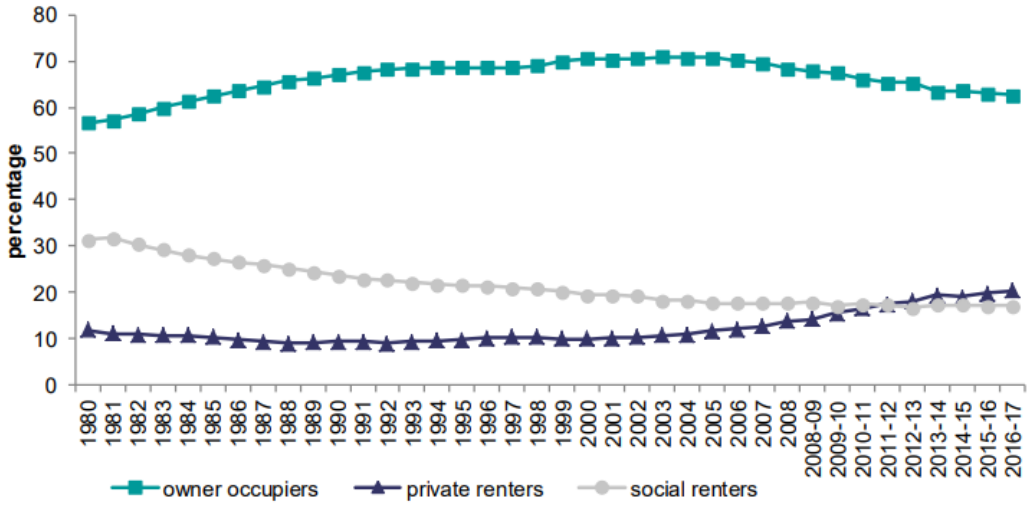
Ultimately, we ask this question: is the PRS primarily providing a much sought-after type of accommodation, or is it growing at the expense of those trying to get on the property ladder?

PART ONE

The growth in the PRS

As the English Housing Survey graph below illustrates, the number of people renting privately has more than doubled since buy to let mortgages were introduced in 1996. Interestingly, we can see that as the PRS has grown, it has overtaken the proportion of households renting within the social sector, while the percentage of owner occupiers has fallen.

Trends in tenure, 1980 to 2016-17



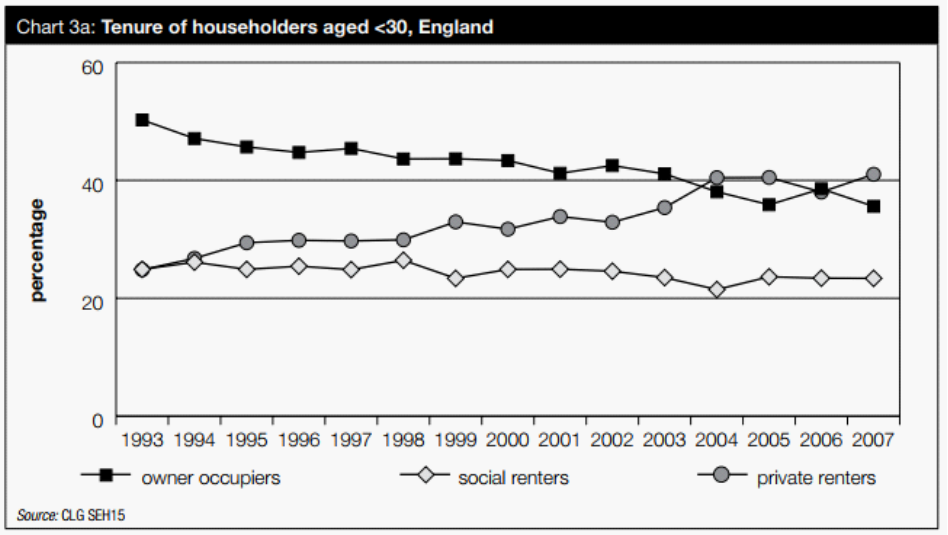
Base: all households
Note: underlying data are presented in Annex Table 1.1
Sources:
1980 to 1991: DOE Labour Force Survey Housing Trailer;
1992 to 2008: ONS Labour Force Survey;
2008-09 onwards: English Housing Survey, full household sample

Tenure	Percentage of households	
	1996	2016-17
Owner occupiers	68%	63% (14.4m)
PRS	10%	20% (4.7m)
Social renters	22%	17% (3.9m)

From this chart and table, it is clear the PRS has grown not just at the expense of home ownership. A large proportion of those renting privately now would have done so in the past as part of the social sector. As such, these tenants are never likely to be able access home ownership.

Sources: EHS 2016-17 https://www.gov.uk/government/collections/english-housing-survey#2016-to-2017
http://webarchive.nationalarchives.gov.uk/20120919150321/http://www.communities.gov.uk/documents/statistics/pdf/1346239.pdf

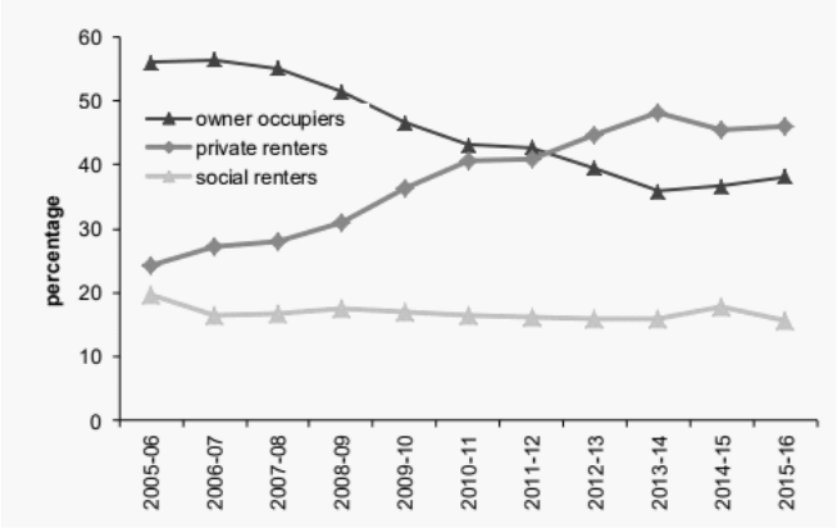
However, this isn't the full story – there has been a key change in tenure for householders aged under 30. In 1996, around 15% more young people owned than rented privately, but by 2006 the pendulum had swung in favour of renting:



When we look into the timing of the fall in home ownership of those in the 25-34 age bracket, the change over the following decade (2005-6 to 2015-6) is even more pronounced, as illustrated in the table from the 2015-16 English Housing Survey below. This suggests the recession has caused a significant boost to the PRS at the expense of home ownership. This may be due to employment uncertainty and lack of wage growth.

However, bearing in mind this was the same time as the recession hit when there was a 47% fall in first-time buyers and many home owners had to let because they couldn't sell their home, it could well be that the credit crunch, property price falls, unemployment and lack of wage growth during this time are potentially the key drivers behind the continued growth of renting during this period.

Source: https://static.halifax.co.uk/assets/pdf/mortgages/pdf/halifax-first-time%20buyer%20review-13-january-2017-

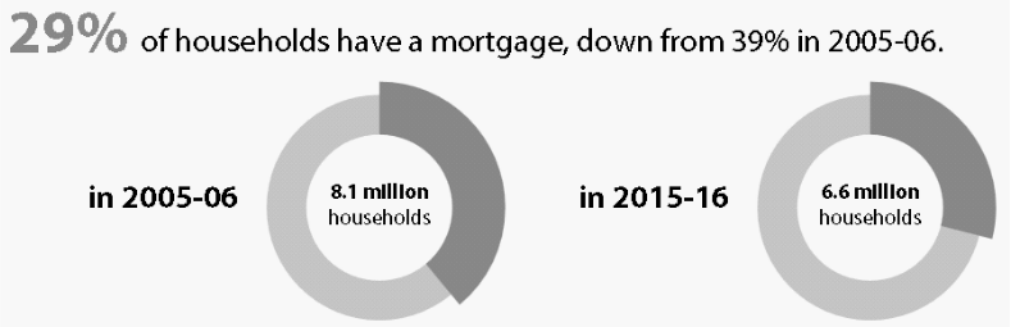


Source: English Housing Survey Headline Report 2015-16

Looking at figures for the percentage of households in England and Wales buying with a mortgage versus renting privately, there is again a marked shift. Over the last 20 years, the PRS has gone from being a quarter of the size of the mortgaged property market to two thirds of the size:

Year	Households buying with a mortgage	Households renting privately
1996	42.6%	10.1%
2006	39.7%	12.2%
2015-16	29%	19.9%

While growth in the PRS has reduced the number of people buying with a mortgage, we have also seen the baby boomer generation paying off their mortgages and an increase in those buying with 100% cash. This has resulted in more people owning a home outright, with 1.5m mortgages being paid off over the last 10 years:



According to the EHS, *"Since 2013-14 there have been more outright owners than mortgagors, and the proportion of mortgagors has declined."*

Although we are now through the recession with many areas (although not all) seeing recovery or growth in their house prices, the PRS is expected to grow further. In research published in 2017, Knight Frank stated that demand for the rented sector is expected to continue to grow, forecasting that there will be some 5.79 million households in the PRS by the end of 2021, approximately a 20% increase.

Source: http://www.knightfrank.co.uk/blog/2017/06/29/tenant-survey-2017-meet-the-tenants

What factors have contributed to the PRS growing in the way it has?

Fundamentally, growth is caused by demand, and there can be no argument that there has been huge demand for privately rented accommodation over the past 20 years. However this is often attributed to affordability issues as opposed to changes in culture – and indeed the impact of government policies such as a reduction in the support of social housing.

Here are the key contributors to the growth in demand for the PRS:

A shortage of social housing

The Thatcher government initiated the sale of nearly 2 million council houses in 1980 with 'Right to Buy' – the result of this can be seen in Figure 1.1 in the previous section, with the growth in home ownership reflecting the drop in social renting. Since then, successive governments have failed consistently to replenish much-needed social housing stock. This has left tenants who qualify for social housing with no alternative but to rent privately.

According to the English Housing Survey, tenants in the PRS who are in receipt of Housing Benefit account for 22% of the sector and clearly are unlikely to be in a position to be able to buy.

More students, both UK and foreign, living away from home

The student population has increased by nearly 800,000 in the last 20 years - now standing at 2.27 million – and the construction of purpose-built accommodation hasn't kept up. This is now being addressed with a surge in institutional investment in the 'multihousing sector', providing desirable, high-end accommodation, primarily for students. Knight Frank estimates that this relatively new sub-sector within the PRS is currently worth £25 billion and will be worth £70 billion by 2022.

In addition, the introduction of student loans has made it more difficult for those in their 20s to secure a mortgage and purchase a home.

The influx of migrant workers from the EU

Since Tony Blair's government relaxed border controls for Eastern European migrants in 2004, there has been a huge influx of EU nationals to the UK. Figures indicate that in 2015 there were around 3.2m EU citizens living in the UK and around 1.2m UK nationals living elsewhere in the EU, giving a total net migration figure of around 2m. In 2015 alone, net migration of EU citizens was estimated at 184,000, up by 10,000 on 2014.

Sources: https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/05/brexit-and-student-accommodation.pdf
https://kfcontent.blob.core.windows.net/research/707/documents/en/the-uk-tenant-survey-2017-4743.pdf
http://www.thisismoney.co.uk/money/mortgageshome/article-3859064/Mortgage-lenders-signal-rising-student-debt-levels-potential-crisis.html
https://fullfact.org/immigration/eu-migration-and-uk/
http://www.migrationobservatory.ox.ac.uk/resources/briefings/eu-migration-to-and-from-the-uk/

Increasing numbers of transient workers and those in temporary employment

These are people on short-term contracts that may require them to move regularly or their income is such that it is difficult to secure a mortgage, so a six-month tenancy agreement is an essential option for them to put a flexible roof over their heads.

Economic uncertainty

Ten years ago, the credit crunch created huge economic uncertainty over finances and job security, and now there's Brexit. In times of economic uncertainty, people tend to hold on to their money and back away from making long-term financial commitments, such as taking on a mortgage. Renting is a much more flexible tenure if people's circumstances change and they need either to relocate or cut back on household expenditure.

Young people who can't afford to buy, but are keen to move out of home

Several generations ago, people often lived with their parents until they got married, when a property was bought with two incomes. However, things have changed a lot since then and, although some still stay or move back home, working adults can leave home earlier and rent their own homes – whether that's a flat or house share with friends, living with a partner or on their own.

Widespread affordability issues with buying

The affordability debate will be discussed in detail in Part Three, but it's a fact that levels of home ownership set off on a downward trend from the mid-2000s. The question is how much this was due to affordability and how much of it was actually driven by the recession, which made buying a property much riskier option than renting. The number of first-time buyers (and other buyers) during the start of the credit crunch fell by 50% and remained at that level for four years, not recovering until 2015 and some areas have still to see prices recover at all.

It is clear from this data that factors prior to the recession – such as an increased number of students, more migration and economic uncertainty – have played a major part in driving the rise in the PRS.

Breakdown of total value of mortgage loans per year in the UK

	Home-owner house purchase (in £millions)			Buy-to-let gross lending (in £millions)	
	First-time buyers	Home movers	Remortgage	BtL house purchase	BtL remortgage
2015	46,700	72,100	55,000	15,600	21,900
2014	45,000	67,700	45,900	12,400	14,500
2013	36,100	58,100	45,100	9,300	10,700
2012	27,500	53,900	41,400	7,400	7,600
2011	23,800	51,700	46,700	6,200	6,400
2010	24,100	54,700	39,600	4,650	3,960
2009	22,000	47,300	51,800	4,530	3,390
2008	23,900	51,800	118,400	12,210	14,610
2007	47,200	107,500	129,200	23,100	20,640

Source: CML Regulated Mortgage Survey (April 2005 onwards)

Although affordability has played a part, it is quite possible that the recession has had a bigger impact on the fall in home ownership, encouraging many to stay in the PRS rather than buy a home of their own.

So if tenant demand, cultural changes and government policy have driven the PRS in many cases, rather than affordability issues, why are so many ‘happy’ to remain renting, if they could afford to buy? One rarely mentioned factor could well be the dramatic increase in the quality of accommodation and good value being offered by some landlords, resulting in renting being as good as buying and, in some cases, better.



Images: GCandan Susoy, Gabriel Murad, 4919421 | Dreamstime

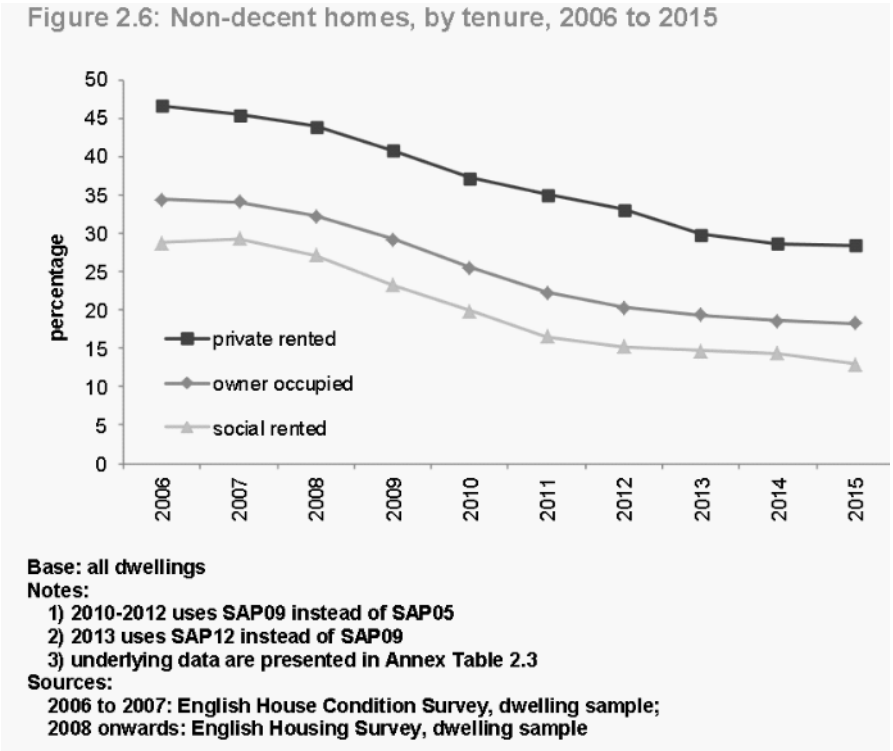
Has the quality of the 'product' created its own demand?

The introduction of buy to let mortgages in 1996 was followed by rush of investors into the market and a sudden increase in available properties. Within five years, ARLA had recorded a 49% increase in new landlords.

Buy to let boomed, fuelled by:

- poor pension and financial returns
- attractive mortgage deals
- an explosion of companies offering buy to let acquisition and management services
- a whole lot of marketing and media coverage through the 2000s 'selling' property investment as the best route to a secure financial future.

At the same time, lots of buy to let investors were encouraged to purchase new builds, often city centre flats which make attractive living for those in their 20s. For those who rent existing homes, various pieces of legislation directed at improving standards were passed, forcing the quality of accommodation in the PRS to rise – especially after the Housing Health and Safety Rating System (HHSRS) and mandatory licensing of HMOs came into force in October 2006.



Source: http://www.telegraph.co.uk/finance/personalfinance/investing/buy-to-let/11176988/1996-the-birth-of-buy-to-let-Britain-in-numbers.html



Image: Wavebreakmedia Ltd | Dreamstime

These factors, together with a recession which in 2009 led to many more homes being rented because they couldn't be sold, have led to increasing competition between landlords to attract the best tenants and the best rents in many areas. The result is that the quality of many of the properties on the market can now be superb: they're safe, modern, well-equipped and often staged to present tenants with a highly desirable home.

Far from renting being the 'poor relation' to home ownership, the best properties out there today offer people a standard of living they would not be able to enjoy in a property they could afford to buy – and, to top it off, all the maintenance is taken care of by their landlord – as long as they are one of the 'good' ones.

Another indication that it is not just affordability that is driving the growth of the PRS is looking at the increase in renting for other generations, not just those not currently on the ladder. For example, Rightmove estimate that some 15% of tenants are also landlords.

Who is renting and why?

In early 2018, PRSim and LSL Property Services carried out a comprehensive survey of their tenants, which included questions about why they were renting and what their expectations were about future home ownership. They were able to put each of the 3,752 tenants who responded into one of four types:

Source: PRSim LSL Tenant Survey 2018

Sources: Citizens Advice report: https://www.citizensadvice.org.uk/Global/CitizensAdvice/Housing%20Publications/PRS-AStateofDisrepair.pdf
http://www.knightfrank.co.uk/blog/2017/06/29/tenant-survey-2017-meet-the-tenants

As might be expected, the survey found that the older the tenant, the less likely they were to expect to buy their own home in the future. Only 34% of the 'Reconciled with Renting' (RwR) group said they intend to buy a home in the future.

In contrast, 81% of 'Young Independents' plan to buy in the future, signifying confidence that they have sufficient years ahead to save and earn enough to be able to afford a home; similarly 74% of 'Flexible Professionals' and 67% of 'Budgeting Families' plan to buy one day. Overall, the 2018 survey showed 63% of tenants plan to buy in the future, versus 58% in 2017.

In Knight Frank's 2017 tenant survey, just over two thirds of all respondents (68%) expected still to be renting in three years' time, with the remaining 32% expecting to have been able to buy a home.

In terms of general happiness with renting, 66% of PRSim LSL respondents overall said they were happy, with satisfaction at its highest in the RwR category, at 72%. In the Knight Frank survey, 37% of tenants were renting through choice, rather than due to affordability issues.

Reasons cited include flexibility, being able to live in an area they could otherwise not afford, and avoiding the responsibility of home ownership.

As one FP tenant in the PRSim LSL Tenant Survey responded: *"'I owned a house previously and now I'm renting after a recent relationship split. It gives me flexibility if I want to move and lets me live in an area that I might not be able to afford if I was buying again."*

Source: http://content.knightfrank.com/research/707/documents/en/the-uk-tenant-survey-2017-4743.pdf

Images: Adam Borkowski, Pavla Zakova, Spotmatik | Dreamstime

PRSim LSL's previous tenant survey, published in 2017, also showed a growth in the trend for renting longer term. The percentage of tenants who have rented for six years or more increased by 4% over the last 12 months, standing at 33% in 2017, up from 29% in 2016. Knight Frank's figure for 2015-16 is around 24%, supporting this trend.

Source: https://www.prsim.co.uk/wp-content/uploads/2017/07/LSL-Tenant-Survey-2017.pdf

Those without children made up the largest proportion of private renters according to Knight Frank's survey at 59%; couples with children were only the third largest demographic at 20%. According to Knight Frank, these figures have remained constant for the last two years.

Tenants making a conscious decision to rent, rather than buy

In Savills' YouGov survey of 2,300 PRS tenants in 2014, nearly a quarter of respondents (24%) said they choose to rent *'because it is less hassle and they like the flexibility'.* Interestingly, 8% of tenants said they were renting because they had chosen to invest their money elsewhere, rather than in a home.

Three years on, over a third of tenants (37%) in Knight Frank's 2017 survey said they were renting primarily through choice, rather than because they couldn't afford to own a home.

The main three reasons they gave for having made that decision were:

- Flexibility of tenure
- Not having the responsibilities that come with of owning a property
- Being able to live in a better area than they could afford.

Furthermore, some young people simply don't want to compromise their lifestyle and make the sacrifices necessary to save for a deposit. One of the respondents to a survey from Halifax and the National Centre for Social Research said: *"I'm not interested in trying to stop my life now when I'm 31 to not go out and not do anything to save up for the £40,000 deposit I need to buy in London. I'd rather live my life now."*



However, all this research still suggests an estimated two-thirds of people who, given the choice, would prefer to own their own home and are only renting because it is an appropriate temporary solution or because they simply can't afford to buy.

What the data does suggest is the idea that the Private Rented Sector has grown at the expense of those wanting to buy isn't necessarily accurate. Many may want to buy in the long term, but for the million+ who are on council waiting lists, needing temporary/flexible accommodation and for those looking to move up or save for a deposit, for now renting suits their purposes.

Sources: http://pdf.euro.savills.co.uk/residential---other/yougov-survey.pdf
https://www.moneywise.co.uk/news/2011-05-31/young-people-choosing-to-rent-rather-buy

This means any policy makers need to be aware that reducing the number of homes in the PRS could damage the number of homes available to those that need them and not necessarily result in those wanting to buy being able to afford to do so.

In addition, millions more are renting because their housing needs are temporary. They are students or migrant workers.

Finally there are those that would prefer to buy but they are divided into two groups: those who can't buy because they are working away temporarily and those who are in an awkward family situation such as divorce which can take years to settle.

It is true there are a proportion who are renting because they can't afford to buy, but there is still a lack of robust research that pinpoints exactly what proportion of people in the PRS are in this

PART TWO

The affordability debate

In their February 2017 Housing White Paper, the government seemed to accept for the first time that some people are renting because it suits them. However, based on PRSim LSL Tenant Survey figures, around 58% of tenants do intend to own a home in the future, so is it just affordability challenges and better rental stock which is stopping them from buying?

It is important to understand that the affordability issue has two parts; the deposit and the mortgage borrowing. While both may be out of reach for some people, others may be frustrated when they can satisfy one element but not the other.

In assessing how affordability has changed, we will consider the last 30 years, from 1987 to 2017, as this takes into account two economic booms and recessions. It also includes the sometimes forgotten era of 15% mortgage rates in the 1990s when some people were spending 50% of their income on mortgage repayments.

Image: Witthaya Prasongsin, Daniel Wiedemann, Julija Sapic, | Dreamstime

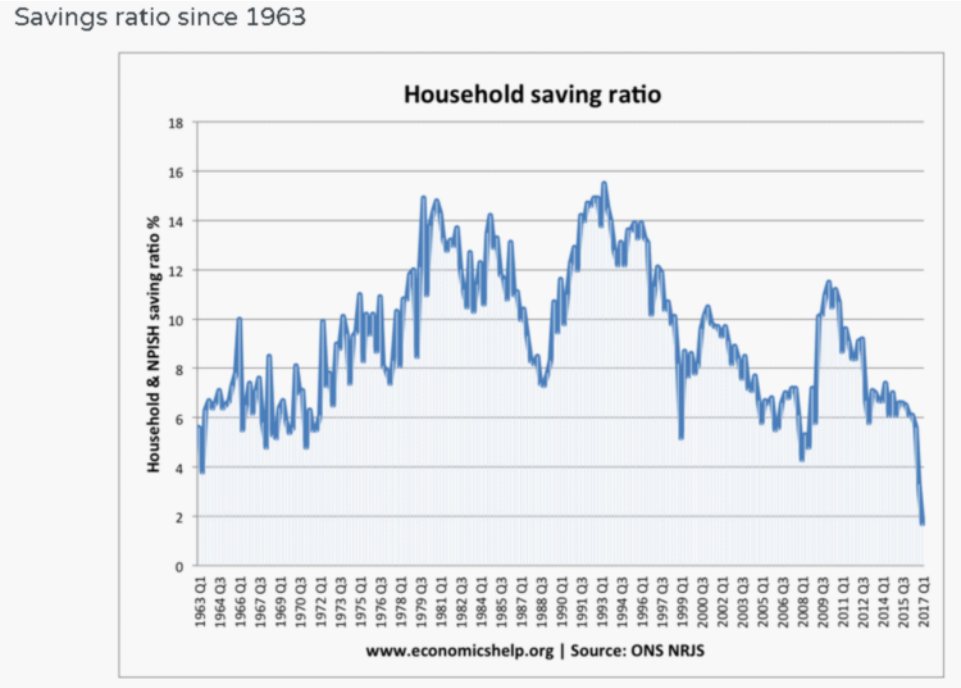
What are all the factors affecting affordability?

As reported in the PRSim LSL Tenant Survey, it is those aged 35 and under who represent the majority of tenants who want to buy and can't currently afford to.

One of the reasons for the difficulty in saving for a property may simply be that they are spending on life events rather than saving for a deposit to buy a home – especially if they feel this is out of their reach.

According to research by estate agent Tepilo, many young people spend over £200 a month on leisure activities and say they are unwilling to give up holidays, meals out, luxury groceries and new clothes. The average cost of a British wedding is now over £33,000 (which includes a honeymoon at an average of £3,630) and many people are splashing out on expensive stag and hen events beforehand.

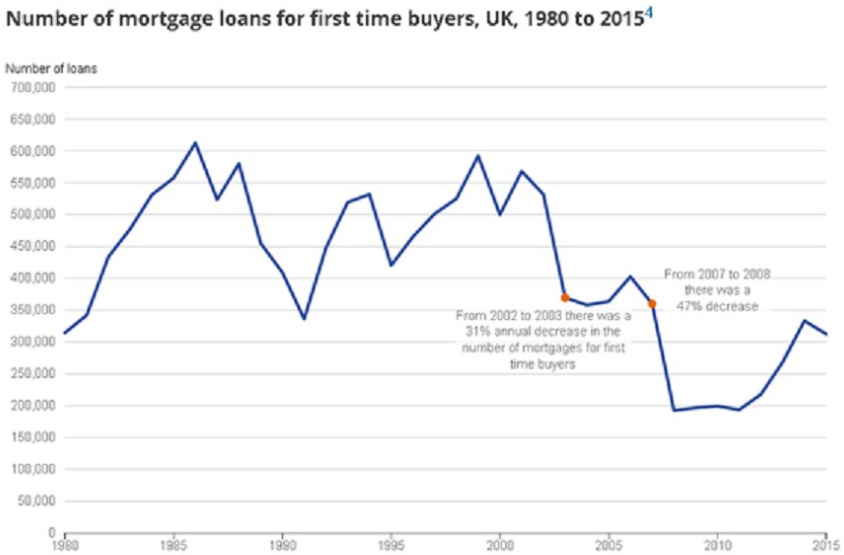
This kind of expenditure doesn't apply to everyone, but it does apply to some who claim they can't afford to buy, when spending cuts could help them to save for a deposit.



Sources: http://www.prsim.co.uk/wp-content/uploads/2017/07/LSL-Tenant-Survey-2017.pdf
http://www.propertychecklists.co.uk/articles/first-time-buyer-property-savings,
https://www.standard.co.uk/lifestyle/london-life/hen-and-stag-dos-now-cost-a-staggering-350-per-person-compared-to-90-ten-years-ago-a3629491.html,
http://www.independent.co.uk/life-style/average-british-wedding-cost-uk-27000-hitched-venue-honeymoon-food-london-midlands-a7937551.html)

Fall in savings

The drop in savings ratio from the late 1990s through to the recession does mirror a fall in first-time buyers, but it also follows rapid rises in house prices.



Source: ONS

What is interesting though is that the number of FTBs in 2017 was higher than it's been for 10 years and this rise matches an increase in savings by the younger generation during the recession.

According to a report carried out in 2012 on 'Spending Power Across the Generations', the older, cash-rich generations are significantly less 'careful' with their money than the under 30s. Some key findings of the report:

- Spending by the over 75s has doubled in the last decade, but decreased by a third for the under 30s.
- Spending power of the under 30s has declined because of high youth unemployment following the recession, wage freezes for those in work, high housing costs and paying off university debts.
- By 2011, people aged 65 and over were spending £1.3 billion more on foreign travel than they had been in 1999, whereas those aged 16-34 were spending £922 million less.
- The under 30s spent 18% less per capita on restaurant bills in 2010, compared with 2000. Those aged 65-74 spent 33% more and the over 75s spent 30% more.
- People aged 65-74 spent 8% less on new cars from 2000 to 2012, while the younger generation spent 80% less.

Source: https://static.halifax.co.uk/assets/pdf/mortgages/pdf/2018-01-27-number-of-ftb-highest-since-2007-HPI.pdf

Lack of wage growth versus house price growth

The other issue is what people can afford to pay for a property. The fall in mortgage rates from 5-7% before the recession to under 3% means that the cost of servicing a mortgage has halved, something which is rarely mentioned in the affordability discussion and isn't considered in the measure of 'average wages versus average house price'.

This fall in mortgage costs is good news for those where house price growth has kept in line with wage inflation. However, for those who have, for example, had their wages restricted due to public sector pay caps and low if non-existent wage growth imposed on them by the private sector, this has made owning a home harder.

This is especially true in areas like London where prices since the market high of 2007 have risen by 40-80% across the London Boroughs.

Where cash rich buyers can afford to purchase property in short of stock areas such as London, the South and East of England, what we have seen is property prices recover quickly from the recession. On the other hand, for the younger generation, clearly spooked by the recession, it is now likely in these same regions that they are finding their wage growth hasn't increased in line with general inflation, let alone increases in property prices.

More people living on their own

As well as looking at house price growth versus wages, another thing which is often overlooked and is, to some extent, a hidden affordability issue, is found in the English Housing Survey. In the 20 years from 1995-96 to 2015-16, the proportion of single-person households increased by 5%, up from 28% to 33%.

When one person has to shoulder the financial burden of purchasing a home, it's naturally less affordable. If renting as a single person, saving for a deposit to buy is even harder, not to mention that they will be making a mortgage application based on just one salary. Furthermore, lenders cannot currently take into account the rent people pay when assessing affordability.

So affordability can play a part in first-time buyers not getting on the ladder and preferring to rent, but to really understand the other issues stopping people getting on the ladder, we need to look at other factors.

For example, this anomaly between the way renting and buying affordability is assessed means it is possible to rent a property that people may not be able to afford to buy.

Sources: https://static.halifax.co.uk/assets/pdf/mortgages/pdf/2018-01-27-number-of-ftb-highest-since-2007-HPI.pdf
http://www.if.org.uk/wp-content/uploads/2013/01/Spending-Power-Across-the-Generations-Report.pdf
http://www.propertychecklists.co.uk/articles/london-property-price-update-January-2018

Those in their 30s will remember the recession they experienced in their 20s

Add to the issues of a lack of savings, low wage growth versus house price growth (in some areas) and the negative reaction to the recession and ten years on, someone who is now in their 30s will have experienced one of the following:

- In areas like London and the South, property prices fell by 15-25% until around 2013, then double digit annual house price growth was experienced for the next few years, which is likely to have quickly outstripped their earnings.
- In contrast, it is only in recent years that those in the Midlands through to the North, Scotland, Wales and Northern Ireland have started to see prices recover to the levels they were 10 years ago. They are likely to have friends and family who did get on the ladder before the credit crunch hit, but may well have seen little or no price growth in their house price and indeed may still be in negative equity.
- Those who were able and brave enough to buy in their 20s at the low of the recession in 2009 will have seen good house price growth and are likely to now have enough equity to be able to move on to their next home.

Property Prices - Regions	Highest average house price pre-credit crunch 2007/08	Lowest average house price during recession 2009	Market low +/- versus market height	Latest month's data Oct-17	How much higher/ lower are latest prices vs height in 2007/8	Year on year change in price in Oct 17	Annual average increase since 2000	Highest yearly average increase since 2000	
								Date	% Increase
North East	£139,400	£117,079	-16.01%	£127,224	-9%	2.4%	6.0%	Jan-04	34.8%
North West	£152,427	£124,654	-18.22%	£154,056	1%	3.9%	6.7%	Jul-04	33.0%
Yorkshire & The Humber	£150,233	£123,833	-17.57%	£155,281	3%	3.3%	6.8%	Jun-04	29.3%
East Midlands	£159,537	£129,876	-18.59%	£184,544	16%	7.0%	7.0%	Feb-03	33.9%
West Midlands	£165,807	£136,966	-17.39%	£186,351	12%	5.2%	6.5%	Jan-03	29.5%
South West	£212,666	£171,356	-19.42%	£251,376	18%	6.7%	6.9%	Jan-03	29.8%
East	£209,624	£168,263	-19.73%	£289,168	38%	6.1%	7.5%	Jan-03	28.9%
South East	£238,670	£191,156	-19.91%	£322,311	35%	4.6%	6.9%	Jun-00	25.0%
London	£298,596	£245,351	-17.83%	£481,102	61%	2.1%	8.0%	Apr-00	28.3%

Source: UK HPI

However all of them will be very well aware that buying a home will not always guarantee house price growth and are therefore still quite cautious to get on or move up the ladder.

If affordability is the main issue for the fall in FTB numbers, is it just areas where house price growth is outstripping wages that are seeing a fall?

The chart below shows the dramatic difference between regional house price changes. The North East is still 9% down versus 2007/8, while London has risen by 61%.

If affordability is the main reason first-time buyers aren't buying, then breaking the numbers down on a regional basis should mean the most expensive regions would be the ones which had seen a fall in first-time buyers.

Although this is true of London – the most affected region, with first-time buyer mortgage applications down 31% – we wouldn't expect to see the next greatest fall in first-time buyers of 22% being in the North of England, nor the next biggest fall being Yorkshire and Humber (-18%).

In contrast, areas considered 'expensive', such as the South West and East Anglia – both of which have seen house price growth in excess of 16% in the last 10 years – have suffered the least, with first-time buyer numbers down just 6% and 7% respectively.

To look at the affordability of renting versus buying, we need to look into more detail on a regional basis of the cost difference between the two tenures to examine the 'old' views that:

- Renting vs buying is 'dead money'
- Buying vs renting is not necessarily the cheaper option it is claimed.

Source: Nationwide



How affordability for FTBs has changed in different areas

When looking at affordability we tend to look at 'average house price versus average wage' but this can disguise what is really happening on the ground.

Secondly, this ignores the 'cost' of affording a home ie how first-time buyers are assessed for a mortgage and the finance they can raise based on their savings and salary.

Have individual FTB property prices changed so much?

First it is worth looking at how much affordability has changed for first-time buyers over the last 25-30 years, using 'actual', not 'average' examples. In both cases, the details for the earlier dates are actual, while the figures for the current likely scenario are approximate.

What each of these case studies looks at is an individual property and a specific person's job from the late 80s and early 90s and compared the affordability if the same person with the same job was buying in today's market.

CASE STUDY 1

1988 – Actual details

Property:	Flat in Chelmsford, Essex
Purchase price:	£48,000
Buyer's job:	PA in estate agency
Annual salary:	£7,636.69
Deposit paid:	£15,000 (31% / 196% of salary) – Parents paid it
Mortgage borrowing:	£33,000 at 11.5% interest only
Monthly payment:	£316.25 (£3,795 per annum)
Percentage of salary:	49.7%

2017 – Approximated likely details

Property:	Flat in Chelmsford, Essex
Purchase price:	£200,000*
Buyer's job:	PA
Average PA salary:	£24,252**
5% deposit:	£10,000
Mortgage borrowing:	£190,000
Monthly payment (3% repayment):	£909.27 (£10,911.24 per annum)
Percentage of salary:	45.6%
Monthly payment (3% interest only):	£475 (£5,700 per annum)
Percentage of salary:	23%

**Property price growth of 5.64% per annum; **Salary growth of 4.54% per annum*

CASE STUDY 2

1992 – Actual details	
Property:	House in Nottingham
Purchase price:	£31,000
Buyer's job:	Postman
Annual salary:	£10,000
5% deposit paid:	£1,550 (15% of salary)
Mortgage borrowing:	£29,450 at 10% interest only
Monthly payment:	£245.41 (£2,944.92 per annum)
Percentage of salary:	29.4%

2017 – Approximated likely details	
Property:	House in Nottingham
Purchase price:	£110,000*
Buyer's job:	Postman
Annual salary:	£18,000**
5% deposit:	£5,500 (30% of salary, although 25% could come from Help to Buy ISA
Mortgage borrowing:	£104,500
Monthly payment (3% repayment):	£500.10 (£6,001.20 per annum)
Percentage of salary:	33%
Monthly payment (3% interest only):	£261.25 (£3,135 per annum)
Percentage of salary:	17%

**Property price growth of 5.64% per annum; **Salary growth of 4.54% per annum*

What these case studies show is where wages have kept up with, or nearly kept pace with, house prices, properties remain affordable, especially from a mortgage perspective, even though first-time buyers have been switched to repayment. If they were allowed to borrow interest only, the mortgage payments would actually be a lot lower than the past.

What is tougher though is securing the deposit, even at levels of 5% and with help from the government or parents.

It's clear that where property prices have outstripped wage growth, this is where the affordability issue can cause those who can't save for a deposit, to rent rather than buy.

One of the issues with the comparison of renting versus buying since the credit crunch is the availability of mortgage finance, coupled with house price inflation being typically a lot higher than rental inflation.

These two factors have fundamentally changed the financials of renting versus buying, making renting potentially a much easier and cheaper option, especially short term, and acknowledging the fact that repayment means they pay off the mortgage and, if prices are rising, build equity.

Change in benefits of renting versus costs of owning

Although some reports suggest it is cheaper to buy than rent, these are often based on assumptions such as the purchaser buying a three-bed home or the assumption that the buyer has a large deposit. This means the analysis doesn't necessarily affect the genuine choice most people have to make between renting versus buying a home.

Historically, house prices tend to rise, on average by approximately 7% per year (UKHPI), while rents rise at around 2% per year (ONS). Clearly over time, renting therefore has become more affordable than buying. While we have had a recession where prices were crashing for several years if not more, there is little incentive to buy when you can rent a perfectly reasonably priced home which allows flexibility and doesn't require saving thousands of pounds for a deposit.

Using a property in the East Midlands worth £150,000 as an example, here is an illustration of the approximate difference in cost between owning and renting:

£150,000 PROPERTY IN THE EAST MIDLANDS

Up-front costs	Buy	Rent
Deposit	£6,000 + government 25% top-up to £7,500	£685
Mortgage/tenant fees:	£1,000	£300
Stamp Duty Land Tax:	£0 (assuming first-time buyer)	£0
Survey fees:	£500	£0
Legal costs:	£1,000	£0
TOTAL UP-FRONT COSTS	**£8,500**	**£985**

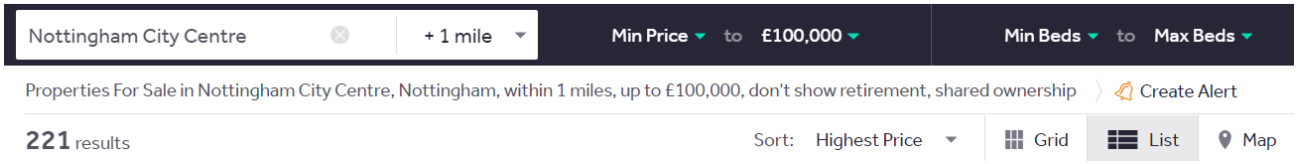
Annual costs	Buy	Rent
Repayment mortgage at 4% over 30 years	£8,240.76	£0
Rent at £572.50 p/m	£0	£6,870
Council tax, utility bills, TV, phone, contents insurance	£3,665	£3,665
Buildings insurance	£167	£0
Maintenance:	£1,000	£0
TOTAL ANNUAL COSTS	**£13,072.76**	**£10,535**



So it costs £7,515 less up front to rent than buy (£8,200 less if you assume the entire deposit is returned at the end of the tenancy) and it's £2,537.76 a year cheaper, which is quite a significant overall saving for tenants. What this does not take into account though is any growth in property prices or indeed that the buyer is paying off the mortgage they owe.

However as a straight comparison, it is clear that renting can be much better value initially than buying, especially in a flat property price market. The landlord pays any maintenance costs and the tenant has the flexibility to move up or down the rental housing ladder.

With regards to affording property versus renting in Nottingham, Rightmove show that at the time of this report being produced, there were more than 200 properties for sale for less than £100,000, allowing two people to buy with a 5% deposit of which 25% could be topped up with the government's Help to Buy ISA scheme and mortgage for each of £48,000.



In London the comparison is even starker, showing that renting versus buying a property worth £400,000 (average price paid by a first-time buyer according to UKHPI) saves someone in excess of £5,000 per year and reduces the savings requirement from over £20,000 to just over £2,000.

£400,000 PROPERTY IN LONDON

Up-front costs	Buy	Rent
Deposit using Lifetime ISA*	£15,937 (5%)	£1,938
Mortgage/tenant fees:	£1,000	£400
Stamp Duty Land Tax:	£5,000 (assuming first-time buyer)	£0
Survey fees:	£700	£0
Legal costs:	£1,200	£0
TOTAL UP-FRONT COSTS	**£23,837**	**£2,338**

Annual costs	Buy	Rent
Repayment mortgage at 3%	£20,426.76	£0
Rent at £1,400 p/m	£0	£16,800
Council tax, utility bills, TV, phone, contents insurance	£2,940	£2,940
Buildings insurance	£0	£0
Maintenance/service charge:	£1,623**	£0
TOTAL ANNUAL COSTS	**£24,989.76**	**£19,740**

*https://www.gov.uk/lifetime-isa

**£1,123 standard service charge plus £500 standard maintenance for flats only

Bearing in mind the ease and flexible nature of renting versus buying and how in the short term it tends to be better value, it is not a huge surprise that renting has grown at the expense of home ownership, particularly during the recession.

For more comparisons of renting versus buying, visit regional reports on Propertychecklists.co.uk

Availability of mortgage finance

Mortgage borrowing is affected by two key things: what criteria the lender requires the borrower to satisfy, ie the measures they use to determine how much of a risk the loan is, and the interest rate, ie the cost of borrowing, which will affect the amount of the monthly repayments.

Historically, we've seen mortgages of 100% loan to value (LTV) and sometimes even more; if the property was going to be improved, some lenders would advance a loan based on the value of the property post-renovation or refurbishment, granting total mortgage lending of up to 125% LTV. However, in the aftermath of the credit crunch, lenders withdrew their more generous products amid calls for an end to 'irresponsible' lending.

In April 2014, mortgage lending tightened significantly with the Mortgage Market Review, which saw:

- a ban on 'self-certified' mortgages
- restrictions on interest-only deals
- far greater scrutiny of borrowers' outgoings
- assessment of affordability being based on rates rising by 3%
- an end to cheaper borrowing through interest-only loans for homeowners, so affordability is based purely on a more expensive repayment basis.

In addition to standard utility bills, credit card and loan repayments and other contractual financial commitments, lenders will now consider how much borrowers regularly spend on 'extras' such as entertainment, holidays, gym memberships and toiletries. They are expected to look ahead and 'stress test' people's ability to repay the mortgage into the future, considering the likelihood of things like redundancy, having a baby or taking a career break.

Image: Dmitrijs Terentjevs, Elliot Westacott, Theclarkester | Dreamstime

One big frustration for tenants is that lenders don't take into account the amount of rent they're currently paying – and may have been paying for a number of years – so they could be refused a mortgage costing £800 a month when they have been paying £1,200 a month for five years.

According to a recent Halifax report on first-time buyers, which looks at attitudes to buying their first home:

"Even if [FTBS] have managed to raise a deposit, a third (33%) feel mortgage criteria is too difficult for them to meet."

The report led Martin Ellis, Halifax housing economist, to comment: *"Even with the highest number of first-time buyers in the last decade in 2016, many young people still feel they are running financial gauntlet – saving for a deposit, finding an affordable property in the right area and managing to fund living in the meantime."*

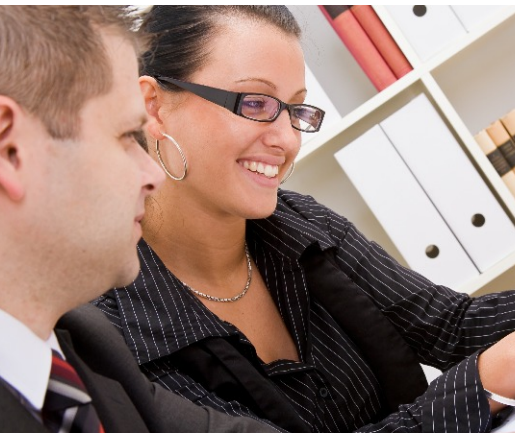


Image: Tamás Ambrits, Tatjana Krstic, Iakov Filimonov | Dreamstime

What help is there currently for those who are struggling to buy?

For those who are struggling to save for a deposit and/or to whom lenders are not prepared to offer a big enough mortgage advance, there are some options. Although not everyone will be able to take advantage of all of them, those who wish to get out of the PRS and onto the property ladder could be in a position to pursue at least one path.

'The Bank of Mum and Dad'

Increasingly over recent years, parents who are now third generation home owners and who are inheriting substantial wealth from grandparents and parents, have been able and willing to help their children get on the property ladder.

They are doing this by lending or giving them the deposit or taking advantage of specialist mortgage lending products such as the Loughborough First Time Family Deposit or the Barclays Family Springboard mortgage.

Some then pay interest back to their parents on the amount of the loan and/or have an agreement that the loan will be repaid at a future date, either when the property is sold or via a remortgage. Some consider it a gift. While some people may be reticent about asking for money, the arrangement can be structured so that it is mutually financially beneficial.

For those who don't have access to 'family' money, there are schemes which allow the government to step in and help:

Help to Buy Equity Loan Scheme

This is a government-backed scheme, launched in April 2013, to assist financially in the purchase of certain new builds worth less than £600,000 in England (under £300,000 in Wales and £230,000 in Scotland).

As long as the buyer has a 5% deposit and meets the criteria, the government will provide them with a loan for up to 20% of the purchase price (40% in London, 15% in Scotland), interest free for the first five years, so the buyer only needs a 75% mortgage. When the property is sold or the borrower repay the loan, the relevant percentage of the current value is repaid to the government. If a property was bought for £200,000 and a 20% loan advanced (£40,000), and it was sold five years later for £220,000, £44,000 would need to be repaid.

By the end of September 2017, more than 144,000 H2B loans had been taken out, 81% by FTBs.

Source: https://www.gov.uk/government/statistics/help-to-buy-equity-loan-scheme-and-help-to-buy-newbuy-statistics-april-2013-to-30-september-2017

Help to Buy ISA/ Lifetime ISA

Many lenders are offering the government-backed ISA schemes, where savings can be topped up by the government by 25%.

For the Help to Buy ISA savers need a minimum balance of £1,600 and the government will top it up on closing by 25% – up to a maximum bonus of £3,000. So if someone has saved £12,000 in one of these ISAs and wants to withdraw it to use as a deposit for a home, the government will pay over an additional £3,000. That bonus is on top of the lender's own interest rate. Each person buying the house can take out a Help to Buy ISA and benefit from the bonus, so a couple buying together could receive up to £3,000 each, potentially adding £6,000 to their deposit.

The Lifetime ISA (also known as a LISA) differs in that the 25% bonus is paid annually, up to a maximum of £1,000 per year. Savers can keep the account and still receive top-ups after purchasing a home, and use it to save for retirement.

Shared ownership

This is something that has been around for many years, whereby the purchaser buys a percentage of the property and pays a subsidised rent on the portion they don't own. It is offered by a number of developers and there is usually the option to buy the rest of the property at a later date. This gives the benefit of security of tenure without the financial burden of a larger mortgage.

Buyers can also consider buying with a friend or relative and sharing the ownership that way. In this case, legal advice should be sought to determine whether it is more appropriate to own the property as 'joint tenants' or 'tenants in common'.

Interestingly, of these schemes, the biggest take-up is not necessarily in the areas with the worst affordability issues. The latest data on Help to Buy equity loan on new builds shows:

- The majority of sales were to first-time buyers (116,898) representing 81% of total sales
- The average (mean) purchase price was £243,818
- The top six local authorities in terms of completed sales are Wiltshire (2,333), Central Bedfordshire (2,042), Wakefield (1,980), Leeds (1,932), County Durham (1,867) and Bedford (1,753)

So not one of the London Boroughs appears as a top area for the take-up of these schemes.

Source: https://www.gov.uk/government/statistical-data-sets/help-to-buy-equity-loan-scheme-quarterly-statistics

When it comes to shared ownership, according to a report from UK Finance (then the CML):

Around 200,000 UK households currently live in shared ownership homes and, unlike Help to Buy, this very much seems to be helping support sales in areas where prices have seen highest growth, with London, the South East and East of England being the three biggest regions for the government-supported scheme:

Table 14:
Shared ownership sales by region (England)

	Year								Total
	2007-8	2008-9	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
North East	40	37	25	38	72	111	79	56	**458**
Yorkshire & the Humber	302	189	107	197	267	314	197	231	**1,804**
East Midlands	653	434	311	439	458	682	660	728	**4,365**
East of England	722	743	358	586	731	1,000	891	1,195	**6,226**
London	2,358	1,392	928	1,276	1,540	2,844	2,318	2,900	**15,556**
South East	2,143	1,468	776	1,383	1,532	2,090	1,999	2,221	**13,612**
South West	893	652	287	461	701	1,113	1,035	1,199	**6,341**
West Midlands	771	593	321	465	553	671	610	744	**4,728**
North West	521	286	191	198	370	511	405	422	**2,904**

Source: CORE

With government plans to grow the sector by up to 70% over the next five years, it does appear this scheme is very much something that is helping to overcome the affordability issues in the more expensive areas.

https://www.cml.org.uk/news/press-releases/shared-ownership-ugly-sister-or-cinderella/

Conclusion

Has the private rented sector grown because of an increased need and desire for rented accommodation, or because people who would rather buy are unable to afford to do so?

The question that this report has tried to answer is whether the PRS has grown purely due to affordability issues or if there are more people preferring or needing to rent than buy.

The conclusions are:

1. The PRS has primarily grown:

- due to an increase in demand from those who would have previously accessed social housing; students; migrant workers and
- because of the recession, especially the public sector 'wage cap' in areas such as London where property prices have easily outstripped wage growth.

2. Areas which have seen an improvement in affordability are also seeing a fall in the number of first-time buyers, suggesting house prices and wage issues are not the only reason for the rise in the number of people renting versus buying.

3. Increased quality of accommodation in the PRS has reduced the 'need' to buy.

4. Affordability has played a part in increasing the need for people to rent rather than buy, but part of this is due to renting being more accessible, less stressful and, when directly comparing buying with a 5% deposit versus renting, it is cheaper in the short term to rent than buy.

5. Increased mortgage restrictions and a 'fear' of buying are impacting on the number of people buying a home.

6. Government schemes such as shared ownership are more successful in areas where affordability is definitely difficult than schemes such as Help to Buy which tend not to match areas where high house price growth has been experienced.

However it is clear that not enough research has been done currently to assess the individual affordability issues from a job/location perspective.

When looked at individually, some people's salaries have kept pace with house price inflation and the fall in cost of servicing a mortgage has been so huge, especially since the 1990s, that although prices have increased, the cost of the mortgage hasn't necessarily increased at all, even when

having to switch from interest-only to repayment. Indeed, if interest-only mortgages were still allowed, despite price rises, the cost of a mortgage could remain the same or even have fallen, although it is more difficult to raise the deposit.

The issue moving forward is to appreciate that the PRS is a sector that provides, in the main, good quality accommodation which is often much cheaper and more easily accessible than buying a home. This reduces the 'incentive' for people to buy rather than rent – whether they are in an area with high price growth or non-existent price growth.

The issues for the government to consider for the future are therefore:

- Whether home ownership is really right for everyone
- How to incentivise and enforce PRS properties to be legally and safely let

Currently the 'crackdown' on BTL investment could mean dampening stock levels so far that a growing demand makes renting become more expensive, damaging its accessibility for those who could and should never buy, eg those on benefits, students or migrant workers.

Secondly it needs to re-examine the crackdown on mortgage lending. Although to some extent tighter criteria is a good thing for the market longer term, this in itself may well be preventing many getting on the ladder, and preventing the government from delivering their own policies.

Ideas which could be considered to help successfully grow home ownership, but in a way that everyone benefited, rather than creating 'winners and losers' in the market, include:

- Providing interest-only mortgages for an initial period of a number of years, rather than insisting on repayment from day one of purchase
- Incentivising landlords to sell to their tenant through tax reductions.

Overall, affordability is one of the reasons the PRS has grown, but it is certainly not the main reason. More research on individual regions and wage changes versus house price growth needs to be investigated to gain a better understanding of the true affordability issues. Without this additional research, it is likely that government will struggle to create the best policies to improve affordability and home ownership.