First time buyers
Is the growth sustainable?

Rob Thomas, Principal Researcher,
Intermediary Mortgage Lenders Association
(IMLA)

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Executive summary

- **First time buyer numbers fell back slightly in 2019 to 352,000, but were still 84% above the low of 191,000 recorded in 2008.** For mortgage lenders, first time buyers have become an increasingly important part of the market as demand from the other main categories of borrower: home movers; remortgaging homeowners; and buy-to-let borrowers has stalled. In 2019 lending to first time buyers reached £60 billion, the highest figure on record.

- **Main drivers of higher first time buyer numbers have been improved affordability as mortgage rates have fallen and lenders' increased appetite to support this group.** Help to Buy has also played a role, supporting nearly 15% of all first time buyer transactions in England in 2018. Government policy disadvantaging buy-to-let as an investment appears to have succeeded in reducing the size of the PRS, with a corresponding increase in buying opportunities for first time buyers.

- **Longer term context suggests that first time buyer numbers are still disappointing.** Despite the strong recovery since 2008, we estimate that the sharp contraction in the number of first time buyers after the financial crisis has created a cumulative shortfall of 2.7 million who could have been expected to buy based on demographic trends. We calculate that, based on these past trends, the UK should have 500,000 first time buyers a year.

- **Short-term outlook is highly uncertain due to the coronavirus but longer-term outlook is positive as strong affordability coupled with a large pool of potential first time buyers points to continued growth.** The coronavirus is impacting all aspects of life and creating job uncertainty for many workers. This is bound to affect the number of people looking to buy their first home. But survey evidence suggests that owner-occupation remains popular with younger households suggesting that the 2.7 million households that have failed to buy so far are still potential buyers when the economy recovers.

- **Lenders need to ensure that the proposed end of Help to Buy equity loans in March 2023 does not create a new constraint on first time buyers of new homes.** Nearly 43,000 first time buyers used the Help to Buy equity loan scheme to buy a new home in 2019 in England alone. With lenders remaining cautious about high LTV lending on new build, alternative approaches which ensure that first time buyers who can afford a new build home are able to buy one should be explored.

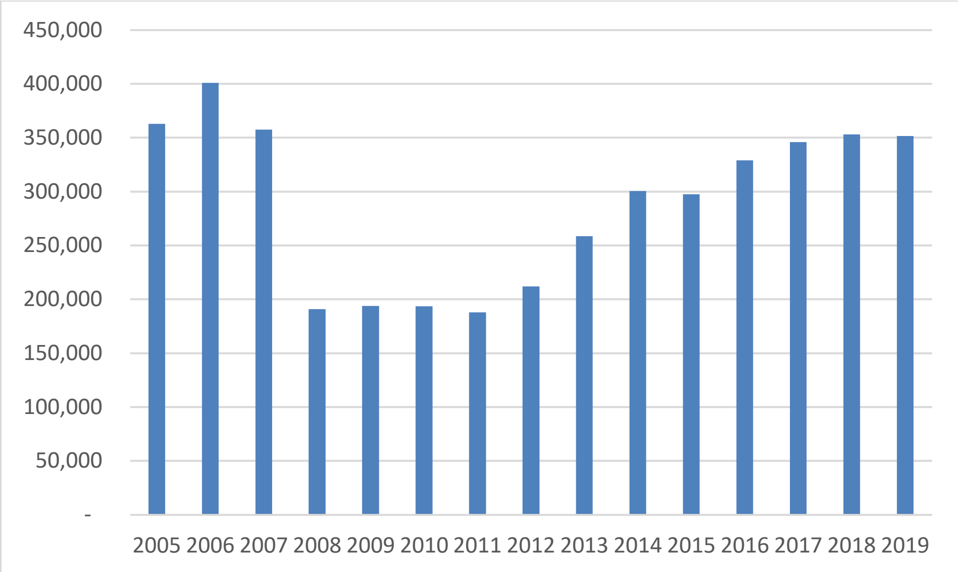
- **IMLA calls for government to assess the impact of post-financial crisis regulatory changes and consider easing these restrictions to help new home buyers lead the post-Covid recovery.** Many of the regulations put in place in recent years fall disproportionately on first time buyers. For example, controls on the proportion of lending that each lender can undertake at higher LTIs impact first time buyers because they typically require higher LTIs than other borrowers, while the changes to Basel capital adequacy rules disproportionately affect the high LTV loans that most first time buyers need. Stress testing requirements in affordability calculations also impact first time buyers harder because these buyers typically need to borrow more relative to income. Now would be a good time for government to assess the cost of these regulations, and potentially easing the path of new homeowners as part of the post-Covid recovery plan.

1. Factors driving the rise in first time buyers

1.1 Post financial crisis recovery

There has been a strong recovery in first time buyer numbers since the financial crisis low of 2008. This has left the number of these transactions close to the level recorded in 2007, the last year before the financial crisis started to bite (see Chart 1).

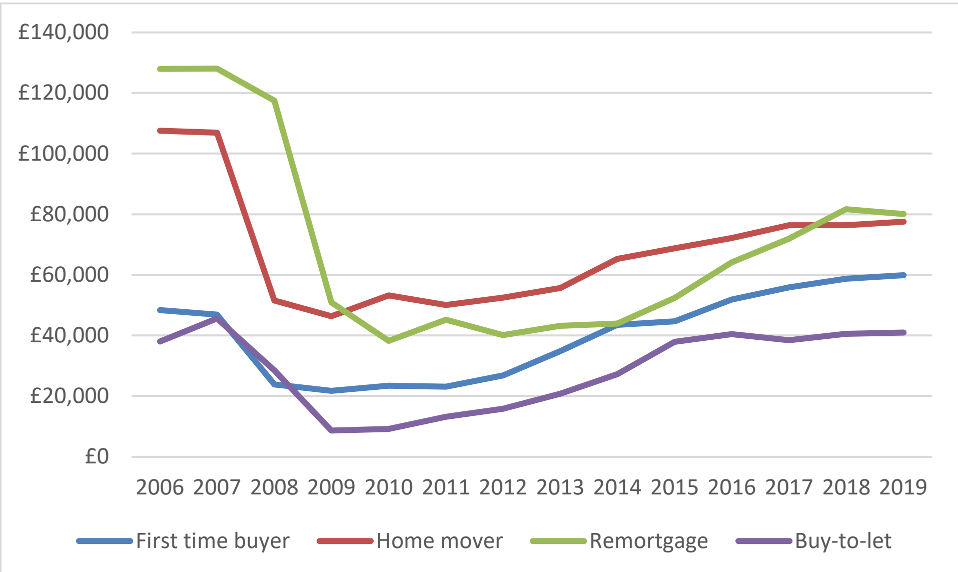
Chart 1 – Annual number of mortgaged first time buyers in UK



Source: UK Finance

The first time buyer segment of the lending market has also rebounded much more strongly than other segments of regulated lending (home movers and remortgages). Between 2009 and 2019, lending to first time buyers rose 176%, compared to 67% for home movers and 57% for remortgages (see Chart 2).

Chart 2 – UK mortgage lending by segment (£ millions per annum)



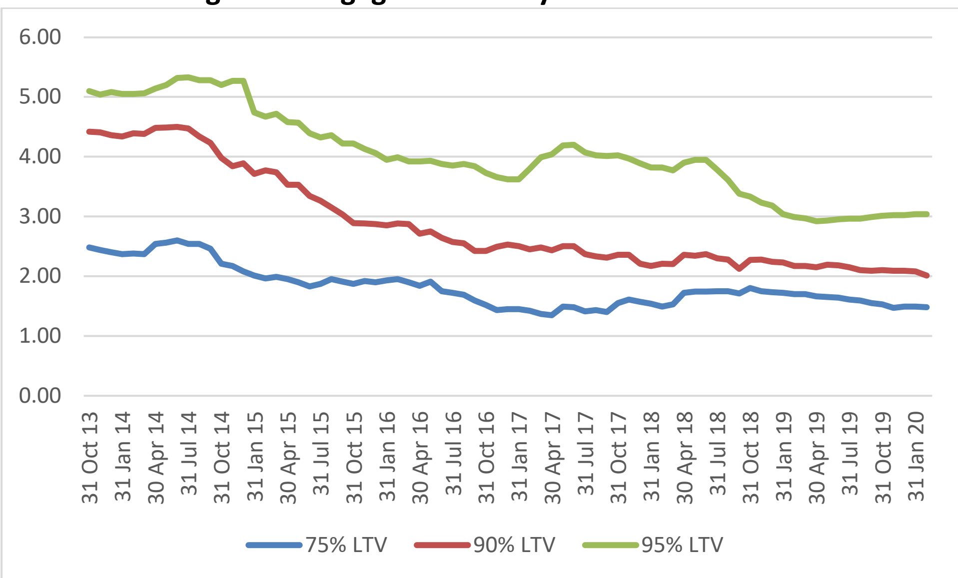
Source: UK Finance

As lending to first time buyers also fell less during the financial crisis, comparing 2019 lending to the immediate pre-financial crisis (2007) figures, it is the only main segment of mortgage lending where the value of lending increased, rising by 28% between 2007 and 2019. Over the same period, the value of buy-to-let lending fell 10%, lending to home movers by 27% and remortgage lending by 37%. The number of mortgaged first time buyers even exceeded the number of mortgaged home movers in 2018 and 2019, the first time this had happened since 1995. And 2019's £60 billion of lending to first time buyers was a record.

1.2 Reasons behind the strong performance

The most significant factors behind the relatively strong recovery in lending to first time buyers are improved affordability as mortgage rates have fallen and improved availability of credit as lenders have gradually increased their risk appetite. First time buyers were particularly vulnerable to the tightening of credit availability during the financial crisis because they typically require a high LTV and often also have quite a high LTI, so they have benefitted most from the re-emergence of a healthy high LTV market.

Chart 3 – Average % mortgage rate on 2 year fixed rate deals



Source: Bank of England

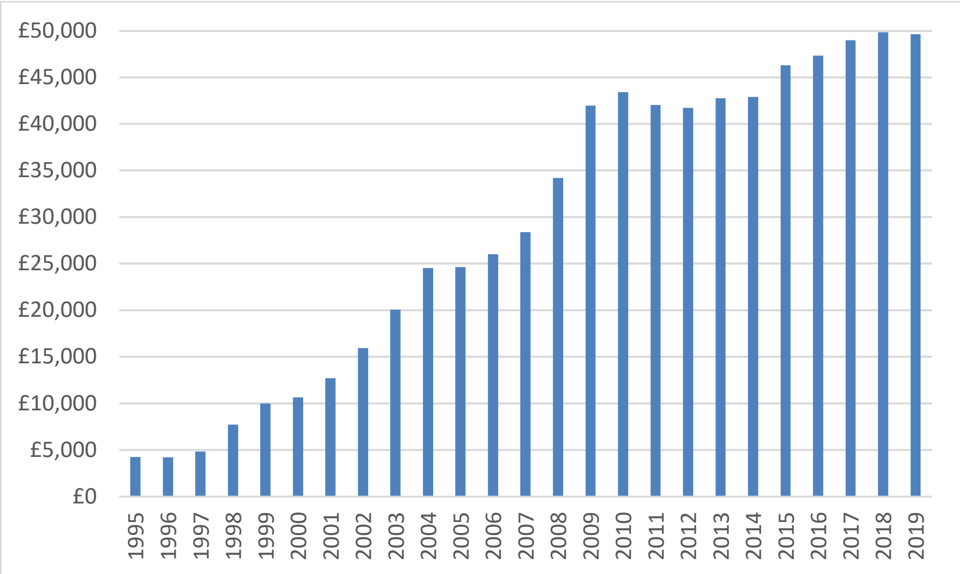
The improvement in mortgage rates available at the high LTVs that most first time buyers require is particularly striking. The average interest rate on a 2 year fixed rate mortgage for buyers with a 10% deposit has fallen from over 4% in late 2013 to 2% on the latest data. The fall in mortgage rates for 2 year fixed rate deals requiring only a 5% deposit is also substantial, with rates falling from over 5% in mid-2014 to 3% now (see Chart 3).

The reductions in mortgage rates translate into sizeable savings in monthly mortgage bills. For example, for a borrower with a 10% deposit borrowing a typical £170,000 on a 25-year capital repayment mortgage, the February 2020 2 year fixed mortgage rate of 2.01% translates into a monthly payment of £721. Had that borrower being paying the average rate at the end of 2013 (4.36%), their monthly payment would have been £931.

Lenders' increased risk appetite can be observed in the number of high LTV products available. Mortgage Brain reported in February that the number of mortgage products above 90% LTV was nearly 800, up 3% on a year earlier. It can also be seen in the number of loans being granted at high LTVs to first time buyers. FCA Product Sales Data (PSD) show that in 2018 (the latest available year) there were 3,800 loans made to first time buyers above 95% LTV, compared to 1,100 in 2015.

However, the increase in lenders' risk appetite has been very controlled. High LTV lending to all borrower groups remains far below the pre-financial crisis level and lenders have been particularly careful to limit loans with both a high LTV and high LTI. This can be seen in the FCA MLAR dataset. Although it is not broken down by borrower type, it shows that lending above an LTV of 95% that is also at or above an LTI of 2.75 times joint income or 3.5 times single income has averaged less than 0.2% in every quarter since 2015, against more than 4% in 2007.

Chart 4 – Mean first time buyer deposit

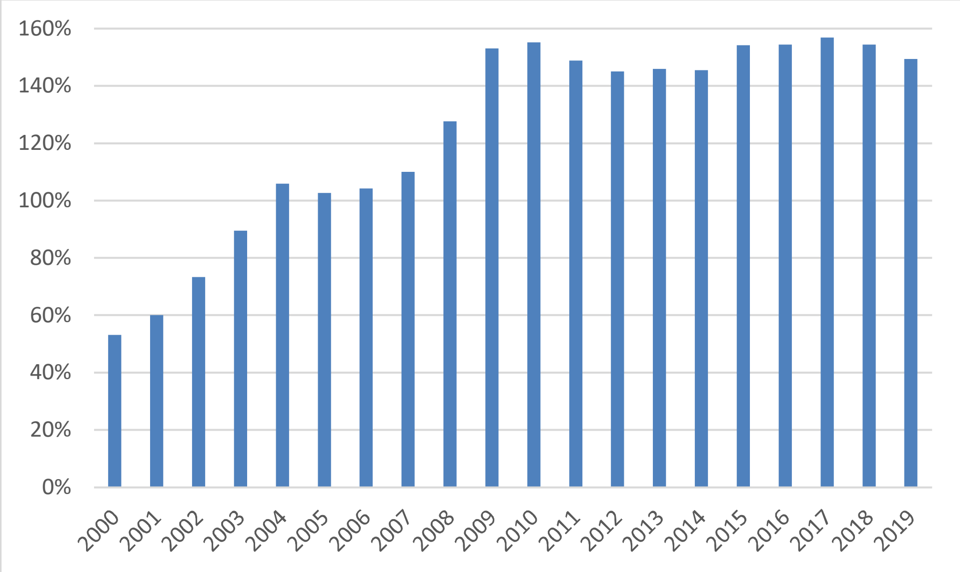


Source: UK Finance

The careful control of lending with both a high LTV and LTI is a particular problem for many potential first time buyers, as they are the borrowers most likely to need to stretch themselves in terms of LTI while having had the least time to accumulate a reasonable deposit. This is a key reason why first time buyer deposits have risen so much in recent years – those with a sizeable deposit are less constrained by limits on the size of mortgage they can obtain.

As Chart 4 shows, the average first time buyer is now putting down close to £50,000 as a deposit, compared to £28,000 in 2007. In effect what is happening is the buyers who need both a high LTV and high LTI loan are being excluded and those that are actually able to get a mortgage are those with substantial deposits. Of course these deposits are often provided by the bank of mum and dad.

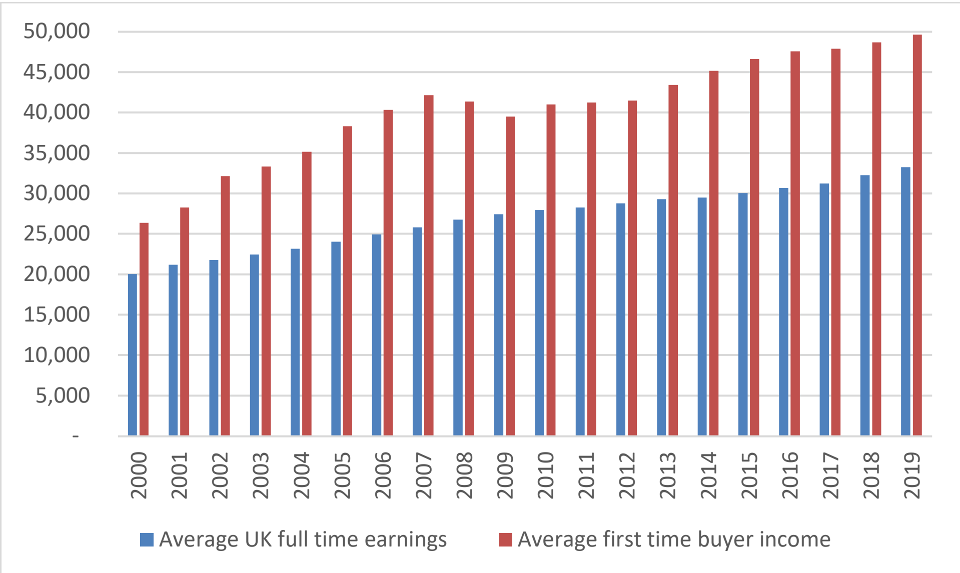
Chart 5 – Average first time buyer deposit as % of average full time earnings



Source: ONS Labour Force Survey, UK Finance

We can express these average deposits as a percentage of average full time earnings to see how great a burden saving the average deposit is for a typical worker (see chart 5). While in 2000 the average worker would need to save 53% of a year's pre-tax wages to accumulate an average deposit, by 2009 this figure had risen to 153% and it has remained close to these extremely high levels since, falling slightly to 149% in 2019.

Chart 6 – Average full time earnings and first time buyer incomes



Source: ONS Labour Force Survey, UK Finance

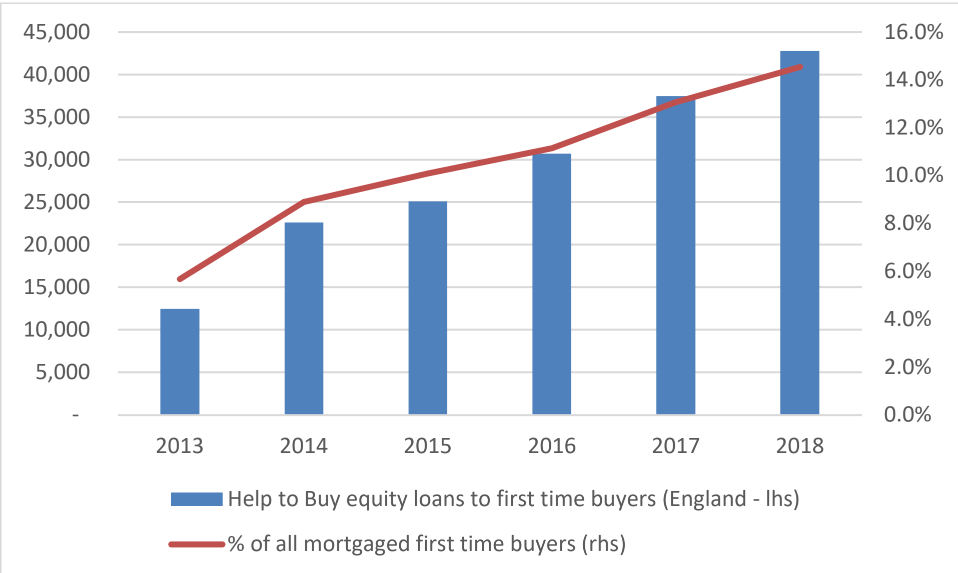
Another sign that actual first time buyers are less typical of the broader population than in the past can be seen in Chart 6, which compares average full time wages with the average income of those buying their first home. In 2000, the average full time wage was £20,000 according to the ONS Labour Force Survey while the average recorded income of first time buyers was £26,400 (32% higher than the average wage). But the average first time buyer income figures include both single incomes and the combined income of joint purchases. So it is unsurprising that recorded first time buyer incomes were significantly higher than average wages.

In 2019, while the average wage had risen to £33,200, the average first time buyer income had risen much faster to £49,600 (49% above the average wage). This widening of the gap between average wages and first time buyer incomes illustrates the increased difficulty average people face buying their first home. Single buyers have been increasingly squeezed out while the lack of lending with both a high LTV and a high LTI has knocked out a segment of the buyer population that previously was able to purchase.

1.3 Government interventions to support first time buyers

Since the early years after the financial crisis, government has played a key role in supporting first time buyers, particularly those seeking to buy a newly built home. Early schemes included HomeBuy Direct, FirstBuy and NewBuy (all focused on new built property). In 2013, the government introduced the Help to Buy equity loan scheme, the most generous in the amount of government support provided. Although NewBuy and Help to Buy were not restricted to first time buyers they mainly appealed to them. For example, between April 2013 and September 2019, 81% of borrowers using the Help to Buy equity loan scheme were first time buyers.

Chart 7 – Help to Buy equity loans to first time buyers (England)



Source: Ministry of Housing, communities & Local Government, UK Finance

With the government providing up to a 20% equity loan (40% in London), interest free for the first 5 years, it is unsurprising that the scheme has proved popular with buyers who can access it using a conventional first charge mortgage of only 75% LTV (55% in London). As Chart 7 shows, it has become an increasingly large component of total first time buyer demand even though it is restricted to new homes. By 2018, nearly

43,000 first time buyers in England bought a home with a Help to Buy equity loan, nearly 15% of all mortgaged first time buyer transactions.

In October 2013, the government broadened support to the secondhand market with the Help to Buy guarantee scheme. In total this scheme, which closed at the end of 2016, supported 104,800 purchases of which 80% were first time buyers. And in 2015 it introduced the Help to Buy ISA, where the government topped up savings in accounts to be used to build up deposits for house purchase.

In the 2017 Autumn Budget the government introduced a stamp duty exemption for first time buyers buying property in England valued at up to £500,000, with no stamp duty payable on transactions up to £300,000. The exemption applied from 22 November 2017 and saves a buyer £5,000 on a £300,000 home.

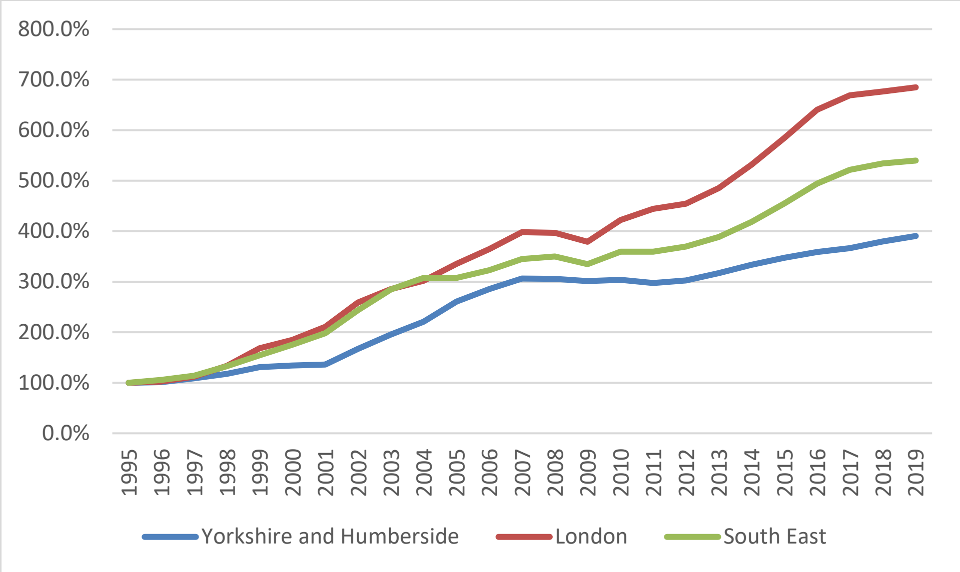
More controversially, since 2015 the government has also introduced a range of tax and regulatory measures that disadvantage the private rented sector (PRS) in a move designed to discourage landlords with a view to opening up a larger part of the market to first time buyers. Government housing tenure data for Great Britain for 2017 (the most recent year available) suggest that this policy is working as the PRS shrank by 43,000 units, the first contraction since 1999, while the owner-occupied housing stock increased by 274,000, the largest increase since 1989.

2. Regional profile

2.1 The challenge of widening regional house price disparities

A rising gap in average house prices between London and the South East and the rest of the country has been the most significant regional trend impacting first time buyer behaviour in recent years. Chart 8 shows the increase in average first time buyer property prices since 1995 in the best two performing regions (London and the South East) and the worst performing region, Yorkshire and Humberside.

Chart 8 – Change in average regional first time buyer house price (1995=100)



Source: UK Finance

A modest proportion of the rising variation in regional house prices is the result of faster earnings growth in London, where full time wages rose 98% between 1997 and 2019 compared to 91% for the UK as a whole and 79% for the worst performing region (the North East). But, as Table 1 shows, most of it was reflected in a rising discrepancy in house price to earnings ratios. Between 1997 and 2019, the ratio of average first time buyer house prices to average regional earnings for all full time workers rose from 2.3 times to 4.8 times in the North East (roughly doubling) but from 3.4 times to 10.5 times in London (roughly tripling).

Table 1 – Average first time buyer house price to earnings ratio

	London	South East	South West	North East	Wales	Northern Ireland	Scotland	United Kingdom
1997	3.4	3.1	3.1	2.3	2.7	2.8	2.3	2.9
2007	8.0	6.4	6.6	4.9	5.4	7.9	4.7	6.2
2009	7.0	5.9	6.0	4.7	4.9	5.9	4.7	5.6
2019	10.5	7.9	7.3	4.8	5.2	4.9	4.6	6.6

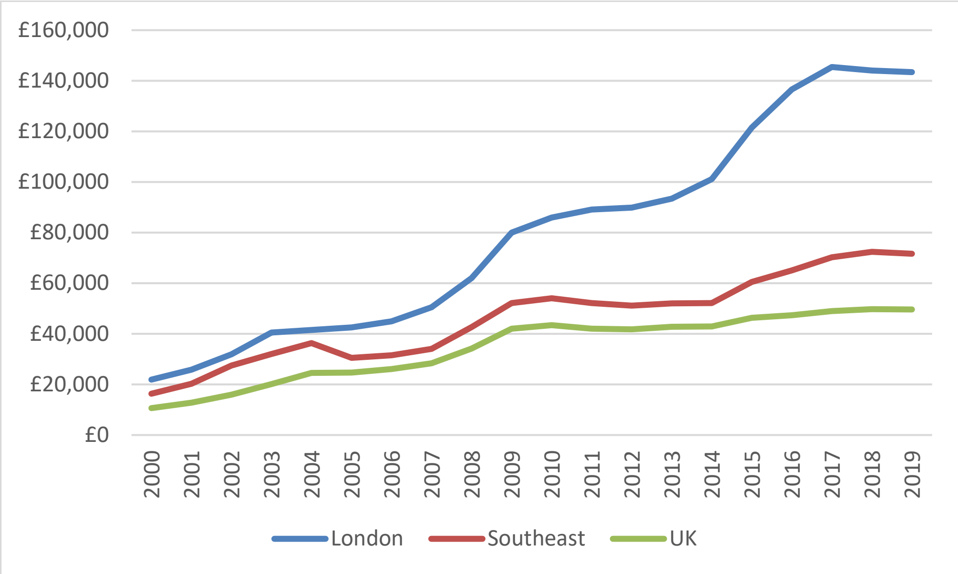
Source: ONS Labour Force Survey, UK Finance

The relative unaffordability of London for first time buyers has increased particularly fast since 2009. Between 2009 and 2019, some regions saw the house price earnings ratio decline including Scotland and Northern Ireland but in London it increased from 7.0 times to 10.5.

2.2 The consequences of widening regional house price disparities

The faster rise in the house price earnings ratio in London might have been expected to lead to a steeper decline in total first time buyer numbers. But between 2000 and 2019, the decline in their numbers was only marginally higher in London (down 32%) than across the UK (down 30%).

Chart 9 – Average first time buyer deposit



Source: UK Finance

But in one respect, first time buyers in London have changed quite significantly compared to those away from the capital. As Chart 9 shows, the divergence in house prices relative to regional incomes has precipitated an even larger divergence in the size of deposit put down by buyers. In 2000, the average London first time buyer put down a deposit of £21,900 against an average across the UK of £10,600 (roughly double). By 2019, the average in London was a huge £143,400 against £49,600 nationally, almost triple.

Expressed as a percentage of the value of the property, deposits in London rose from 18.3% in 2000 to 32.4% in 2019. This is a much sharper increase than seen nationally, where deposits rose from 15.0% to 22.5%. You might anticipate that the opposite would be true – that where house prices have become most stretched relative to incomes, buyers would struggle to save the same percentage deposit.

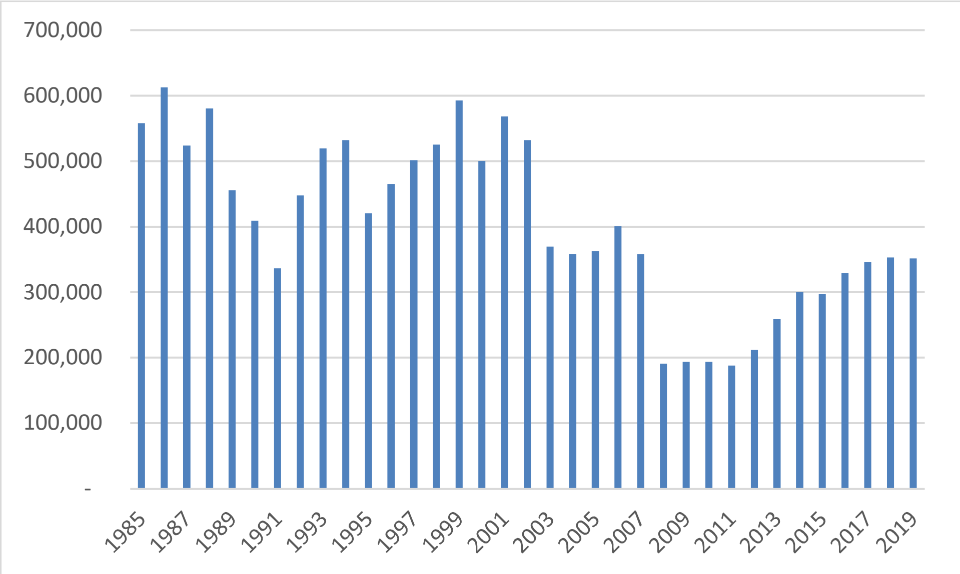
So what is going on? It seems that the FCA's stressed affordability requirements and the cap that no more than 15% of a lender's loans are at an LTI of 4.5 times income or above, together with lenders' own affordability limits, are having a disproportionate effect in London and the South East. Once house price to earnings ratios rise above a certain level it becomes impossible for average earners, even in two-wage couples, to obtain a mortgage that covers the cost of even the cheapest properties without the supplement of a large deposit. So in London, those that are able to buy their first home now typically need very large deposits (often obtained from parents) and are therefore even less typical of the overall population than in the UK as a whole, where, as we saw in Section 1 first time buyers are themselves less typical than they used to be.

3. First time buyer numbers in a longer-term context

3.1 The twenty-first century buyer slump

While Chart 1 on page 4 shows the impressive recovery in first time buyer numbers since the financial crisis, the picture looks quite different when these numbers are placed in a longer term context. Looking at first time buyer numbers since 1985 shows that the 2019 total is well below what would have been considered normal prior to the year 2000 (see Chart 10).

Chart 10 – Annual number of first time buyers



Source: UK Finance

Of course the number of people in the typical first time buyer age range is not a constant and this will affect the number who actually buy. To adjust for these demographic effects, we have constructed a model that calculates the expected number of first time buyers based on the propensity to buy in each age group over a base period of 1981-84, a time when the housing market was considered to be in broad equilibrium, neither in a boom nor a slump.

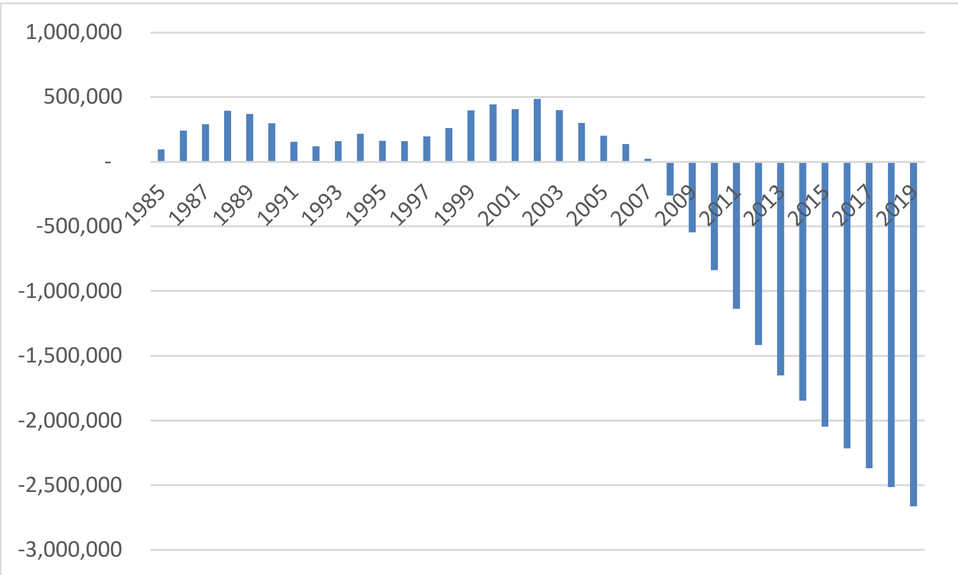
Using the data from the base period, holding the propensities to buy constant in each age group, we can construct a figure for the expected number of first time buyers each subsequent year which reflects the changing number of people in the relevant age groups. The results are shown in the blue bars in Chart 11. Although there was a demographic bulge in the late 1980s, which no doubt helped to account for the large number of first time buyers recorded then, the demographics suggest that the numbers should be even higher today.

Chart 11 – Actual and expected annual first time buyer numbers

Source: ONS, UK Finance, IMLA

Indeed, our model shows that the expected number of first time buyers, based on demographics, was a record 500,000 a year between 2016 and 2019, following years of strong population growth. Despite the robust recovery in first time buyer numbers in recent years (shown by the red bars in Chart 11), these have still fallen well short of the expected total, and in 2019 remained 150,000 short.

Chart 12 – Cumulative shortfall in number of first time buyers



Source: ONS, UK Finance, IMLA

Using our model, we can track the cumulative shortfall or surplus in the number of first time buyers since 1985. The results are presented in Chart 12, which shows that cumulatively between 1985 and 2007 the number of first time buyers was exactly as the model predicted it would be based solely on demographic shifts. But since 2007, there has been an increasing cumulative shortfall, which reached a dramatic 2.7 million by 2019. This means that by the end of 2019, 2.7 million people who would have been expected to buy their first home based on demographic trends, have failed to do so.

This cumulative shortfall in first time buyer numbers, which is also visible in the data on homeownership by age group (which shows much lower numbers of younger households owning now compared with previous decades), should be a source of concern to policymakers. Not only do most people have a preference for owning their own home but homeownership can help to build financial self-sufficiency, reducing the financial burden imposed on the state.

4. The outlook for first time buyers

4.1 Short-term market forecast

Forecasts for this year have been thrown into turmoil by the coronavirus. With households being advised to avoid unnecessary contact from 23 March, property transactions have all but ceased. First time buyer numbers will thus be exceptionally low for the duration of the lockdown. But there is also great uncertainty about how the economy and housing market might perform as the lockdown is eased because many businesses that have suffered a substantial loss of cash flow may struggle to resume normal business, and unemployment is likely to be much higher than it was, even with the government's Job Retention Scheme in place.

In economic terms, the lockdown has caused an unprecedented contraction of private demand (as well as supply), as people limit their purchases mainly to essentials and most businesses are not in a position to spend and invest as they normally would. Even with an easing of the lockdown, such a negative shock to demand could be expected to ripple through the economy as one person's spending is another person's income. So even though the government has been quick to respond with interest rate cuts, other monetary interventions and a massive increase in government spending, with the prospect of more if required, few doubt that the economy will still suffer serious dislocation for the rest of this year.

There are many unknowns which could work against a speedy recovery in housing market activity in general and first time buyer numbers in particular. For example, we do not know if the threat of renewed lockdown will weigh heavily on the market. We do not know how quickly consumer sentiment and private spending can bounce back. Such uncertainty cannot be a positive for the housing market but interest rates are even lower and government may take additional action to get the market moving later this year (a stump duty 'holiday' has been mooted).

4.2 Longer-term forecast

Once the short-term dislocation caused by coronavirus eases, there is every reason to believe that the economy can stage a robust recovery. Within this broader economic picture, housing could be a bright spot because the fall in interest rates should result in lower mortgage rates, further improving already robust affordability (although there has been considerable volatility in the swap rates used to price 5 and 10 year fixed rate mortgages).

Moreover, as explained in Section 3, demographics suggest that the UK should be witnessing around 500,000 first time buyers a year, yet the number in the last few years has averaged 350,000 a year. This suggests there is scope for higher numbers of new buyers to enter the housing market even without taking into account the cumulative backlog of 2.7 million people who have failed to buy since 2008.

As Section 2 revealed, some of the cumulative shortfall in people entering owner-occupation is the result of unprecedented house price to income ratios in London and, to a lesser extent, the surrounding areas. This poses specific problems for first time buyers because it means that even a modest percentage deposit can be difficult to save and LTI ratios also become stretched. Heavily stressed affordability requirements and other post-financial crisis regulatory changes, as well as the high provisioning required for high LTV loans, have exacerbated these constraints, keeping some potential buyers out of the market.

If government can find innovative ways of encouraging those who have missed out on buying over the past decade to finally make the move, the outlook for first time buyer numbers could be very positive in the medium to longer term. As we have argued in the past, one approach government could take is to undertake a review of the barriers these buyers face including the regulatory barriers to see if changes are warranted to help support more solvent buyers into the market. Now would be an excellent time to undertake such a review, as easing buyers' path into the market could aid the post-coronavirus economic recovery.

5. Conclusion

First time buyers are the lifeblood of the UK housing market. And fortunately, their importance in the market has rebounded so that by 2019 they constituted 28% of regulated lending compared to only 12% in 2008. In 2018 and 2019, for the first time since 1995 there were more mortgaged first time buyer purchases than mortgaged moving owner-occupier transactions.

But our calculation of the shortfall in first time buyer numbers of 2.7 million suggests that the progress that has been made in reviving their number has not been sufficient to fill the gap that developed after the financial crisis nor even to return new buyer numbers to the expected level given demographic trends. With the coronavirus lockdown having effectively shut the market in the short term, first time buyer numbers will plunge temporarily, further frustrating the aspiration to buy of many thousands of households. As the government starts to consider how it can revive the economy once life starts to return to normal, it should look at these buyers as a group that can help to lead the recovery.

If the government does want new home buyers to help lead an economic recovery from coronavirus it should examine the regulations put in place in recent years, as many have a disproportionate effect on first time buyers. For example, controls on the proportion of lending that each lender can undertake at higher LTIs impact first time buyers because they typically require higher LTIs than other borrowers as does stress testing in the affordability calculation, while the changes to Basel capital adequacy rules disproportionately affect the high LTV loans that most first time buyers need. We urge government to assess the costs these regulations are having in terms of reducing the proportion of solvent borrowers who can get onto the housing ladder.

Media contacts

For further information please contact:

- Rob Thomas, Director of Research, on 020 7427 1406
- Nick Seymour at Rostrum, on 020 7440 8670

imla@rostrum.agency

About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses via the broker channel. Its membership of 43 banks, building societies and specialist lenders include 18 of the 20 largest UK mortgage lenders (measured by gross lending) and account for approximately 93% of gross mortgage lending.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market.

Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), UK Finance and the Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high-profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.