# Where next for first-time buyers?

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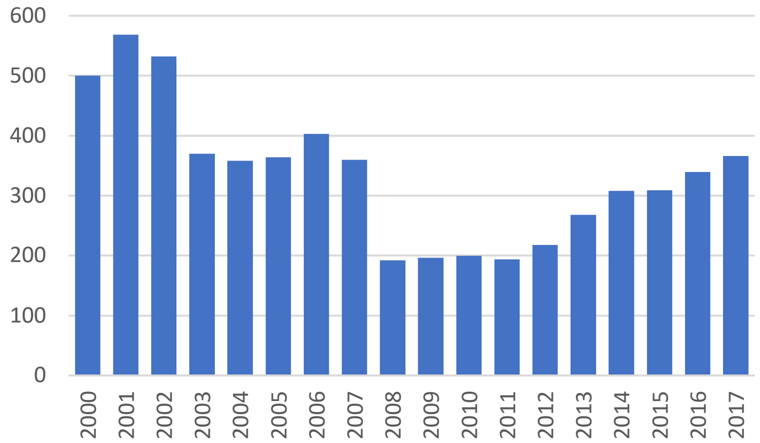
## Introduction

The latest figures confirm that there were about 366,000 first-time buyers in the UK in 2017. This is a positive outcome, in a year when overall property transactions eased back a little. First-time buyers now account for 30% of overall housing market activity.

**Chart 1: Number of first-time buyers, 000s**




Source: UK Finance

The number of first-time buyers was 8% higher than 2016 - itself a year of strong growth - and marks the strongest annual performance in more than a decade. At more than £59 billion, the value of mortgage loans advanced to first-time buyers represents a new record high, for the second year in a row.

So, there is much to celebrate in these figures. As well as bringing a strong sense of well-being to those becoming home owners, first-time buyers provide a key source of liquidity for the wider housing market and are vital to its overall health and dynamism.

But, at the same time as welcoming such developments, we should be careful to avoid complacency. If we look behind the headline figures, then we realise that things are not quite as positive as they first appear.

In a very real sense, the difficult years of the global financial crisis – characterised by the collapse in higher LTV lending - and the slow recovery of the post-crisis period have blunted our expectations as to what a strong outturn looks like. A figure of 366,000 represents a near-doubling from the post-crisis lows of less than 200,000 reported over the 2008-11 period. But such a performance is less impressive, when judged against the fact that first-time buyers comfortably averaged more than 400,000 per annum for the 30 years preceding the crisis!

Given that the demographics are still highly favourable, with near-record numbers of under 40s – comprising the age cohorts most likely to become home-owners – a baseline figure in the 400-450,000 range would seem a more appropriate benchmark to gauge satisfactory performance.

Given that few anticipate a return to such levels of first-time buyer activity anytime soon, stakeholders share a significant challenge and there do not appear to be any easy remedies.

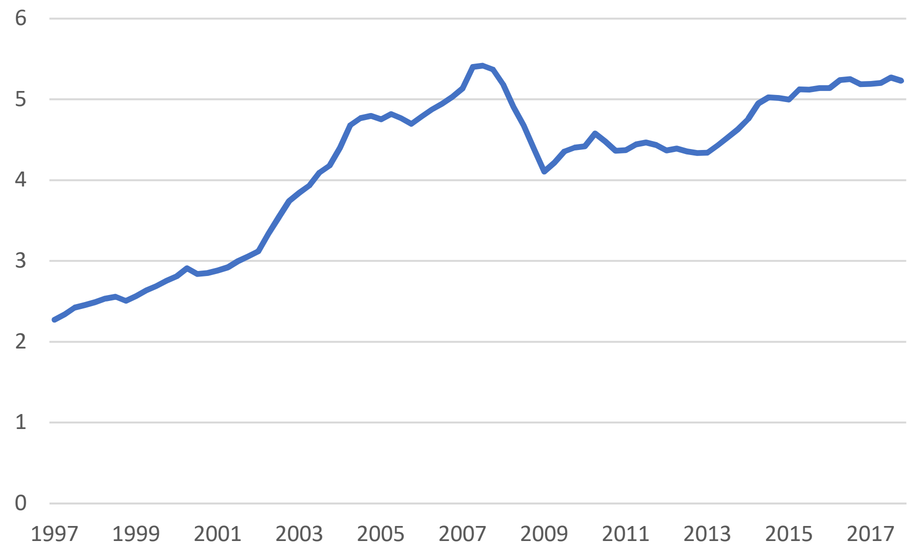
**Affordability**

As most of us know, a range of factors have been bearing down on first-time buyer numbers for a long while, and in some cases since the early-mid 1990s. These include, but are not limited to, greater participation in higher education, lifestyle choices, greater choice in the private rented sector, higher numbers of young inward migrants less likely to buy, and high and rising house prices.

Affordability pressures represent some of the most obvious and persistent headwinds for prospective first-time buyers.

There are many ways to think about affordability, but here, our focus is on the basic relationship between house prices and household incomes or earnings.

**Chart 2: First-time buyer house price to earnings ratio, UK**




Source: Nationwide BS

Whichever particular metrics we use, it is clear that the position has deteriorated profoundly over time. Broadly speaking, the housing affordability ratio has doubled over the past 20 years, that is households now have to commit double the multiple of earnings when purchasing a home.

Much of this deterioration took place in the decade leading up to the credit crisis.

Lower interest rates, made possible by the taming of inflationary pressures, was one of the key drivers, as this meant that larger mortgages could be serviced from a given level of income, allowing households to bid up house prices.

Trends reversed sharply in the wake of the credit crisis, but any respite was short-lived. Affordability pressures have resurfaced over the past few years, and in some parts of the country have intensified to record levels.

Fortunately, better mortgage credit availability, alongside a revival in lenders' credit risk appetites and stronger competition for new business, has meant progressively lower mortgage rates. This has, for the time being at least, helped to offset any negative impact on monthly mortgage bills or the ability of households to service them.

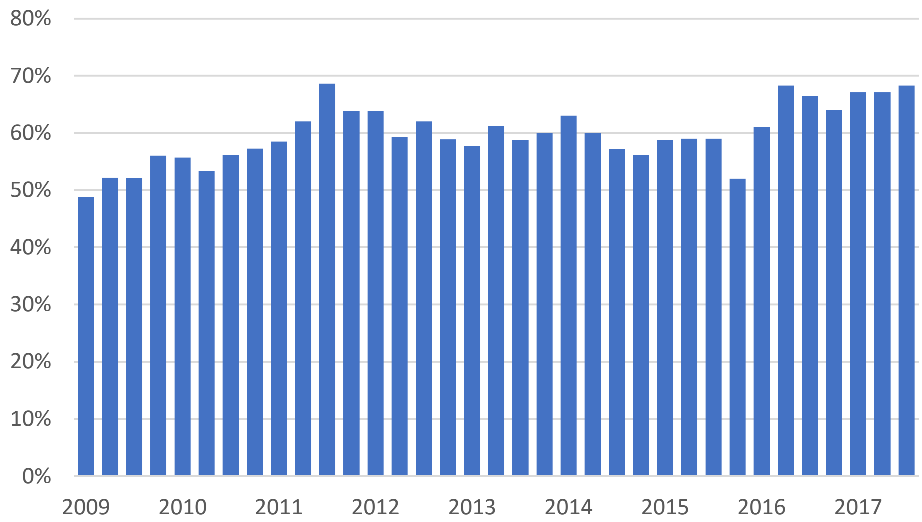
So, while most mortgages currently appear to be "affordable", we should not lose sight of the fact that the divergence between house prices and earnings means that deposit constraints have acted as a severe brake for those wishing to get on the property ladder over the past decade.

Although precise calculations are not possible, UK Finance metrics suggest that a typical first-time buyer still needs to put down a deposit that is equivalent to about 90% of their gross income, a proportion that does not appear to have eased over recent years.

If figures based on those who have succeeded to get on the property ladder show ongoing challenges around deposits, it does not require a great leap of the imagination to infer that the ability (or not) of households to raise a sufficient deposit plays a big part in determining who gets onto the housing ladder.

No surprise, then, that for the past 7 years, raising a deposit has consistently been seen as the biggest obstacle to purchasing a home, according to the BSA's Property Tracker.

**Chart 3: Raising a deposit likely to stop someone buying a home, % of respondents**




Source: BSA Property Tracker

We do of course need to recognise that, as for so many aspects of the housing market, there is considerable variation according to geography. There are material challenges for those wishing to buy in London, and to a lesser extent the South East, and these deposit constraints look no less challenging than five years ago. Elsewhere, the picture is more mixed, with less elevated local housing markets and signs of constraints easing to some degree in Scotland, Wales and Northern Ireland, but not really across the English regions.

**Short term prospects**

Housing market activity softened across the board in December. Although it is unclear at this stage whether the market is now set for a more sluggish period, looking ahead, it is hard to envisage further strong gains in first-time buyer numbers, in the absence of fresh positive catalysts.

Despite more upbeat metrics in January, household confidence has been undermined somewhat by recent falls in real incomes and uncertainties associated with Brexit and the future path of interest rates. Although the wider economy has fared much better over the past year or so than many commentators had feared, the immediate future appears to hold more downside risks than upside opportunities.

House price pressures have eased a little in some parts of the housing market, most obviously in and around London, but this is not the case elsewhere, and significant house price falls are not on the horizon.

Indeed, for the time being, affordability pressures seem to be pushing income multiples still higher. The median figure for first-time buyers now stands at 3.65, according to the latest UK Finance press release. That is, half of new lending to first-time buyers is at an income multiple higher than 3.65 and half below that level. This is the highest figure on record, and more than 10% higher than five years ago.

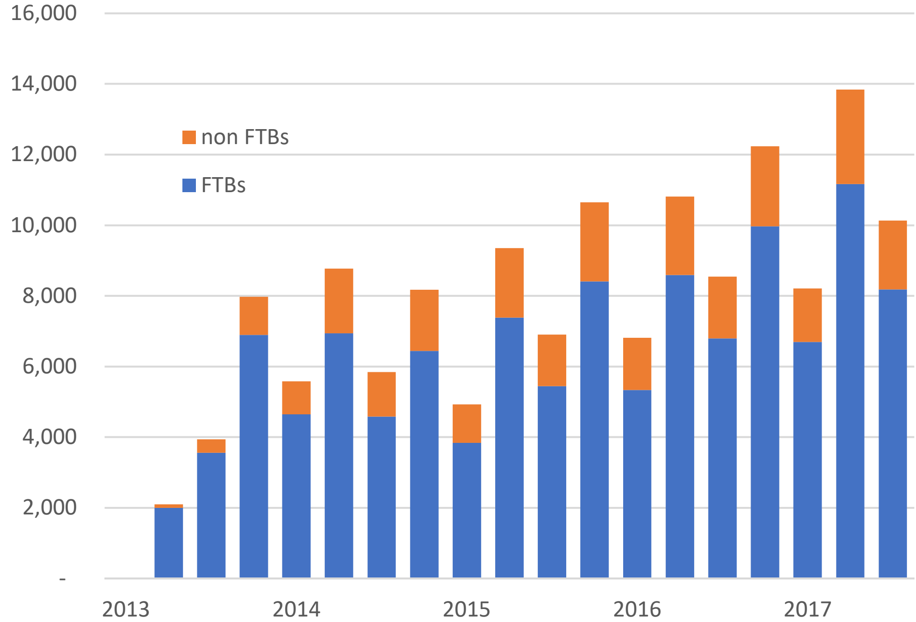
As part of its macro-prudential oversight, the Financial Policy Committee (FPC) closely monitors how income multiples are evolving, as it is aware that households have discretion to leverage how much they borrow by lengthening their mortgage term. This has been a major feature over recent years, with 30- and 35-year mortgages increasingly becoming the norm amongst first-time buyers.

One of the FPC's housing tools limits loans where income multiples are 4.5 or above to no more than 15% of new lending. Firms continue to have a degree of headroom below this threshold, currently, which suggests that first-time buyer numbers can continue to expand for now. However, last Summer the regulator modified the affordability test which lenders must carry out on mortgage applicants. This means that higher base rates will translate into stricter interest rate stress tests and an added challenge for households already stretching to get on the housing ladder. With the odds of another base rate rise shortening, this may tilt the balance against much stronger first-time buyer numbers.

With affordability pressures showing few signs of abating, government interventions have been critical for the recovery of first-time buyers. Help to Buy Equity Loan (and its national equivalents) and shared ownership have been key initiatives in this regard, as both help to ease deposit constraints.

The vast majority of Help to Buy – about 81% - has been taken up by first-time buyers. Recent figures from MHCLG (formerly DCLG) show that the take-up of Help to Buy loans has been increasing – in part reflecting the provision of London Help to Buy since early 2016 which allows eligible households to take 40% equity loans. For England as a whole, Help to Buy has grown to account for 12% of first-time buyer purchases over the past year – just over 36,000 in the year to September 2017.

**Chart 4: Number of Help to Buy Equity Loans, England**




Source: Ministry of Housing, Communities and Local Government

Given the recent momentum, additional recourse to Help to Buy could help to underpin higher first-time buyer numbers in 2018.

Elsewhere, last November's Budget announcement on stamp duty - removing first-time buyers' liability on the first £300,000 of a property's value, on sales with a market value of up to £500,000 – looks to be of only marginal relevance at best. Most commentators expect much of any benefit to dissipate quickly through higher house prices, and so provide only very limited stimulus to purchases.

Weighing all the above factors together, it is hard to be fantastically bullish about the near-term prospects for first-time buyers. In the absence of major fresh policy initiatives, the most likely trajectory for first-time buyers is one of only limited further gains at best.

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