Time to Save

Measuring the deposit barrier

Spring 2016

hamptons.co.uk

HAMPTONS INTERNATIONAL

Contents

Focus Report: Time to Save

Introduction

Hamptons International's new index completes the affordability story

Homeownership levels in England and Wales have been steadily dropping over the last decade – they are now at their lowest level since 1984. Deteriorating affordability is a key factor, but for first-time buyers, the main barrier to entry today is not the cost of servicing a mortgage, rather it is the increasing cost of the deposit on their first home. In the last 10 years alone, average deposit sizes have risen from £15,700 to £29,600.

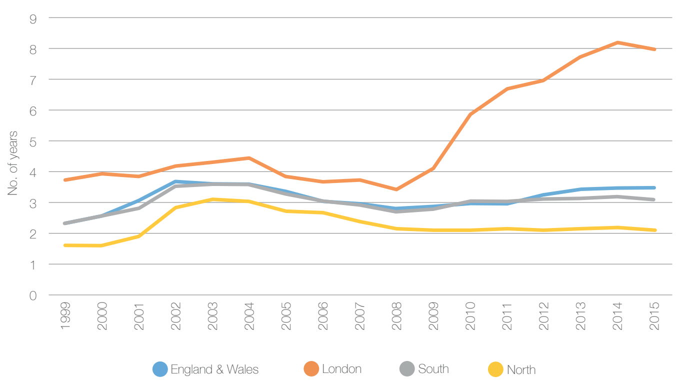
While housing affordability is often couched in terms of house prices relative to incomes, the reality is a bit more complex. There are 2 main components to housing affordability; the initial cost of the deposit and the cost of servicing the mortgage. Following on from the global financial crash in 2008, changing economic conditions have had a significant effect on both parts.

From our Ability to Buy index, which measures the pressures buyers face from changes in the cost of living as well as changes in interest payments and house prices, we know that it has become easier for homeowners to service their mortgages as a result of falling cost of living and, significantly, record low mortgage rates. However, those making their first step on the ladder are faced with a market where mortgage credit is more readily available to only those with larger deposits. Raising a deposit is the biggest barrier for many first-time buyers and with house prices forecast to continue to grow beyond incomes, they will find it increasingly difficult without financial support from family or the ability to take higher loan to value mortgages.

The Hamptons International Time to Save index presents the other side to the Ability to Buy story and allows us to understand how changing market and economic dynamics impact the average first-time buyer's ability to save for a deposit. First-time buyers being able to transact is vital for a healthy housing market as they make up around 46 per cent of the mortgaged market.

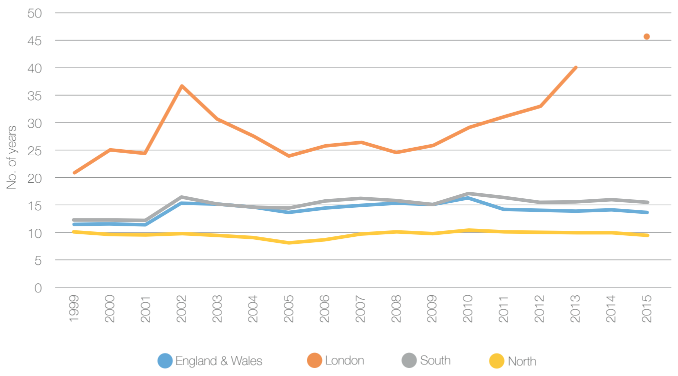
How long it takes to build up a deposit is influenced predominantly by three factors; how much house prices grow, how much incomes grow and the loan to value ratio for the purchase.

Time to Save - Couple Working Full-Time



Source: Hamptons International

Time to Save - Single First Time Buyer



Source: Hamptons International

Note: In 2014, deposits size were growing so fast in London that it would have been impossible to save for a deposit without saving more than 24% of income or getting additional financial support from elsewhere.

> *"Understanding the length of time it takes to save for a depostit provides an indication of future transactions in the market."*

Executive Summary

Rising house prices, stagnant wages and tougher mortgage criteria have all contributed to lengthening the time to save.

- In England and Wales an average couple working full-time would need to save for 3 and a half years from 2015 to raise a 15 per cent deposit. This is unchanged from the previous year but 15 months longer than it was in 1999 - the start of the index and the shortest time recorded.

- A single, aspiring first-time buyer would have to save for 13 and a half years; almost four times as long as a couple and 30 months longer than it was in 1999. However, in a sign that affordability is improving somewhat, single buyers can now save their deposit 9 months faster than in 2014.

- There are significant regional variations in the time to save. The North East, where earnings have risen faster than house prices since the financial crash, has the shortest time to save with couples able to save in 2 years and single first-time buyers saving in 8 years and 9 months.

- London buyers face the longest wait with couples having to save for 8 years and single first-timers needing almost 46 years. Here houses prices have surged since the crash and has resulted in the time to save increasing the most. Since 2008, the length of time to save a deposit has almost doubled.

- We estimate that for housing to be reasonably affordable, by conventional measures given current incomes, it should take an average couple working full-time around 2 years to save and 9 years for a single first-timer.

- Three things affect the time to save:

  1. House Prices: It would take a 1.7 per cent fall in house prices annually to make the time to save 'reasonable'. But as the gap between house price growth and wage growth reduces it will also take less time to save a deposit. A 1 per cent fall in forecast house price growth with average wage growth of 3.7 per cent, takes 15 months off the time to save.

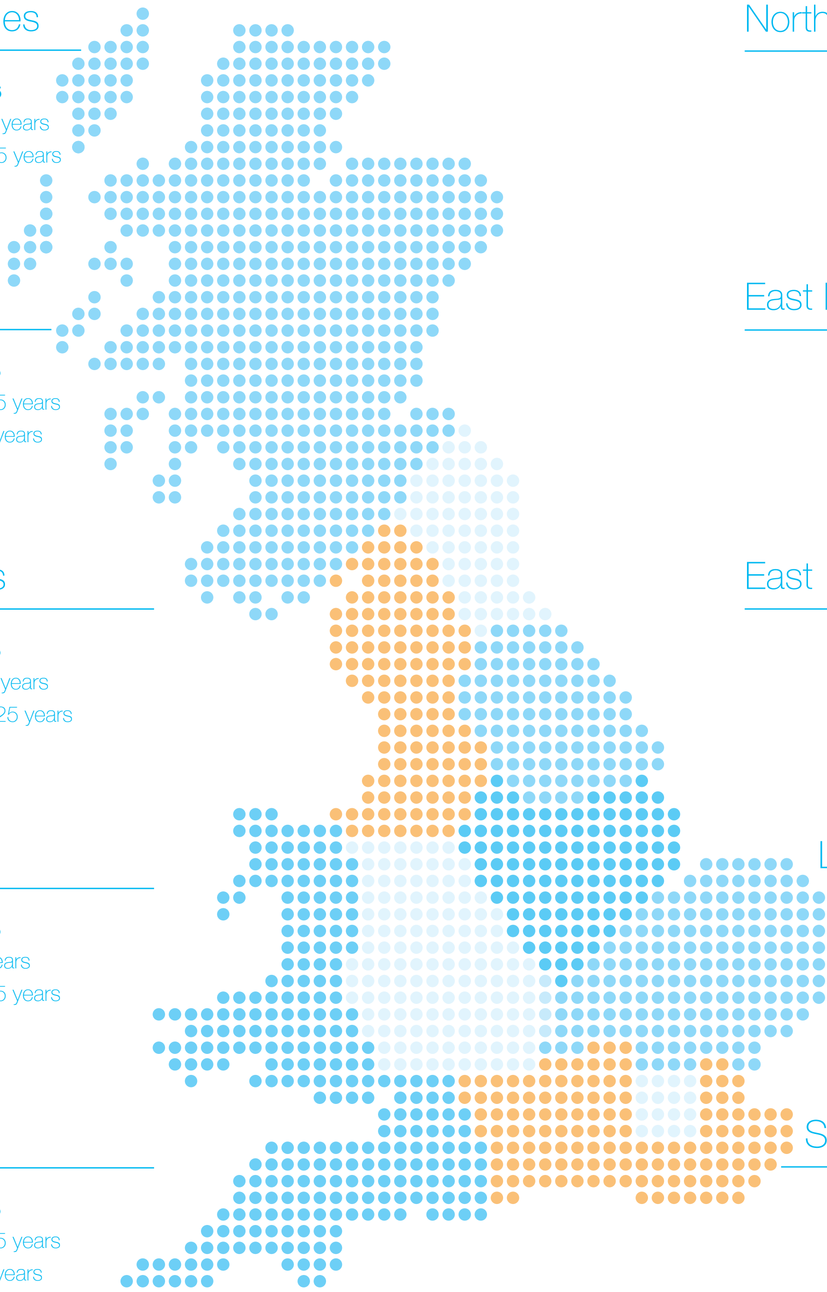
  2. Earnings: Areas where the gap between earnings growth and house price growth are smallest have the shortest time to save. Earnings are forecast to grow by 3.7 per cent but if they grew a per cent more it would reduce time to save by 18 months for the average single first-time buyer.

  3. Loan to Value (LTV) ratios: The higher the LTV available, the faster it will be to save a deposit. Historically, first-time buyers had access to 90 per cent loans but this reduced after the financial crash. With access to 90 per cent loans, buyers in most regions will be able to save at or below the reasonable benchmark – at 95 per cent only buyers in London would be saving for longer than the benchmark.

- The Help to Buy ISA scheme will allow buyers, saving a 15 per cent deposit, to reduce their time to save by 3-12 months. However, given the size of deposits required, it has a relatively small impact and would need a far larger subsidy to reduce the time to save to more affordable levels.

How Long Does it Take to Save?

The regional variations across the housing markets.



England & Wales

	2007	2015
Couple	3 years	3.5 years
Single	14.9 years	13.5 years

North West

	2007	2015
Couple	2.4 years	2.25 years
Single	9.4 years	10 years

West Midlands

	2007	2015
Couple	2.5 years	2.5 years
Single	11.9 years	12.25 years

Wales

	2007	2015
Couple	2.8 years	3 years
Single	10.3 years	9.25 years

South West

	2007	2015
Couple	2.6 years	2.25 years
Single	16.9 years	16 years

North East

	2007	2015
Couple	2.4 years	2 years
Single	9.6 years	8.75 years

East Midlands

	2007	2015
Couple	2.6 years	2.75 years
Single	10.8 years	11.5 years

East

	2007	2015
Couple	3 years	3.5 years
Single	15.6 years	14.5 years

London

	2007	2015
Couple	3.8 years	8 years
Single	26.4 years	45.75 years

South East

	2007	2015
Couple	3.3 years	4 years
Single	15.3 years	15 years

Key

Couple

Single

Source: Hamptons International

But How Long is Long Enough?

Quantifying the length of time it takes to save for affordable housing.

Buying a home is expensive so we would expect it to take a reasonably long time for households, particularly single first-time buyers, to save a deposit. But what is a reasonable time to save for a deposit?

One commonly used benchmark of affordability is that prices should be no more than three times gross income and has historically been the rule of thumb. With prices at that level, we can estimate the length of time which would be 'reasonable' to take to save a deposit when saving 22 per cent of income after spending and taxes. For a couple working full-time this works out at at least 2 years, while single buyers would need to save for over 8 years.

Couples working full-time in England and Wales are not far off this benchmark, having to save only over a year more than the affordability criteria suggests while single first-time buyers have to save for over 4 years more.

London is a special case and this is glaringly illustrated in the time to save. In the Capital, couples have to save for over 5 years more while single buyers save for over 35 years more. Realistically, only those able to save larger portions of their income or earning more than the average wage would be in a position to build up a deposit.

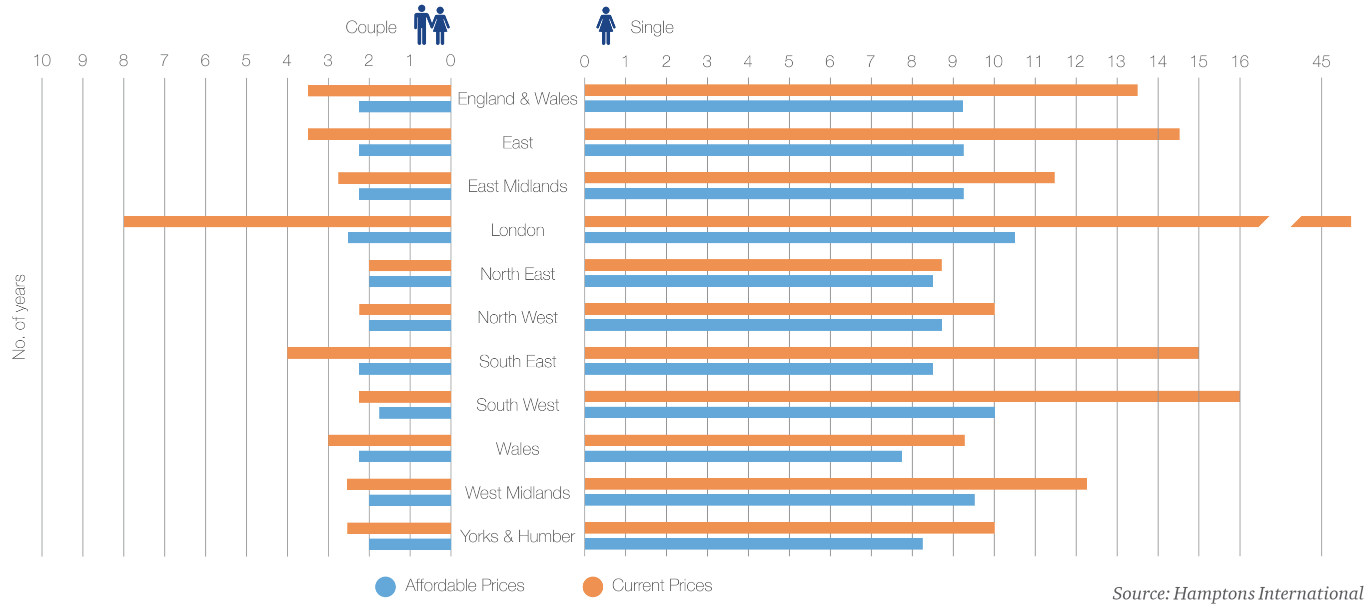
> *"In London single buyers will need to save for over 35 years more than the 'reasonable' threshold."*

Has the 'Reasonable' Affordability Threshold Ever Been Met?

	Couples		Singles	
	Year(s)	Time to Save	Year(s)	Time to Save
England & Wales	-	-	-	-
East	-	-	-	-
East Midlands	1999	1.8 years	-	-
London	-	-		
North East	1999-2001, 2005	<2 years	2005	<8 years
North West	1999-2001	<2 years	2005	<8 years
South East	-	-	-	-
South West	1999-2000	<2 years	-	-
Wales	1999-2000	<2.5 years	-	-
West Midlands	1999-2000	<2 years	-	-
Yorks & Humber	1999-2000	<2 years	-	-

Source: Hamptons International

Time It Takes to Save a 15% Deposit for an Affordable House



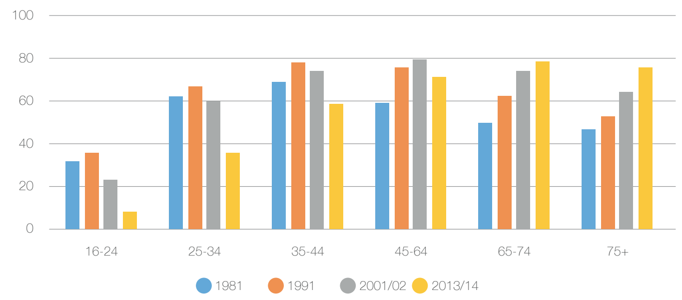
Source: Hamptons International

Slowing Down the Market

A modest slowdown in the pace of house price growth will have a big impact on time to save in expensive regions.

Home ownership has been falling in England and Wales since 2003. What is striking is that the rates have increased amongst the older generations, but declined sharply amongst the young. That's because cheaper house prices before the housing boom decades meant they could buy younger. The median age of the average first-time buyer is now 30, rising from 26 when records began in 1974. In 1991, 67 per cent of those in the 25-34 age group were homeowners, by 2014 this had fallen to 36 per cent, partly as a result of higher deposit requirements.

% of Age Group That Are Home Owners in England



Source: English Housing Survey

The Time to Save index gives us an insight into how a slowdown in price growth would improve the time it took for households to save a deposit.

A 1 per cent slowdown in the rate of house price growth would not change the fortunes of couple working full-time but a single first-time buyer would be able to save their deposit 15 months faster. Single first-time buyers' time to save is reduced most as rising prices are outpaced by the rate their savings accumulate for a longer period.

The difference is more pronounced in the most expensive markets, even though the time to save is still high compared to other regions. In the southern markets single buyers would save almost 2 years faster than previously; for those in London, saving time would be cut short by 18 years, from 46 years to 27.

What Annual Price Change Will Bring Time to Save to the Reasonably Affordable Threshold?

	Annual Price Change
England & Wales	-1.7%
East	1.3%
East Midlands	-0.7%
London	-7.9%
North East	4.3%
North West	2.8%
South East	-4.2%
South West	-2.2%
Wales	1.3%
West Midlands	0.8%
Yorks & Humber	1.3%

Source: Hamptons International

Effects of House Prices Growth of 4% Rather Than 5%

Source: Hamptons International

Earning Your Keep

Rising house prices have not been the sole cause of a longer time to save.

> *"Since 1997, house prices have grown around 6 per cent annually, twice as fast as earnings."*

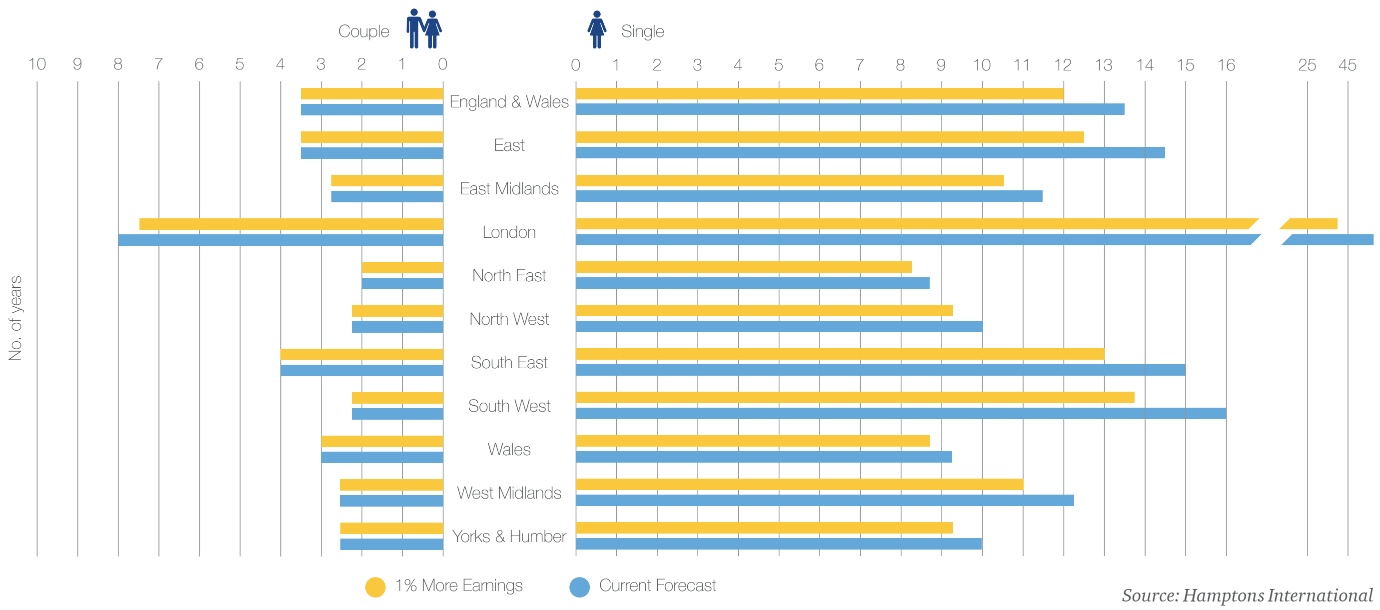
Earnings play a big part in time to save and the growing disparity between earnings and house price growth since the mid-1990s is fundamental to the barriers first-time buyers now face. But the effect of lower earnings growth has been softened by lower costs of living meaning that there has been more income left out of which to save.

In the North East earnings have risen faster than prices since the financial crash, which has contributed to the fall in the length of time to save a deposit, but the opposite has happened in London and the South East where buyers now have to face raising larger deposits or borrowing much more to cover the income gap.

The time to save index allows us to look at the effect changes in earnings growth would have on the length of time it takes to build a deposit. If earnings growth was 1 per cent higher than the Office for Budget Responsibility (OBR) forecast, single first-time buyers see a significant reduction in the time to save, but it remains unchanged for most couples. That is because in most regions the additional income in a couple means that they can save more quickly, so there is less time for the effect of higher earnings to build up.

In London first-time buyers have to save for almost 46 years, but with a 1 per cent increase in earnings this could be trimmed by over 20 years.

Effects of Increasing Earnings Growth by 1%



Source: Hamptons International

The Smaller Loan Challenge

More risk averse banks since the financial crash has meant buyers need to save larger deposits.

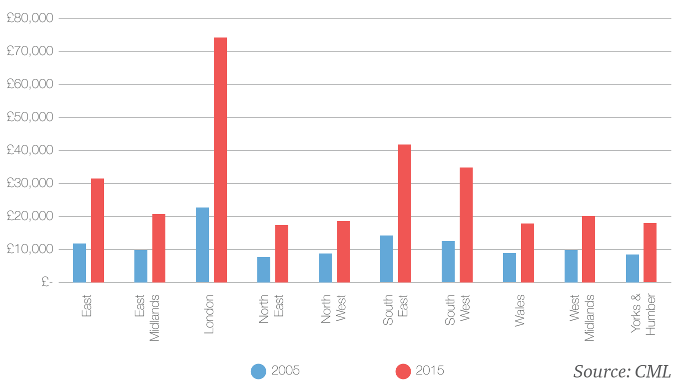
First-time buyers suffered from the evaporation of high loan-to-value (LTV) lending after the crash as banks lost their appetite for risk. In 2007, loans at over 90 per cent LTV made up around 15 per cent of overall new mortgage lending but by 2009 this had fallen to only 1 per cent. By 2009 the median first-time buyer LTV had fallen to a record low of 75 per cent. Thankfully high deposit requirements are now beginning to ease, and have been aided by the Help to Buy Mortgage Guarantee scheme allowing those with smaller deposits to get on to the ladder.

The index allows us to estimate how much a 5 and 10 per cent increase in LTV ratio would reduce the time to save.

A 90 per cent LTV ratio would allow couples and single first-time buyer households, outside of the expensive London, South East & East regions, to save a deposit in line with the 'reasonably affordable' benchmark. At a 95 per cent only those in London would still be saving for longer than that threshold.

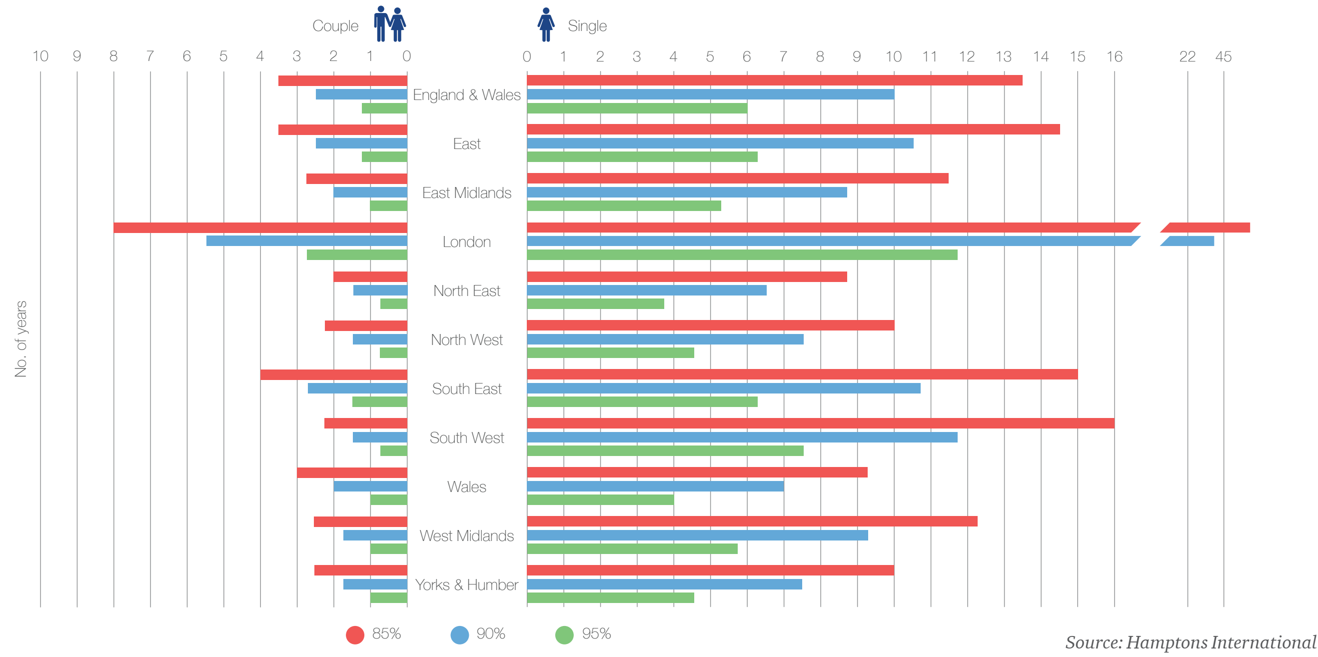
The lower LTV since the financial crash is unusual as historically first-time buyers could take out a 90-95 per cent loans more easily. As credit availability increases, allowing for more high LTV mortgage products in the market, time to save will reduce naturally. However, the Bank of England has expressed concerns about the impact high LTV lending in the market can have on economic stability. It has the power to limit LTVs if it sees a threat to the economy and this would undoubtedly increase the time to save. While maintaining a stable economy is essential, some thought should also be directed to the implications it will have on the liquidity of the housing market and what the cost might be to aspiring homeowners. Careful consideration should be taken to ensure that high LTV lending, traditionally the route on to the ladder, can still take place albeit only to those who pose less of a risk.

Average Deposit Size



Source: CML

Effect of increasing LTV requirement to 90 & 95 per cent



Source: Hamptons International

A Helping Hand from the State

Will the Help to Buy ISA unlock the market for savers?

Housing affordability has been high on the public's agenda for several years and the government's desire to increase access to home ownership means that it is now introducing policies aimed at making it easier to get on the ladder. The Help to Buy ISA is aimed at lowering the hurdle of raising a deposit. It allows first-time buyers to save up to £200 a month towards a home, with a bonus from the government of 25 per cent. The maximum bonus is £3,000 so if a person saves £12,000, they will have a deposit of £15,000. But how much does this improve their prospects of getting on to the ladder?

We have assumed that the households would still save the same amount but split between the Help to Buy ISA and an Instant Access Savings amount. The households will save up to the maximum allowed in the ISA and any remainder will be saved in the instant access savings amount. When they have reached the £12,000 target to get the full bonus, they would start saving fully in a Cash ISA. Couples are assumed to have two separate Help to Buy ISA so has to benefit from a £6,000 bonus from the government.

> *"Given the size of deposits required and the rate that they are increasing, the subsidy's effectiveness is quite limited."*

Couples using the Help to Buy ISA scheme will see their time to save reduced by 3 to 6 months while single first-time buyers see a 9 to 12 months reduction. For those in London, while any improvements in their ability to get on the ladder is welcome, the 12 month reduction in their time to save still means they have almost 45 years to wait before they build up the required deposit.

The Help to Buy ISA will prove to be beneficial for many first-time buyers but given the size of deposits required and the rate that they are increasing, the subsidy's effectiveness is quite limited– especially in the expensive London and South markets where deposit barriers are highest for first time buyers.

How much government subsidy would be required to bring time to save to the affordability threshold?

	Couple	Single
England & Wales	81%	116%
East	96%	146%
East Midlands	28%	57%
London	408%	606%
North East	0%	4%
North West	18%	27%
South East	146%	205%
South West	36%	153%
Wales	44%	38%
West Midlands	26%	68%
Yorks & Humber	26%	44%

Effects of Help to Buy ISA

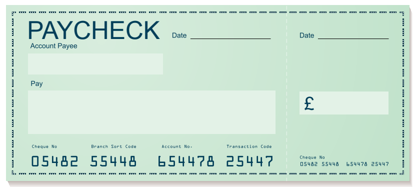
Source: Hamptons International

Time to Save Explained

Understanding how the time to save is calculated.

We assume 2 households - couple working full time and a single first-time buyer. All aged under 30.

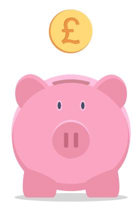
Both earn the regional average wage[1] which grows in line with the earnings forecast. We also assume an uplift to account for career progression over time.



The couple pay the average rent[2] for a 1 bedroom flat and the single buyer rents a room in a house share. Rents grow at government statistics rate.

They pay taxes and essential living costs[3]. Living costs grow in line with the forecast inflation rate[4].

We assume each household saves 22% of their remaining income. Their savings earn interest at the Cash ISA rate[5].



Buyers need to raise a 15% deposit for a property that cost 85% of the regional average house price[6]. Prices are assumed to grow at the OBR house price forecast.

Time to Save is the length of time it takes for their savings to match the deposit required for the house.

[1] ONS Annual Survey of Hours & Earnings, [2] Estimated rents using English Housing Survey & Valuation Office Agency, [3] Costs estimated regionally, [4] OBR CPI Forecast, [5] Bank of England, [6] Land Registry

Drawing on over 140 years of experience, Hamptons International is one of the premier international residential agents – with a network of more than 85 offices in the UK and key overseas markets.

We continue to expand to be one of the most valuable and innovative residential property groups in the world. Our name is synonymous with an unrivalled level of expertise and the finest properties.

Our services include:

- Sales
- Lettings
- Residential Development
- Valuation
- Land & Professional Services
- Property Management
- Mortgage Finance
- Corporate & Relocation Services
- Interior Solutions

www.hamptons.co.uk/research

Fionnuala Earley
Residential Research Director
earleyf@hamptons-int.com
+44 (0)207 758 8465

Michael Adefuye
Residential Research Analyst
adefuyem@hamptons-int.com
+44 (0)207 591 7336

hamptons.co.uk

GOLD LARGE ESTATE AGENCY of the YEAR 2015 THE SUNDAY TIMES THE TIMES

HAMPTONS INTERNATIONAL