Response to the House of Lords Select Committee on Economic Affairs

Inquiry into the Economics of the UK Housing Market

December 2015

Building Societies Association

Summary

S1. The Building Societies Association welcomes this opportunity to respond to the House of Lords Select Committee on Economic Affairs' Inquiry into the UK Housing Market. In this response we argue that:

S2. In general: A diverse housing market better preserves economic stability, by ensuring that housing supply is responsive to changes in the market and society more generally. Although we welcome the cross-party political commitment to significantly increase the supply of new housing, more attention should be given to providing homes across a range of tenures, types of housing and price points.

S3. Government schemes: The Government's focus on shared ownership is very welcome. While the Help to Buy equity loan has largely met its policy objectives to date, we would like to see careful management of London Help to Buy and a smooth transition out of the Help to Buy guarantee scheme.

S4. Tax: Tax revenues should be hypothecated to keep housing for young people permanently affordable. We are concerned that the changes to inheritance tax have the potential to dis-incentivise downsizing. The Government might consider a publicity campaign around the tax credit in order to avoid this.

S5. Mortgages: Although the changes to regulation implemented by the Mortgage Market Review have largely been positive, we are seeing some side-effects. However, what the mortgage industry needs now is a period of regulatory stability in order to focus on innovation.

S6. Planning: While the National Planning Policy Framework has largely been a success, further measures could be taken to incentivise build-out of planning permissions. The issue of funding infrastructure is a particularly crucial one, though a further review of the Community Infrastructure Levy is likely to create uncertainty.

S7. Private rental: The cumulative effects of the Government's different policy measures on buy-to-let are likely to be significant. We are concerned, however, that tenants may be affected the most by the changes.

S8. Rent restrictions: While some corporate 'build-to-rent' landlords restrict rents voluntarily, we would be concerned about rent restrictions being imposed on the wider market, which is largely made up of small-scale landlords.

S9. Social housing: The policy intention behind the extended Right to Buy is clearly a good one – but achieving 1-for-1 replacement is absolutely vital in order to preserve housing associations' asset bases. The cut in social housing rents is in danger of undermining private lenders' confidence in the sector in the long-term, and in the short-term is likely to reduce development.

Introduction

1. The Building Societies Association (BSA) fulfils two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the Government and Parliament, the Bank of England, the media and the general public. Our members have total assets of over £330 billion, and account for approximately 20% of both UK mortgage and savings balances. It's estimated that more than a third of the UK population has a financial service relationship with a building society.

2. We welcome this opportunity to contribute to the Select Committee's Inquiry into the Economics of the United Kingdom Housing Market. We have a wide perspective of the UK - none of our members are headquartered in the City of London. They are all based in towns and cities outside of the capital serving the real economy and, in particular, their local housing markets.

3. Over the years since the financial crisis, building societies have a particularly good story to tell. Since the start of 2012 net new lending by building societies – that is gross new lending minus repayments - has topped £56 billion, compared to £14 billion from all other mortgage lenders put together. Building societies particularly excel in areas of the mortgage and housing market which other lenders find it difficult to serve – such as self-build, shared ownership and lending into retirement.

4. Our fundamental point is that a thriving housing market includes a range of tenures which give consumers a choice – including home ownership, shared ownership, private rental and social housing. While the Government has a clear priority to increase home ownership, it is important that these measures do not simply stoke up demand to the detriment of the wider market.

5. Building societies exist to help finance house purchases. Most lending is for home ownership but building societies also lend across the whole range of tenures. However societies do require economic stability and for any tenure they lend on to offer reliable security for the mortgage. The BSA believes that a diverse housing market better preserves economic stability by ensuring that housing supply is responsive to changes in the market and society more generally. This helps to prevent prices from becoming divorced from economic fundamentals, avoiding unsustainable price increases that are not in either lenders' or borrowers' long-term interests.

1. Private ownership: What measures can be taken to increase the supply of reasonably priced housing in the UK?

1.1 It is widely recognised that the UK housing market has many structural issues. We have been under-building new homes for years – consistently building less than half of the 240-260,000 completions needed each year. It is therefore very encouraging that both the Government and the opposition parties have made housing a political priority in this Parliament.

1.2 In the recent Spending Review the Government unveiled a Five Point Plan to deliver 400,000 affordable housing starts over the Parliament through a mix of Starter Homes, an expansion of shared ownership and various other schemes. This is certainly a laudable aim but the focus must now be on delivery.

1.3 To some extent we question whether all the focus should be on building 'reasonably priced housing' – which appears to be an aim centred solely on first-time buyers. However, there is undersupply across all housing tenures and types and across all age groups. Building housing at higher price points could incentivise people further up the housing ladder to move. As their homes come onto the market this creates buying chains and could stabilise prices further down the ladder as more homes come onto the market. The market can also better absorb a range of new housing tenures, prices and types.

1.4 One example of this comes from Legal and General research, which surveyed a group of people over 55. They found that despite 32% having considered moving to a smaller property in the last five years, only 7% had actually done so[1]. These home movers may have significant amounts of equity and be able to pay a higher price tag but seem equally as frustrated in their search for a home suitable for their needs as first-time buyers.

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[1] Legal and General, 'Last time buyers', www.legalandgeneralgroup.com/assets/portal/files/pdf_175.pdf

1.5 The BSA conducts a quarterly survey of consumers called *Property Tracker,* asking about the main barriers to purchasing a property. In our September edition[2] it was found that nearly a fifth of homeowners who were looking to sell their property said difficulty affording their next property is a barrier to putting their home on the market. This shows that affordability is an issue across the housing chain.

a. Government schemes

1.6 The BSA is very supportive of the Government's plans to expand shared ownership. This would benefit young people and families especially if this form of tenure became more mainstream with a viable secondary market. Therefore the Government's plans to loosen some of the eligibility criteria seem sensible. We are also supportive of the changes to the 'Pre-emption right' announced earlier in the year.

1.7 A number of building societies are active in shared ownership lending and have gained confidence from moves to standardise the shared ownership product in recent years, through initiatives such as the model lease. However, consistency amongst housing providers continues to be an issue. There are often subtle differences between shared ownership schemes offered by each housing provider and in each post code, which consequently makes lending more resource-intensive. We are keen, however, to dispel any myths that lending on shared ownership properties is riskier – our data shows that arrears figures are only marginally higher than the overall average for other forms of lending and losses are negligible.

1.8 The Government has a further intention to 'de-regulate' shared ownership. We await the detail but welcome this principle in general. However, we would take issue with attempts to change things such as the model lease or, as another example, the 'Mortgagee Protection Clause' which gives lenders recourse to the full value of the property in the event that a shared ownership home is repossessed.

1.9 In terms of Help to Buy we will take the various schemes in turn. It would appear that the Help to Buy equity loan has been successful in kick-starting the new build market in various parts of the UK. Most of the effects have been seen in housing markets outside of London which is positive. On the other hand, while this intervention is effective in helping buyers without the ability to save substantial deposits to get onto the housing ladder, it has not improved 'real' affordability. Although Help to Buy helps people with their first purchase, unless they can later pay off the equity loan element from their own resources, their position with regards to obtaining another affordable home is not improved. Essentially they will still need to find a larger deposit when they want to move up the ladder, as repaying the equity loan reduces their purchasing power.

1.10 The Government has also recently announced London Help to Buy – offering an equity loan of 40%. Extending a current scheme is the right way of doing this as simplicity sells for both buyers and lenders. However, given the concerns about house price inflation in London prior to the original Help to Buy – and given that Help to Buy has so far avoided this – we would want to see the Government carefully managing this London scheme to guard against adverse consequences.

1.11 We would also want to ensure that borrowers will not be unduly burdened with debt under London Help to Buy. Using some simple maths – the 40% equity loan is available on London homes up to £600,000 meaning that the borrower could take a loan of up to £240,000, which will begin to bear interest after 5 years[3]. This is on top of their mortgage debt. Although the equity loan will not require monthly repayments, this is clearly a substantial sum for the

[2] BSA, Property Tracker September 2015, https://www.bsa.org.uk/document-library/statistics/property-tracker/bsa-property-tracker-september-2015.pdf
[3] DCLG, London Help to Buy scheme summary

borrower to discharge upon sale of the property and amplifies the barriers with moving up the ladder as outlined above.

1.12 The Help to Buy guarantee scheme was essentially designed to meet the needs of high-street banks who largely pulled out of high loan-to-value lending during the financial crisis. No building society takes part in the scheme and societies have continued to lend using private forms of mortgage insurance.

1.13 However with the Help to Buy guarantee scheme due to end in 2017 and the Government unlikely to continue it, we are keen to see that there is a smooth exit strategy put in place – likely through a private-sector solution - so that high-street banks stay in this space. Building societies would not be able to service all of the market demand and would not wish to do so from a risk perspective. Given the need for high loan-to-value lending to help first-time buyers onto the housing ladder it is desirable to have a range of lenders competing in the market.

b. Taxation: Are there tax measures that would improve housing supply and affordability?

1.14 We like the idea, as set out in our report *Housing at the Heart of Government*[4], of hypothecating some tax income to help provide housing to younger generations. A revolving fund could be created from tax receipts and used to help housing associations and the UK's growing number of Community Land Trusts to ensure properties remain permanently affordable. We believe this would provide greater security for lenders and encourage a more competitive market.

1.15 The BSA has suggested this idea to the Welsh devolved government as they gain control over Stamp Duty Land Tax (SDLT) receipts in 2018. This could also be a good use for the extra SDLT income generated for the Treasury by the surcharge announced in the Spending Review.

i. We have not done any detailed modelling on the effects of the inheritance tax changes. It would be interesting to know whether the general public is aware of the downsizing 'inheritance tax credits' element of the policy. The Government may wish to carry out a publicity campaign on this point if there are worries about the tax change's effect on housing transactions. We can anticipate that unless people are aware of this, the changes are likely to lead to a reduction in downsizing.

ii. Modelling by others has shown that reform of the 'slab' structure of SDLT bands in the Budget has had the desired effect of removing bulges at the various price points. However, perhaps unsurprisingly, the effect on wider affordability appears to have been minimal. Interestingly, our *Property Tracker* - which asks whether SDLT is a barrier to purchasing a property - has consistently found that SDLT is a relatively minor barrier to house purchase, with 10% citing this as a barrier in September but moved up to 13% in December. This recent change could be down to the SDLT surcharge for additional homes announced in the Spending Review. We wait to see whether there will be a rush for people buying additional homes to complete their purchase prior to the policy coming into effect on 1 April 2016.

c. Mortgages

1.16 The changes to regulation implemented by the Mortgage Market Review (MMR) were for the large part very sensible. We cannot take issue with the principle that lenders should make every effort to ensure that borrowers can afford to repay their mortgage. The move to having almost all borrowers receive regulated mortgage advice did take some time to bed in and could

[4] BSA, 'Housing at the Heart of Government: A Manifesto for Change', https://www.bsa.org.uk/document-library/press-and-public-affairs/public-affairs/bsa-housing-manifesto.pdf

explain why there were some damp quarters of lending – though there was nothing like the chaos anticipated in some parts of the media.

1.17 However it is difficult to be sure whether these damp periods were down to the changes implemented after MMR. Over a similar period the Bank of England has also intervened in the mortgage market, and Financial Policy Committee (FPC) members' comments on the risks emanating from the housing market were covered extensively in the media. The FPC's recommendation to limit lending at high loan-to-income multiples is likely to have affected first-time buyers the most. It is therefore difficult to disentangle the effects of the MMR changes on the market from those of the FPC's interventions.

1.18 There are pockets of the mortgage market where the effects of the MMR changes are more pronounced however. The changes to interest-only, for example, mean that this kind of lending has been vastly reduced. As a result there appears to be a move towards longer mortgage terms of 30 and 35 years, with many borrowers needing to take a mortgage into retirement. The BSA recently published a report on *Lending into Retirement*[5] in which it was found that around one in four people today who will borrow beyond the age of 65 is a first-time buyer[6]. Our research shows that around half of 25-34 year olds think they will need a mortgage lasting into retirement.

1.19 However in terms of whether further changes are needed on the level of the MMR our answer would be no. Mortgage lenders are currently dealing with implementing the European Mortgage Credit Directive by March 2016. What is most needed thereafter is a period of stability and reflection. Currently a significant amount of lenders' resource is spent on implementing regulation, leaving little to research and design innovative products which meet regulatory requirements but deliver the right outcomes for borrowers and meet changing customer needs.

d. Planning

1.20 We are not planning experts so will leave a substantive answer under this heading to others. However the National Planning Policy Framework appears to have led to an increase in house-building, and the measures announced in the Government's document *Fixing the Foundations* to get councils to adopt local plans are certainly welcome. We note that there are some fairly significant changes to planning policy currently being consulted on – including proposals to redefine 'affordable housing' to include Starter Homes.

1.21 However there continues to be a mismatch between the number of homes that receive planning permission and the number that are actually built out. Clearly some of this gap will be down to legitimate issues with viability. But the Government could consider further measures to get developers with sites holding planning permission to actually build out the homes. The independent Lyons Housing Review last year suggested 'Use it or Lose it' powers where council tax could be levied on the developer if homes are not built out within a reasonable time period. This would incentivise the developer to either build the homes or sell the site to another developer who will.

1.22 In terms of wider planning issues our forthcoming *Property Tracker* research found that the biggest opposition to house-building comes from people worried about a lack of infrastructure. 82% of people opposed to local developments either agree or slightly agree that new homes will put a strain on roads, trains, schools and hospitals. Clearly then any planning for new homes in a local area must take a strategic view to ensure that those homes are supported by sufficient infrastructure provision.

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[5] BSA, 'Lending into Retirement: Interim report', https://www.bsa.org.uk/document-library/information/publications/lending-into-retirement-report.aspx
[6] FCA Product Sales Data Q4 2014

1.23 The issue of capturing land value uplift to pay for infrastructure is seemingly back on the agenda with a review of the Community Infrastructure Levy (CIL). We note that the original intention of CIL was to be a development impact tax commensurate to the infrastructure costs which new development imposes on the local area. This element was lost in favour of local authorities specifying a charging schedule. While CIL is not a perfect system, the charging schedule does at least offer greater certainty to developers, which is needed to make long-term investment decisions – but this will not be the case unless CIL is allowed to bed in.

2. Privately Rented Accommodation: What measures can be taken to increase the supply of low cost private rental properties in the UK?

a.

2.1 Our forthcoming *Property Tracker* research suggests that the reduction of tax relief announced in the Budget could well increase the cost of renting privately. 21% of the buy-to-let (BTL) landlords surveyed said they would respond to the changes by increasing rents. This was the most frequently chosen answer. However there are limits to how much rents can be increased. Rents are in part determined by net incomes – how much people can afford to pay for their housing costs, unless tenants are expected to make cutbacks in their other expenditure. This creates a cap on how much landlords can continue to increase their rents above wage inflation.

2.2 Rents are essentially a result of the structure and make-up of the wider housing market. It is unclear, however, where the 'breaking point' would be as tenants will often make significant sacrifices to pay the rent. Many private renters already spend close to half of their income on rent in some housing markets and may be unable to afford further rent increases. It is also unclear how many landlords would be willing to take a hit on their rental income or whether they would sell the property instead. This depends on current and future rental yields and will play out differently in different local housing markets.

b.

2.3 The Chancellor stated an intention with the changes to BTL tax relief to level the playing field for home ownership. Whether these changes, in conjunction with the stamp duty surcharge announced in the Spending Review, will lead to landlords reducing their portfolios remains to be seen. In any case, margins are likely to be squeezed considerably. However there will always be people who can only ever afford to rent, and many who choose to do so. These changes may hit tenants the hardest if a constrained supply of rental properties drives up rents.

2.4 It is also unlikely that these changes will reverse the decline in home ownership. The decline in ownership is in large part due to house price inflation – which is a function of the total housing stock on the supply side, while in terms of demand we have experienced a growing population and greater household formation over recent decades. In 1981 two in ten households consisted of a person living alone, by 2013 this was 3 in 10.

2.5 It is also important to note that the high point of home ownership came on the back of two main factors. The first was Right to Buy - which the Government has been trying to reinvigorate since 2012 and is planning to extend to housing association tenants. The second was the broad increase in credit availability. The entry of banks and others into mortgage lending in the 1980s increased the overall supply of credit and the number of players in the market. Mortgages linked to endowments were also very prevalent then, as were other interest-only mortgages. Both of these options increased the number of people who could access mortgage finance but are no longer widely available.

2.6 In terms of how to encourage a stable long-term rental culture we have two points. The first concerns BTL. Some building societies offer mortgages which allow the landlord to give a 3-year tenancy. However, uptake is generally small. Uptake could become even smaller due to the changes to BTL tax relief, which will squeeze rental income and potentially shift landlords' mind-sets even more towards the short-term of churning tenancies to adjust rents.

2.7 The second concerns build-to-rent, which the Government has supported through their Build-to-rent Fund and Guarantees schemes. There are now some exciting companies in this space – such as Fizzy Living and Essential Living. A number of housing associations also find the market increasingly attractive and are often backed up by long-term institutional investment. These companies can offer longer-term tenancies with inflation-linked rent increases, as this matches their 'patient money' business models.

2.8 The difficulty with expanding build-to-rent is that the model requires scale in order to achieve efficiency in managing the properties. However build-to-rent schemes have to compete for land with the large housebuilders who are primarily building homes for sale. This can make the upfront land costs significant and whereas housebuilders will get a large capital receipt once homes are sold, build-to-rent investors have to wait far longer to make returns. Some experts have suggested creating a special planning use class for build-to-rent schemes, or building them on public land with a covenant that the properties built will be kept in the rental sector. Either of these proposals may enable build-to-rent developers to become established.

c.

2.9 As mentioned above, a number of build-to-rent landlords already link rent increases to inflation. This system can give greater certainty to both landlord and tenant and is similar to the rent restrictions proposed by the Labour Party. Labour proposed to extend these restrictions to the entire private rented market, but we believe this could lead to under-investment in the rental market overall.

2.10 To make this point, consider that interest rates are expected to rise in the next year or so. A landlord with a buy-to-let mortgage on a standard variable rate cannot precisely predict how much their mortgage rate will increase by. As buy-to-let mortgages are based on rental cover (rental income divided by the monthly mortgage payments), restricting rents limits one of these two variables. If mortgage rates rise more quickly than expected then this could quickly erode rental cover (typically around 125% is required) and cause serious difficulties for the landlord. Landlords may choose not to invest in repairs and maintenance of their properties in order to keep down costs, which would only be detrimental to the tenant.

2.11 Combined with all of the other changes on the horizon for buy-to-let - tax relief changes, stamp duty increases, regulation of some parts under the Mortgage Credit Directive and potential macroprudential regulation by the Bank of England – to add rent restrictions could severely restrain the market.

3. Social Housing: Are any measures needed to increase the supply of social housing?

a.

3.1 The policy intent behind the idea of the Right to Buy for housing association tenants is clearly a good one – opening home ownership up to a range of people who may not otherwise have the opportunity. However the key is in its implementation. The Government has promised 1-for-1 replacements for housing stock sold under Right to Buy and full compensation for housing associations.

3.2 Since the inception of Right to Buy, government has never reached anything close to 1-for-1 replacements. The difference with extending the scheme to housing associations is that there is a significant amount of private investment in the sector, making replacing these assets absolutely crucial. Building societies, banks and bond investors have all lent significant amounts of capital to housing associations, secured against their housing assets. These must be replaced if housing associations are not to be in danger of breaching loan covenants.

b.

3.3 There is a danger with the changes to social housing rents that the Government undermines confidence in the sector. As with asset cover, rental income is a significant factor in an investor's decision whether to lend to a housing association. Indeed, government increased the importance of rental income by shifting from capital investment to rental subsidy with the move to affordable rent over the last Parliament.

3.4 Government also agreed a ten-year rent formula with inflation-linked rental increases which was supposed to give investors confidence to lend to the sector. This is no longer the deal as the 2015 Budget will now reduce rents by 1% a year over the Parliament. While associations may be able to manage this in the short term by reducing their development programmes or cutting other services, there is a danger that any further rent reductions will affect investor confidence. The credit ratings agencies are already signalling a weaker outlook for the sector – compounded by the changes to housing benefit, which has hitherto underpinned a significant amount of housing association income, as well as the overall benefit cap.

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