BSA Response to the Affordable Housing Commission

Restricted
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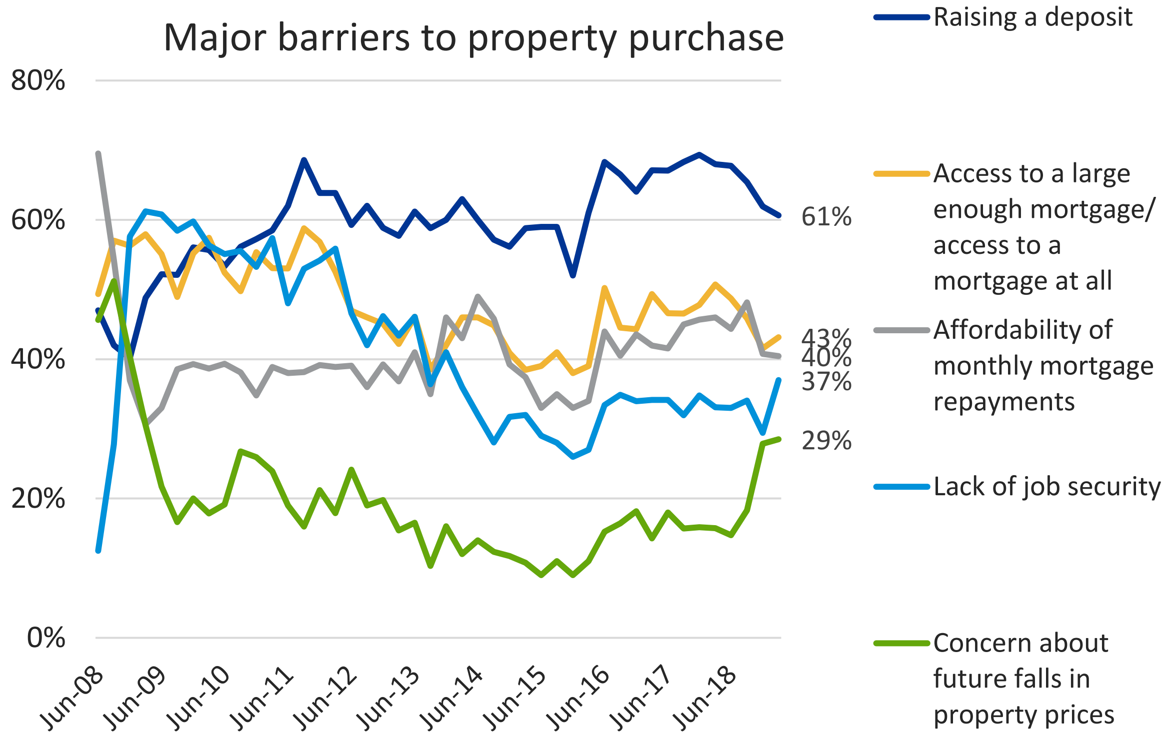
Who we are

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 4 credit unions. Building societies have total assets of over £400 billion and, together with their subsidiaries, hold residential mortgages of over £320 billion, 23% of the total outstanding in the UK. They hold over £280 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 37% of all cash ISA balances. They employ approximately 42,500 full and part-time staff and operate through approximately 1,470 branches.

Understanding the affordability challenge

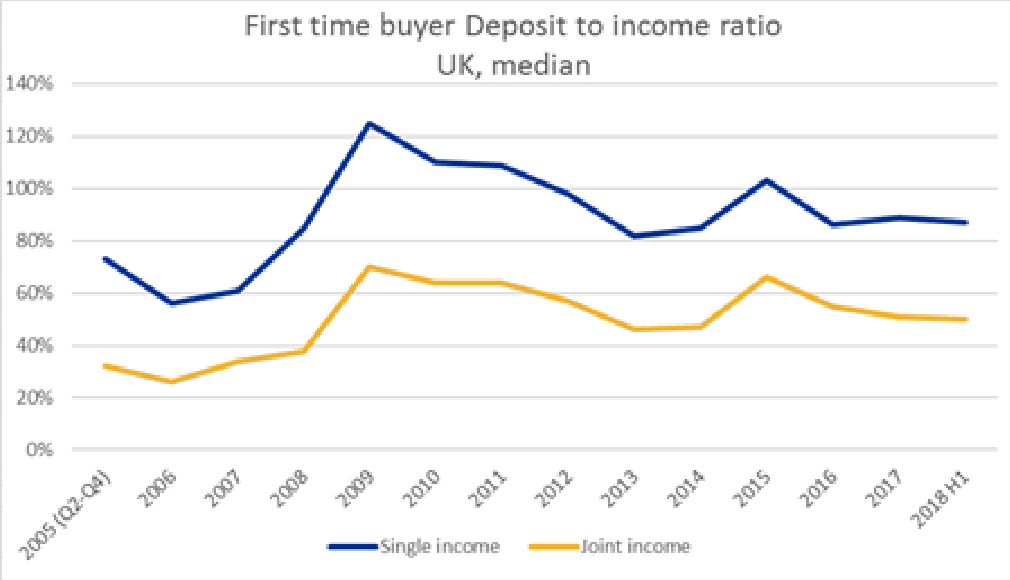
The Deposit Challenge

Saving for a deposit is consistently seen as one of the biggest housing affordability challenges, according to the BSA's Property Tracker. In the BSA's latest survey, March 2019, 61% of people cited this as a barrier, similar to the 63% in December 2018. The chart below shows the trend, in which raising a deposit (61%), access to mortgage finance (43%) and repayment affordability (40%) have been the top three barriers to home ownership for some time now.



Source: [BSA Property Tracker, March 2019]

The challenge of raising a deposit for a first mortgage is further evidenced in the chart below, which shows the size of deposits relative to income for building society lending.



Before the financial crisis, a first time buyer getting a mortgage had a deposit of about 60% of their nominal income if they were buying by themselves, or about a third of their joint income if they were buying with a partner.

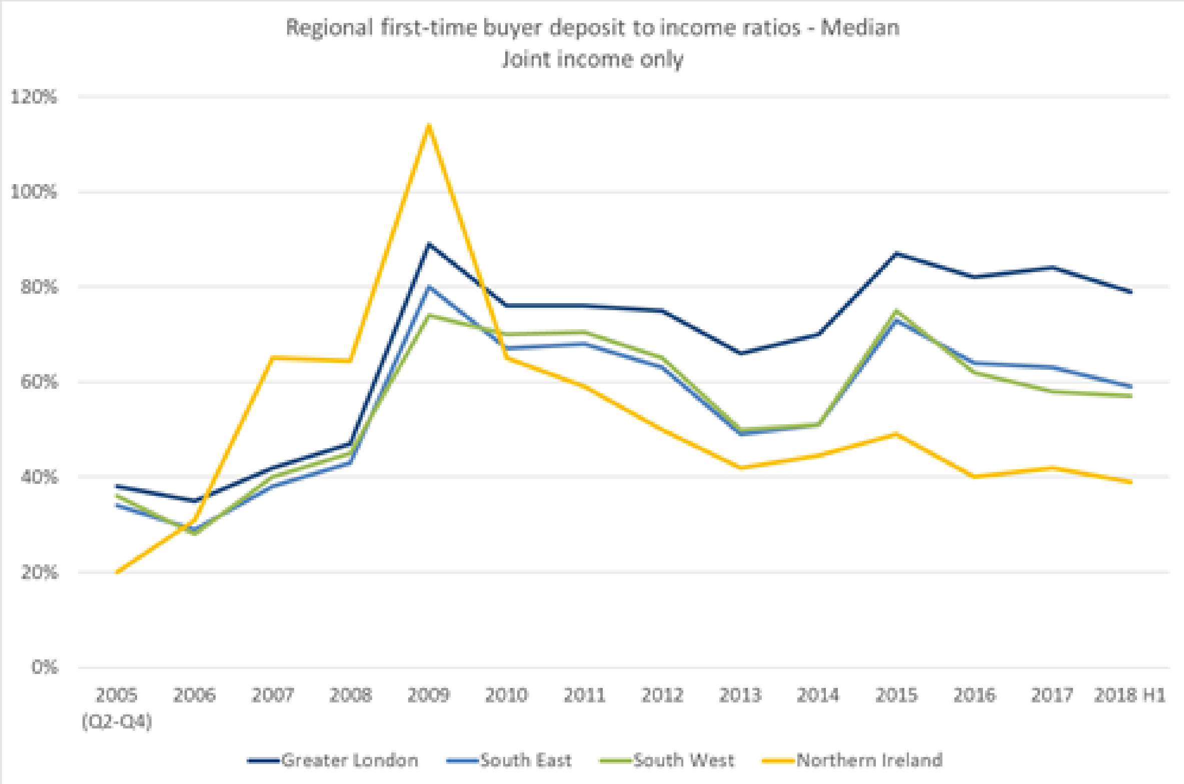
However, since the crisis, changes in lending criteria, relatively weak income growth and changes in house prices, particularly in some regions, mean that the deposit required has risen to be a much greater proportion of income.

In the last two and a half years, the ratio of mortgage deposits to incomes has averaged almost 90% of a single first time buyer's income, and half of joint buyers' incomes.

Regional differences

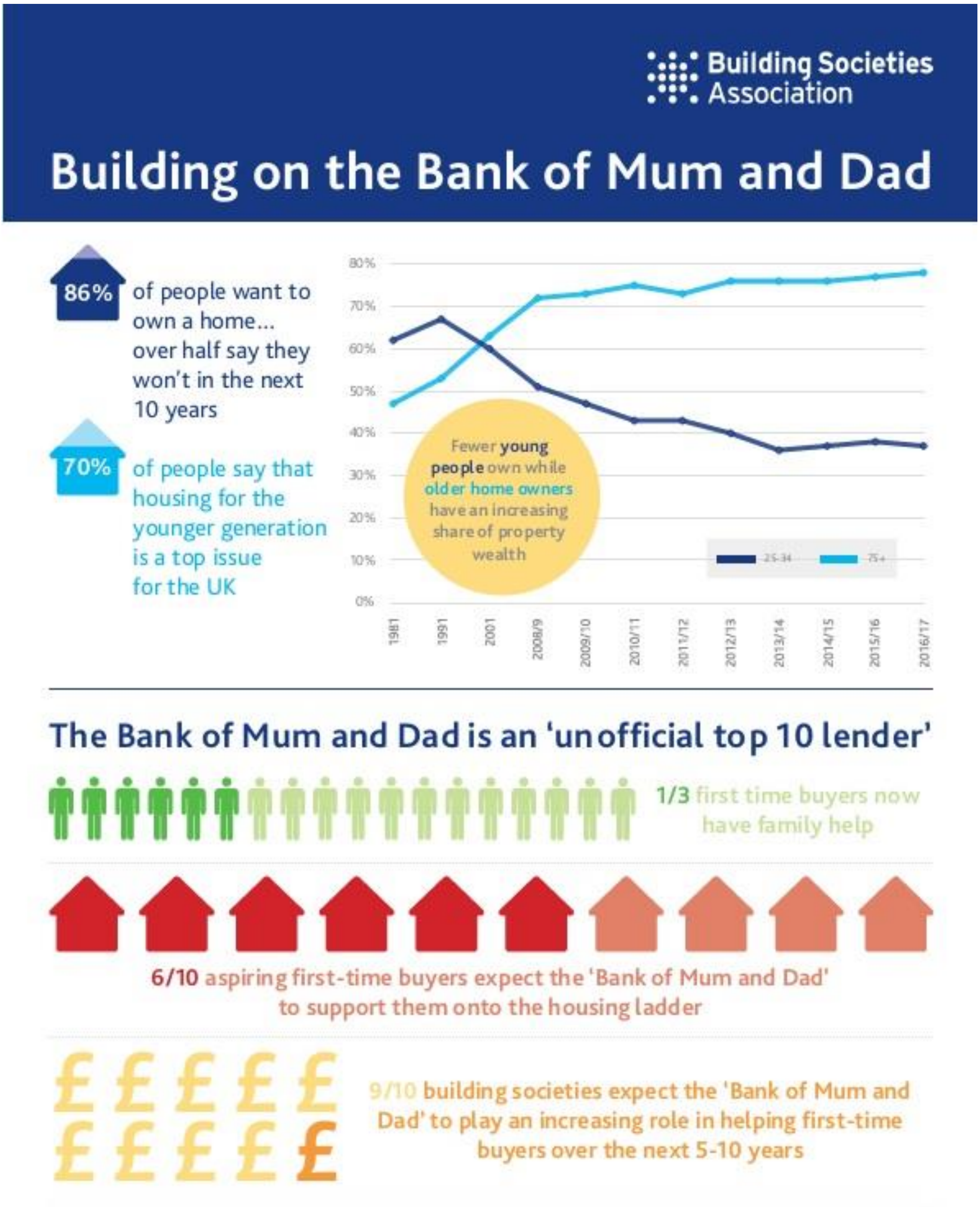
The figures are even starker at a regional level, where the growth of house prices in some regions is evident in the deposits required by first time buyers, as shown in the chart below.

London stands out as having seen a persistent increase in the ratio of first-time buyers' deposits to income, with joint borrowers putting down deposits equivalent to about 80% of their combined income in recent years, compared to below 40% before the crisis. In Southern regions, joint first-time buyers have deposits of around 60% of their incomes. In contrast, the house price bubble in Northern Ireland leading up to 2009 can clearly be seen in the data.



The increased challenges in raising a deposit have led to interventions from Government such as the Help to Buy schemes, which aim to support buyers struggling to raise the necessary down-payment. The so-called Bank of Mum and Dad has also taken a more important role, either directly via gifts or loans, or via intergenerational lending products, offered by many building societies, such as guarantor mortgages or loans that make use of parent's savings with the lender.

Intergenerational effects: The Bank of Mum and Dad
The BSA issued a report in 2018 titled 'Building on the Bank of Mum and Dad' ('BOMAD report'), some key findings of which are set out in the infographic on the next page.



Source: Building on the Bank of Mum and Dad, BSA 2018

Wider housing and mortgage trends

According to the English Housing Survey in 2017-18, of 23.2 million households, 14.8 million (64%) were owner-occupiers. This represents a reversal of the steady growth between the 1980s and 2003, when owner-occupation peaked at 71%. Since then owner-occupation has gradually declined to its current level, although it should be noted that it has remained largely unchanged for the last five years.

Since 2013-14, there have been more outright owners than mortgagors. In 2017- 18, 34% of households were outright owners while 30% were buying with a mortgage, though this has increased by two percentage points since 2016-17. These headline statistics suggest a concentration of housing wealth among older generations who are more likely to have paid off their mortgage and own outright, with younger generations struggling to get onto the housing ladder.

The reduction in owner-occupation has occurred despite a range of Government interventions aimed at increasing home ownership, and the fact that 86% of renters say they aspire to own their home according to the British Social Attitudes Survey.

Alongside this, the BSA's *Lengthening the Ladder* research highlighted that based on current trends for home ownership, mortgage debt, housing equity and population change, there is likely to be a significant shift in the customer base of the mortgage market between now and 2030. Mortgage debt in the over 65s will almost double to £39.9 billion, while mortgage debt held by 20-29 year olds will close to halve.

Why is housing unaffordable?

With the affordability of housing becoming increasingly stretched across all tenures, it is a key issue facing both political leaders and individual consumers alike. Many people misguidedly believe that the affordability challenge started with the credit crisis in 2007/8. The fact is that it was becoming an issue for many well before this, primarily as a function of a mismatch between housing supply and demand. While the number of net additions has been increasing in recent years, to around 220,000 in 2017/18, this is still well short of the Government's 300,000 net additions per year target.

Changes in tenure

In the mid-1990s around 90% of households lived in either owner occupied homes or in social housing. Today, the private rented sector accounts for almost 20% of households, with around a third of these properties financed through buy to-let mortgages. However, recently buy-to-let lending volumes have been declining due to tax changes for landlords and stricter underwriting criteria established by the Bank of England.

Building societies are supportive of the Government's policy objectives to tip the balance away from buy-to-let landlords and back in favour of home-ownership if it is evidenced that the scale has tipped too far. However, this should not be done at all costs. The private rental sector has become an increasingly important tenure and there will always be people who cannot afford to own. The BSA campaigns on the theme of 'Housing for All' and is supportive of measures to increase the building of social housing and to make private rental a more secure, well-regulated tenure.

Population trends

Between 2007 and 2017 the UK population rose from just over 61 million to over 66 million. Population demographics continue to change rapidly, with the population projected to increase by 9.7 million over the next 25 years. Net migration is expected to account for 51% of this increase.

Household composition is also changing, with average household sizes declining over the last fifty years, the number of households are increasing more rapidly than the number of people. In 2011, two-person households in the UK accounted for the largest number of households, followed by one-person households. One-person households are projected to increase by 72,000 per year, 34% of the total increase up to 2037. With the problem set to be exacerbated in the coming years we have to tackle the problem head on and consider solutions to address the chronic shortage of housing in the UK.

What's being done and is it working, and what are the implications and policy trade-offs?

Public vs private housebuilding

In 1980 57% of the 251,820 properties built were provided by private developers, 35% by Local Authorities and 7% by Housing Associations. By 2018 81% of the 192,070 properties built were provided by private developers, 17% by Housing Associations and just 2% by Local Authorities.

Today we rely on private developers to provide the bulk of UK homes, and to build the circa 300,000 properties we need to build each year to satisfy the UK's expected growth in population. Yet the last time private developers built more than 200,000 homes in one year was 1968. The large developers have said that they do not have capacity to provide all of this volume, as they struggle to access skilled labour and suffer materials shortages in times of increased building, which leaves an unrealistic gap to be filled by others such as smaller developers and selfbuilders.

It is important, therefore that local authorities and housing associations are able to increase their contributions to housing supply, likely focusing on areas where the housebuilders do not, such as social housing and Build-to-Rent, and using Modern Methods of Construction which can be suitable for building at higher volumes and tap into different forms of skilled labour and materials to the traditional housebuilding model in the UK.

Government schemes

Building societies did not partake in the Help to Buy Guarantee scheme due to many having access to mortgage indemnity insurance which protects the lender at higher loan-to-value ratios (LTVs). The Help to Buy Equity Loan (HtBEL) scheme has been more successful, although there have been concerns about the level of administration required. A number of our building society members are offering remortgages for HtBEL.

Since 2010, over 481,000 households have been helped to purchase a home through government backed schemes. This includes over 60,000 new Shared Ownership Properties according to Government statistics. There are currently around 180,000 shared owners in England.

Over the period since the launch of the HtBEL scheme in April 2013, Government statistics show 183,947 properties were bought with an equity loan. The total value of these equity loans was £9.90 billion, with the value of the properties sold under the scheme totalling £46.52 billion. Most of the home purchases under the scheme were made by First Time Buyers, accounting for 81% of the total.

While the Help to Buy Equity Loan scheme has been successful in reinvigorating the new build market, the BSA is supportive of the scheme being pared back to focus on first-time buyers from 2021. This should enable a smoother transition when the scheme closes in 2023. Mortgage lenders are now thinking through what should follow the HtBEL, as lending at high LTVs on new build property carries higher risks. The BSA is beginning to see private proposals emerging, among fintechs and startups, but a larger scale solution is likely to be needed. The Government may see the long-awaited Starter Homes scheme as part of this solution.

Building society data from the UK Regulated Mortgage Survey show between January 2015 and December 2018, building societies have agreed 82,196 mortgages backed by schemes such as shared equity and shared ownership.

Towards a new affordable housing offer – increasing supply

How can government support the funding and financing of affordable housing and what needs to change with the current system?

Private shared ownership

In recent years the BSA has seen an increasing number of private providers seeking to enter into the shared ownership market, often backed by pension fund money and seeking an exposure to property. While we see great potential in scaling up the shared ownership model, there is a strong need to ensure that consumer protections remain at the heart of any private offerings.

Homes England's model lease and the various forms of guidance around arrears and possessions provide a greater degree of confidence for mortgage lenders. We would like to see the spirit of these measures reflected in private offerings. There is also a need for standardisation. While new private providers may see a business advantage from emphasising their difference for others, for mortgage lenders there is an increased resource cost in having to understand the slight variations in different proposals. In our view, something akin to a voluntary Code of Practice which private providers can sign up to would be a good first step.

What needs to change to ensure the skills and capabilities are in place to deliver more affordable housing?

In 2016 the BSA launched a report on construction types within housebuilding Laying the foundations for Modern Methods of Construction (MMC). The report explores the addition of this form of housebuilding, particularly offsite construction, into the mainstream repertoire of the UK housing industry: housebuilders, mortgage lenders, surveyors, new build warranty providers and general insurers. At scale the BSA believes it offers one way of easing the UK's housing crisis, which is primarily caused by a lack of housing supply.

Our discussions with developers suggest that MMC could reduce buildout times by up to 30-40%. This speed advantage would clearly help in meeting the country's housing targets, and would also minimise disruption to local communities and likely therefore aid in improving public acceptance of building, with positive effects on the planning process. While currently there is little evidence to suggest that MMC would bring down the cost of new homes, there may be an opportunity for more volumetric forms of MMC to reach scale and achieve cost savings and waste reduction in that way.

The report's ten recommendations include:

- Government has the chance to nurture this small but growing industry by leading the way on its own developments, such as Northstowe near Cambridge; and act as the catalyst to bring the housing industry together to allow innovative building technologies to reach critical mass. We are already seeing the effects of such an approach at the Graven Hill self and custom build site in Bicester, which a number of building societies are lending on.
- The Royal Institution of Chartered Surveyors should produce guidance for its members through its Valuation Professional Standards. This specifies the standard approach that valuers should take when providing a valuation for mortgage purposes.
- To help valuers and lenders understand the multiple different systems of MMC available, terminology and systems should be standardised and more information provided through an online hub. We are seeing an appetite for data from the Government's MMC Working Group, chaired by Mark Farmer.

- A programme is needed to improve the image of these modern properties: Robust, visually impressive and cheaper to run than their traditionally built counterparts – today's offsite offerings are a world apart from the flimsy prefabs of post-war Britain.

One of the key recommendations from the report was for the Government to lead the way in bringing together the housing industry to understand how to make MMC more mainstream. This Group was convened in 2018 and is working on standardising terminology as well as a 'Warranty Acceptance Protocol' (WAP) which should help lending on MMC to become more mainstream.

In terms of mortgageability and ensuring that MMC homes remain sellable, the BSA has highlighted some key issues to the working group

- Durability – Lenders need assurance that properties will not deteriorate and lose value in the long-term. Mortgage lenders take on risk for the length of the mortgage term, and homeowners until they are able to sell their home. Schemes such as the Build Offsite Property Assurance Scheme have helped to improve confidence.
- Repairability – It is important that repairing an MMC home does not put a great burden on the homeowner in terms of unreasonable costs or sourcing replacement parts. The BSA understands that there will be a greater focus on evidencing repairability in the WAP.
- Local trade skills – Linked to the point of repairability, it is vital that local tradespeople have the correct skills to repair and adapt MMC properties, or that MMC technologies are designed to be repaired by general tradespeople. It is our understanding that there will also be a greater focus on this aspect in the WAP.

A final point is that where housing associations and local authorities opt to use MMC, it is crucial that they do so with one eye on the private sale market. We have seen with various previous incarnations of MMC, often led by the public housing sector, that the various incarnations of Right to Buy can lead to homes coming into the private sale market but later becoming unmortgageable due to poor design or quality assurance. Our conversations with housing associations have been encouraging in this aspect but it is important that this frame of mind is embedded across the housing sector.

Self and custom build

Building societies have a history of lending in the self-and-custom build market and form the vast majority of lenders offering mortgages. While self-build tends to be quite local and on a single home, custom build offers an opportunity to scale up this expertise on larger developments.

Our members are regulated by the Prudential Regulation Authority which offers guidance (SS20/15, known as the 'Sourcebook') on their expectation of how much lending societies should do in particular niche areas. The limits for lending on self-build are 7.5% of the loan book or 15% depending on the sophistication of a society's risk management. The text of the guidance under self-build lending makes it clear that the regulator views these limits as also applying to custom build. This could create constraints on custom build lending going forward if custom build were to scale up significantly.

Towards a new affordable housing offer: managing demand

What tax and macro-economic policies and changes in mortgage lending would help ensure housing is more affordable?

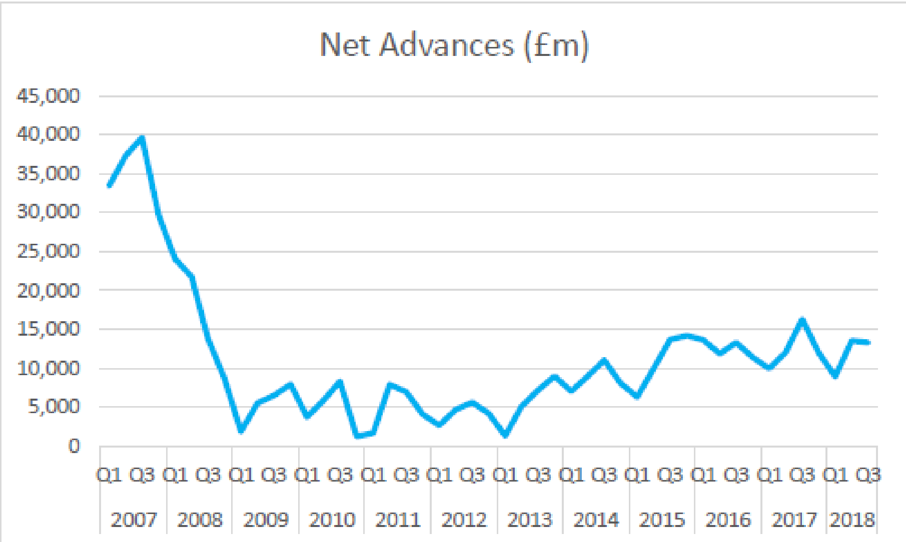
State of the mortgage market

In the BSA's view the mortgage market works well for the overwhelming majority of consumers. There has been much regulatory change over recent years, from the Mortgage Market Review to the Mortgage Credit Directive and now the Mortgages Market Study, through to other initiatives by the Financial Conduct Authority and the Bank of England's macroprudential tools. Lenders have broadly settled into this environment and we have seen a period of stability. This stability is now enabling rapid development and innovation with many of our members investing heavily in areas such as technology and improving their processes.

New mortgage lenders

Building societies provide real customer choice in the market by offering niche mortgages alongside standard products. First-time buyers, the retired, the self-employed or those with more complex needs will find a mortgage to suit them in the building society sector.

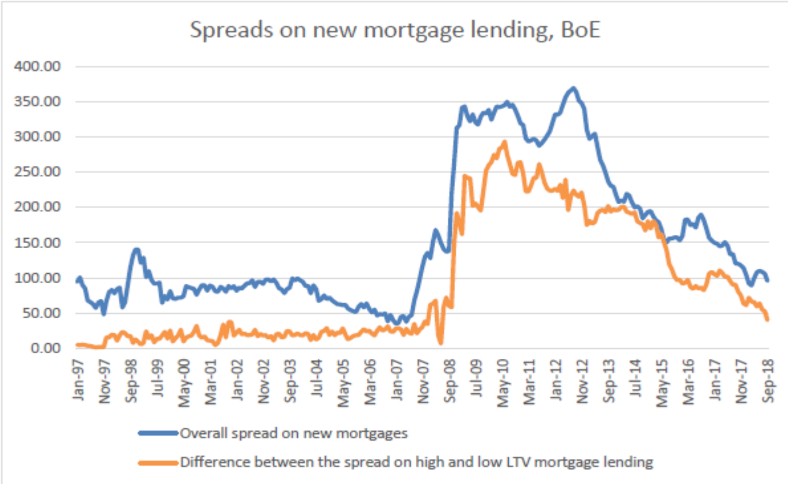
The mortgage market is highly competitive, as we have seen in recent years with the entry of a number of challenger banks and specialist lenders. Some of these new entrants have struggled recently with the need to grow quickly. We would caution against any role for Government in forcing further entrants into the market as this has the potential to undermine existing business models, ultimately to the detriment of the customer. The chart below shows the large decline in net advances during the financial crisis, which has been slow to start recovering.



Source: MLAR

There are currently around 170 mortgage lenders active in the market, and the largest six holding a market share of circa 73%. This leaves the vast majority to compete over the remaining 27%.

It is increasingly difficult for the many lenders to compete on price in the high 'prime' market meaning that many are choosing to carve out niches in which they can compete and price more effectively for risk. These niches are also becoming more competitive as increasing numbers of lenders enter them, putting pressure on margins.



The role of regulation

In our BOMAD report we surveyed building societies on whether they felt various pieces of regulation had made it easier or harder for first-time buyers to access mortgages. 72% of societies thought the Mortgage Market Review had made it harder, and 62% thought the same about the Financial Policy Committee's housing tools.

Regulatory initiatives in recent years focusing on affordability have certainly made the mortgage market more prudent and we are not seeing a return to the high risk forms of lending evident before the financial crisis. However, there is also a need to balance regulation with the social policy objective of enabling people to get onto the housing ladder. In the BSA's view, the Financial Policy Committee's requirement for lenders to stress mortgage rates by 3% on the reversion rate, where the term lasts less than five years, is out of step with market expectations on where rates will head in the next five years. Particularly as rates slowly start to increase, there is a risk of locking out first-time buyers who on every other affordability measure can afford their mortgage repayments.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £400 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.