Losing at home games

Frances Coppola looks at whether the government should, or could, try to reduce house prices to help young people be able to afford buying their own homes

The "proportion of UK adults in their 20s and 30s co-residing with their parents has risen by over a third over the last two decades", says the Institute for Fiscal Studies (IFS). In a new report, it shows that adult children are particularly likely to continue living with parents in areas where house prices have risen the most.

That's not news, but it's also not just an inconvenience to those particular individuals: high housing costs appear to contribute to the ageing of society and low overall productivity.

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The IFS says there's a decline in marriage and parenthood rates among adults in their 20s and 30s. It won't draw a straight-line relationship between this and high house prices, but the cost of housing seems likely to be a factor. UK house prices are 44% higher than the OECD average, according to the Resolution Foundation, a think-tank focused on improving living standards for those on low to middle incomes. In many parts of the country, it takes two full-time incomes to afford a mortgage or even pay rent. That's hard to maintain if you have children.

Similarly, households that are already stretched to pay for housing are less likely to invest in education and training, and may not be able to move to areas with better employment prospects. That is a drag on productivity. So, should the government try to force down house prices?

Co-residing is most prevalent among those on low incomes: in families in the bottom fifth of incomes, almost half of adult children are living with parents. In contrast, among higher-income families, parents give money to their children to help them buy or rent houses. More than half of adult children in the top fifth of income have received financial transfers from parents. One way or another, parents are subsidising their adult children's housing costs.

For years now, governments have been helping young people buy houses – or juicing house prices, depending on how you look at it. In 2011, the coalition government considered government-backed 95% mortgages, and in 2021 the Conservative government introduced them. The Help to Buy scheme enabled people to borrow the money for a deposit. It ended in March 2023, but there are still many government-backed schemes to help people raise deposits and obtain mortgage guarantees.

The private sector is also doing its bit. Banks reintroduced 95% mortgages in 2013 and 100% mortgages in 2023. Equity release schemes that enable parents to draw on their home equity to subsidise their children's house purchases are proliferating. And now, banks are extending the term of mortgages because saving like mad for a deposit won't get you a mortgage if the repayments are 10 times your income. The standard 25-year mortgage on 2.5 times joint income is long gone. These days, lenders are offering 40-year mortgages on 4-6 times joint or single income.

All these measures have one purpose: to enable young people to buy much more expensive houses than their parents and grandparents did. In doing so, they ensure that the housing market does not grind to an ignominious halt. The young have little choice but to dig deep. Whether they rent or buy, the housing shortage ensures that cheaper options are not available, at least not anywhere near a well-paid job. The Centre for Cities, a think-tank dedicated to understanding and improving the economies of UK cities, estimates that there are 4m 'missing' homes.

While interest rates remained stuck at near zero, helping young people to take on enormous amounts of debt didn't seem a big deal. Yes, they'd be saddled with it for almost all of their lives, but their incomes would rise more than interest rates, so they'd be able to afford it. And, with full-time childcare and schools providing breakfast and after-school clubs, mortgages that were only manageable if both parents worked full-time wouldn't be an insurmountable problem.

That ship has now hit the rocks. Interest rates are at pre-2008 financial crisis levels and many people are having to refinance their mortgages at significantly higher rates. The rocketing price of childcare is also making mortgages based on two full-time incomes unaffordable.

More houses, lower prices?

Attention is now turning to the supply of houses. Simple supply-demand economics says that vastly increasing the annual number of houses reaching the market should bring about a sustained fall in house prices, assuming no commensurate rise in demand for housing. It's an attractive idea, but no government since the nineteenth century has managed to deliver sufficient new housing to bring it about. While there have been housing booms, and falls in house prices, the overall trend in house prices as a multiple of average earnings has, since the early twentieth century, been ever upward.

The current government has targeted a new build rate of 300,000 houses per annum, the highest rate since the 1950s. If it achieves this ambitious rate, will prices fall?

The short answer is no. The government expects the private sector to build and finance these houses, but no builder will build into a falling market. If they think prices are about to fall, perhaps because of sharp rises in interest rates, they will down tools and wait for better times to return. And banks won't lend into a falling market either. For them, houses are collateral: if prices fall, the value of their collateral falls. In a falling market, the supply of construction finance and high loan-to-value (LTV) mortgages would evaporate like the morning mist, enforced by regulators worried about financial stability.

> “One way of cooling the housing market might be a radical reform of property taxes

Furthermore, even with a large increase in new-builds, the supply of houses in the market would still principally depend on the willingness of homeowners to sell. For most people, selling is a choice and people understandably like to maximise their returns on the sale of their house. If house prices fall, they are likely to stay where they are rather than selling. This is particularly true if house prices fall so much that people with high loan-to-value mortgages find themselves in negative equity, as they did in the early 1990s. Selling up wouldn't raise enough money to pay off the mortgage, so they stay put until house prices recover – which eventually they do.

In theory, the government could force up the supply of houses by building large quantities of public sector housing and selling it off through the Right to Buy scheme. (That would also cool the rental market.) But increased supply in the housing market doesn't necessarily mean lower prices. One aspect of this is that the UK uses more homes per head of population than it did in the past. Notwithstanding the number of young adults living at home, the proportion of single-person households is up from 17% in 1971 to 30% in 2022, according to the Office for National Statistics.

Raising interest rates to the levels that older generations paid might bring down house prices with a bump. But, with mortgages of £500,000 or more becoming common, interest rates of 15% would be unaffordable for most. The distress this would cause to young families already struggling with large mortgages is incalculable.

Another way of cooling the housing market and reducing prices in hotspot areas might be a radical reform of property taxes, such as introducing a land value tax.

The government has not chosen any of these approaches. Instead, it seems to be focusing on increasing the supply of houses without upsetting the housing market. Reducing house prices is simply not on the agenda. And with good reason.

More than 60% of people in the UK own their own homes. Some 38% of these do so without a mortgage, and the proportion is rising as the population ages: outright ownership of property is heavily concentrated among over-65s. And for middle-income homeowners, their house constitutes much of their wealth.

These elderly middle-income homeowners are the ‘Bank of Mum and Dad’. Many draw on their home equity to fund their children's house purchases. Many more will draw on it to pay for social care. And many hope to leave their homes to their children, who are relying on this inheritance to pay off their enormous mortgages.

Bringing down house prices to, say, 1995 levels would destroy much of these people's wealth, and it would also wreck the finances of many mortgagees. No government would dare pursue such a strategy: it would be forced out of office, possibly long before the next scheduled election.

So, despite the government's housebuilding strategy, house prices seem set to remain unaffordable for many young people. When the homeowning generation dies, what will remain? Perhaps the future will be not Margaret Thatcher's dream of homeownership for all, but lifelong tenancies for all. Because, what is a mortgage that is never repaid but rent in another form?

Frances Coppola writes and speaks on finance and economics, following a 17-year career in banking. She is the author of *The Case for People's Quantitative Easing*, published by Polity Books in June 2019, and is writing *The Absolute Essentials of Banking* for Routledge