

The Truth about First-Time Buyer Affordability

- First time buyers still account for almost 40% of house purchase transactions
- Only about 20% of homeowners are in the 20-24 age group, compared to around 30% ten years ago
- Deposits and income multiple constraints are a bigger hurdle for 'true first-time buyers' than debt servicing costs
- Less than 10% of 22-29 year olds can overcome lending income multiple constraints
- Young Teachers, Nurses and Policemen cannot afford to buy alone – especially in London

Commenting on the research Fionnuala Earley, Nationwide's Group Economist, said:

The Truth about First-Time Buyers

"First-time buyers are often heralded as the main driver of the housing market. Injecting brand new demand, they add liquidity and help to support house prices. The proportion of first-time buyers in the market has been falling over time, but, given the rapid rise in house prices, the resilience of this group is perhaps a little surprising. Remarkably, first-time buyers still account for almost 40% of all house purchase transactions in the UK.

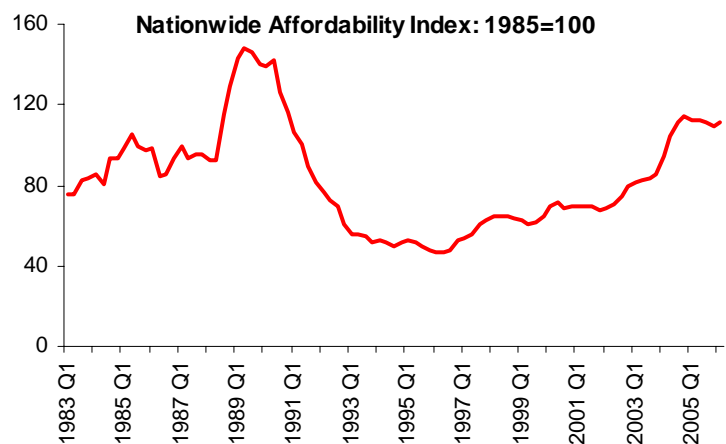
The answer to this puzzle lies in the types of homebuyer that fall into the first-time buyer category. No longer can we think of first-time buyers as the fresh-faced young person, or couple, getting their very first foot on the housing ladder after saving hard for a deposit. Rather the category includes a significant proportion of buyers returning to the market, perhaps after a spell in rented accommodation or moving from dissolving households. These buyers differ from the stereotypical picture of a first-time buyer as they tend to be older and thus on higher incomes. More importantly however, such buyers often have access to deposits funded from past increases in house prices which ease them back into the market. In 2005 'returners' may have accounted for up to 20% of all first-time buyers.

Whatever happened to the fresh-faced first-time buyer?

The implication is that there are fewer younger first time buyers. Indeed, the proportion of young people who are home-owners has fallen significantly over time. In 1994 34% of adults aged 20-24 were home owners. Ten years later this proportion had fallen to only 20%. So it seems that affordability may have hit the true fresh-faced, first-time buyer more than the top level figures suggest.

Nationwide's affordability index attempts to track the movements in affordability for true first-time buyers by using earnings data which captures all prospective home owners¹. Importantly this measure is close to the household income of renters so it fits well with the pool of people who are most likely to be aspiring home owners. As the chart shows, affordability has deteriorated significantly over the last 10 years.

Mortgage payments for a first-time buyer on average earnings would now account for around 42% of take home pay compared with only around 18% in 1996. However this still seems relatively modest compared to the height of the late 80s house price boom when the ratio was more than 55%. House prices have increased by more than 200% since 1996, whereas earnings have increased by less than 50%.



Notes: A rise in the index indicates a worsening of affordability

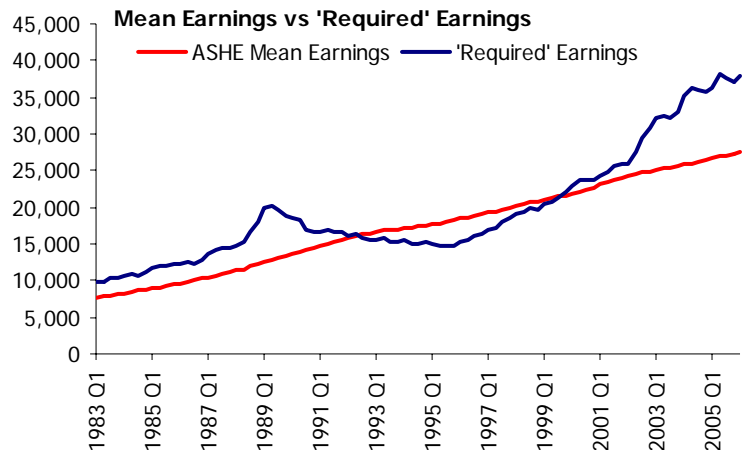
¹ See methodology appendix

Low interest rates help, but ...

The affordability of servicing the debt has been helped enormously by lower interest rates over this period. In 1997 base rates averaged 7.25% compared with 4.5% now. This has helped to subdue growth in the first-time buyer affordability index in spite of the increase in prices.

However, affordability is not just about servicing the loan. Deposit and income multiple constraints are equally, if not more, binding on first-time buyers and would prevent many from entering the market at all. Since around 2002 a gap has been widening between actual earnings and the earnings required to overcome income multiple constraints.

This is in spite of a significant, if gradual increase in income multiples over the last five years. In 2001 the average income multiple for first-time buyers was 2.4x compared to 3.1x now. But as house price inflation has outpaced earnings growth more borrowers have been excluded.



Source: Nationwide, ASHE, CML

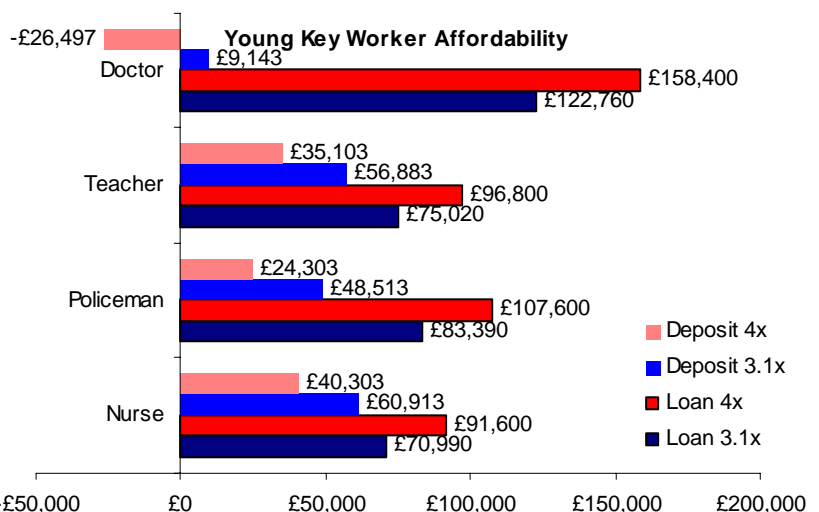
...average earnings are insufficient to meet income multiple criteria

Average earnings are now around £27,500, which at the current income multiple of 3.1x would support a loan of £85,250. Even the more generous income multiples of around 4x available in the market today, would only allow a loan of £110,000. Borrowers would need to raise a deposit of nearly £22,000 to be able to buy a typical first-time buyer property costing £131,903.

Aspiring homeowners would need to earn over £38,000 to be able to borrow at 3.1x income and have only a 10% deposit. To borrow at 4x income they would need to earn almost £30,000. Both of these are above average earnings. The situation is even more difficult in London where house prices are much higher. To meet the 3.1x and 4 x income constraints in London, earnings would have to be around £62,000 and £48,000 respectively. In fact average earnings in London are closer to £34,000.

Younger buyers suffer...

The average age of first time buyers has changed over time. It is now 29, but the distribution of earnings shows that only the top 5-10% of the 22-29 age group in the UK earn enough to be able to meet the income multiple criteria and buy with only a 10% deposit. This is much lower than the 20% in 2000 earning at this level. Even older first time buyers are finding it more difficult. Only the top 20% of the 30-39 year old age group earn enough now compared with the top 40% in 2000.



Source: Nationwide, ASHE

Notes: The chart shows the amount which can be borrowed subject to the 3.1x and 4x income constraint along with the associated deposit needed to purchase a typical first time buyer home. Doctors can raise more than the purchase price on 4x income, hence the negative deposit.

...especially young key workers

The average salaries of young nurses, police officers and teachers all fall below the required income level and brings home how difficult it is for younger people to get onto the ladder. In the 22-29 age group, only doctors are able to borrow enough alone to be able to get on the ladder without being constrained by the income multiple. Even the joint income of a young nurse and a teacher only just manage to overcome the income criteria in London. But even then they still need to raise a 10% deposit of more than £20,000 – more than 40% of their combined gross annual salary.

Estimates of Key Worker Average Earnings				
	Average all ages		Aged 22-29	
	UK	London	UK	London
Nurse	£26,000	£28,000	£23,000	£25,000
Policeman	£35,000	£37,000	£27,000	£29,000
Teacher	£33,500	£36,000	£24,000	£26,000
Doctor	£62,000	£65,000	£40,000	£42,000

Source: Nationwide estimates based on ASHE

Big deposits mean inheritance comes early?

With the average first time buyer property costing over £130,000 a first-time buyer on average earnings would have to raise a deposit of over £46,000 which could take up to 10 years to save up for. Even if stretched to the 4x income multiple the required deposit of nearly £22,000 would take around five years to save. In London the situation is worse still. It would take over 15 years to save the required deposit of over £100,000 and almost 12 years to save the £77,500 deposit required to meet the 3.1x and 4x income multiples respectively.

Remarkably a significant proportion of first-time buyers manage to raise substantial deposits. Official data from the Survey of English Housing suggests that in 2003 around 8% of *non returning* first-time buyers were able to pay a deposit at least as large as their gross salary. This strongly suggests that there are other sources of finance. Parents are the most likely, bringing forward inheritance gifts. Rapid house price growth, low interest rates along with highly competitive remortgage and equity withdrawal deals have helped to make this simpler to achieve.

Overall it is not the financing of the loan that is the biggest obstacle to the fresh faced first-time buyer – rather it is finding the deposit necessary after the income multiple constraints. The reason why the proportion of first-time buyers has remained high is likely to be due to the large proportion of returners that fall into this category with access to both higher than average incomes and access to larger deposits. For many true, and particularly young, first-time buyers, the deposit and income multiple constraints are too strong and prevent them entering home ownership at all. This is even before considering other calls on their income such as student debts.

References:

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 Holmans (2005) *Recent Trends in the Number of First-Time Buyers: A review of recent evidence*
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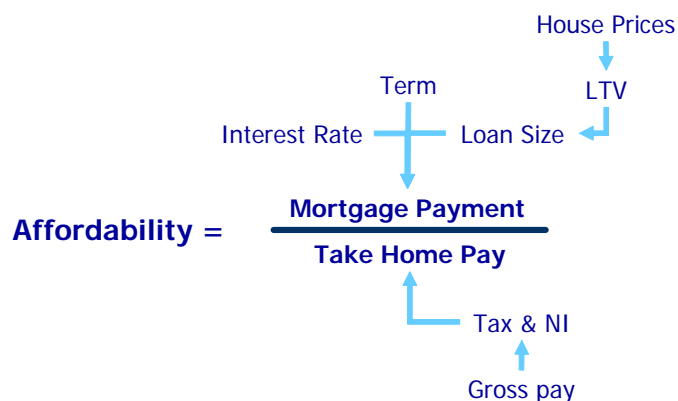
Appendix: Data and Methodology

Nationwide First-Time Buyer Affordability Index. 1985=100														
	North	Yorks & Humb	North West	East Mids	West Mids	East Anglia	Outer SE	Outer Met	London	South West	Wales	Scot	N Ireland	UK
2000 Q1	46.0	57.5	71.9	75.4	79.4	69.8	70.9	68.8	65.3	71.6	70.7	62.6	82.3	69.8
2000 Q2	49.6	62.1	72.9	74.4	81.5	70.0	70.8	70.9	66.6	73.8	69.7	64.7	93.0	71.4
2000 Q3	48.7	57.9	70.3	73.7	80.8	68.1	69.6	67.8	62.9	70.9	67.5	63.2	85.4	68.7
2000 Q4	48.6	60.5	70.8	75.7	80.2	66.6	70.6	69.3	63.3	69.9	69.0	62.0	87.9	69.8
2001 Q1	49.3	60.4	71.8	74.7	79.7	70.1	71.5	67.5	61.9	70.2	67.9	60.0	90.1	69.3
2001 Q2	45.2	59.8	71.6	74.5	78.9	68.5	69.8	67.7	67.1	68.6	69.1	59.3	88.6	69.2
2001 Q3	51.5	58.3	72.4	77.9	82.3	71.3	71.1	68.5	65.2	70.0	68.3	59.2	85.3	70.0
2001 Q4	48.1	56.9	69.5	74.6	77.1	68.5	70.4	66.5	63.5	68.0	62.3	57.2	78.5	67.7
2002 Q1	45.8	58.3	69.4	76.1	79.8	68.7	71.2	66.8	62.8	71.1	65.4	55.5	79.0	68.1
2002 Q2	47.9	60.0	71.6	79.7	82.2	75.7	74.0	69.8	63.2	70.9	66.7	56.0	84.4	70.7
2002 Q3	50.4	62.4	74.7	85.6	88.8	75.3	78.7	71.7	67.5	77.1	69.0	58.5	81.8	74.3
2002 Q4	55.2	71.1	78.1	87.5	95.9	83.1	84.0	77.8	70.0	81.7	76.8	58.7	83.1	79.3
2003 Q1	57.5	68.2	81.2	92.2	100.3	84.7	87.7	79.8	71.4	82.8	76.0	57.1	86.3	81.5
2003 Q2	59.7	73.0	84.4	97.6	96.3	84.3	87.4	79.0	70.3	83.6	80.2	60.6	85.2	82.3
2003 Q3	61.6	74.2	87.0	98.4	102.6	83.9	85.1	78.3	70.1	84.5	83.3	60.6	83.1	83.5
2003 Q4	64.7	78.5	88.2	102.5	105.4	83.9	87.1	79.0	71.9	87.0	86.0	62.2	84.5	85.7
2004 Q1	74.8	88.3	101.0	110.9	115.2	91.6	94.3	85.5	76.8	94.2	104.5	66.4	93.7	94.0
2004 Q2	82.1	99.1	112.2	124.2	127.3	102.1	102.9	91.0	82.8	103.6	110.3	76.4	99.8	104.0
2004 Q3	85.4	106.2	122.3	130.4	135.9	108.3	111.2	95.0	88.5	110.7	121.3	82.1	102.6	110.9
2004 Q4	89.3	110.1	128.4	132.8	135.7	112.4	111.3	96.6	88.7	112.0	125.0	86.3	110.3	113.8
2005 Q1	82.1	108.7	127.3	130.1	136.0	109.1	110.7	95.3	86.6	111.6	131.3	86.5	110.9	112.4
2005 Q2	86.5	107.2	126.1	129.2	134.4	108.8	110.0	94.6	86.6	109.4	125.8	83.7	113.4	112.0
2005 Q3	90.8	110.0	124.6	128.9	135.7	106.8	108.8	93.4	87.0	108.3	124.4	84.3	113.9	111.0
2005 Q4	83.6	105.9	123.3	125.1	129.2	106.5	108.0	91.1	85.5	109.7	118.6	83.8	119.9	109.4
2006 Q1	87.9	109.5	126.4	127.1	134.1	107.5	109.9	92.4	86.2	110.2	123.6	85.6	122.8	111.6

Notes: The full data set can be found at www.nationwide.co.uk/hpi

Methodology

Nationwide affordability measures look at initial mortgage payments as a percentage of take-home pay. The diagram below illustrates the assumptions which feed into this:



Mortgage Payment Components

- Initial mortgage payments for a repayment mortgage
- Average loan size based on 90% of Nationwide FTB House Prices over time. Whilst LTV ratios vary over time, 90% has been the average of the last 10 years.
- The mortgage term is held constant at 25 years
- Interest rates used are CML new business interest rates for lending to FTBs; typically initial interest rates tend to be slightly higher for FTBs due to higher LTV ratios.
- Changes in Mortgage Interest Tax Relief overtime have been taken into account.

Earnings

- Earnings are adjusted for changes in Income Tax and National Insurance over time
- Individual mean earnings for a full time worker, based on the ONS Annual Survey of Hours & Earnings (ASHE) (and prior to 1998, the New Earnings Survey). Using national earnings data allows us to better capture income of potential as well as actual purchasers. For example, using data from the CML based on mortgage transactions may create a self selection bias, with only incomes of those actually participating in the market captured.
- Comparing the ASHE series to the CML's data for (all) House Purchasers and FTBs shows that all of the series move together over the long run, although there has been some divergence over recent years. The ASHE measures individual earnings, while CML proxies household income by capturing the total income the mortgage is based on.
- The ASHE individual income data is close in level to the household income of private renters and is closely correlated with the Private Renters Household Income series over the last few years, a group which could be viewed as a pool of aspiring home owners.

