



Intergenerational mortgages:

Building on the Bank of Mum and Dad

An independent report by
Bob Pannell and Dick Jenkins

 **Building Societies
Association**

November 2018

Foreword



The Building Societies Association celebrates its 150th anniversary next year which has led us to reflect on what lies at the heart of building society purpose. A core and consistent part of building societies' DNA is the pursuit of Housing for All.

It is the goal of home ownership that drove the building society pioneers. Today's economic and social conditions may be a world away from the rapidly industrialising cities of the eighteenth century. Technology is changing the way we lend money and save for life. Yet fundamentally the ambition to live in a good quality home that we own remains as strong for people today as it was for the workers gathered in the Golden Cross Inn in Birmingham in 1775, whose proprietor Richard Ketley founded the first known building society in the world.

Our report last year with the International Longevity Centre - UK, *Lengthening the Ladder*, looked at the changing age patterns of home ownership and mortgage borrowing in the UK. While our focus in that report was on older generations, it also painted a worrying picture for young people struggling to get onto the housing ladder.

That is why we commissioned two people well-known in the mortgage industry – Bob Pannell, former Chief Economist at the Council of Mortgage Lenders, and recently retired Bath Building Society CEO, Dick Jenkins – to take an independent look at the issue of intergenerational inequality.

It is a topic that is firmly in the spotlight and critical to society. Government sees housing as a top issue. Journalists reflect constantly on the realities being faced by many, dedicating column inches to what it all means for the relationships between children and their parents, or increasingly grandparents, aunts and uncles.

It is no surprise that the Bank of Mum and Dad (BOMAD) features heavily in the analysis of what building societies can do on a practical level to help first-time buyers. Our decade-long series of Property Tracker consumer surveys consistently puts raising a deposit as the main barrier to a property purchase in the UK – and family are often the first to lend a helping hand.

Such gifts will continue to be a major part of BOMAD's product portfolio, but as this report shows, increasingly there are other ways older generations can leverage their wealth beyond simply handing over cash. Our sector aims to be at the forefront of this mortgage market innovation and I hope this report will help stimulate further change.

It is a reflection of what building societies do, what they overwhelmingly see as a key part of their distinctive social purpose – to help young people gain their first foothold on the housing ladder.

Robin Fieth
Chief Executive of the Building Societies Association

Introduction

By Bob Pannell and Dick Jenkins

The challenges facing young people wanting to get on the housing ladder are well known and widely debated.

They have been building since long before the global financial crisis. We should not be looking for quick fixes or easy solutions to the deep-seated problems in our housing market. Housing interventions by successive governments have increased in pace and scope over recent years, but we still seem to be only scratching the surface of the affordability issue.

There is no shortage of discussion, nor lack of ideas, around these issues. But it may be several more years before policy-makers and stakeholders identify and agree on what further far-reaching reforms may be necessary in order to begin what will then hopefully be the slow process of transformation.

Meanwhile, the housing choices of our young people are being determined by today's realities of high house prices and limited alternatives to buying or renting privately. For some, their decisions will weigh on their future well-being for decades to come.

So, the stakes are high and the backdrop could hardly be more challenging.

Our report, commissioned by The Building Societies Association, does not offer a simple panacea for our broken housing market, because there is none. Our aim is to share practice and ideas that are already helping more young people get onto the housing ladder on a sustainable basis.

Critically, we recognise that the Bank of Mum and Dad – widely defined – is already playing a positive role, and that building societies are well-placed to promote and to broaden its contribution in future years.

The great thing is that family members instinctively want to help. This report highlights a wide variety of ways in which family members can support young people into home-ownership, without jeopardising their own financial futures.

The innovative approach of the building society sector, which we highlight here will not transform the housing market for all young people, but it may make a key difference for some.

About the researchers



Dick Jenkins

Dick joined Bristol and West Building Society in 1992 to run its intermediary lending operations. After a period as Managing Director of Bank of Ireland Mortgages, he left in 2003 to take up the position of CEO at Bath Building Society. 'The Bath' developed a reputation as an innovative lender in the years following the financial crisis, launching a suite of products aimed at helping first-time buyers to access home ownership.

In 2015-17 Dick held the position of Chairman at the Building Societies Association, having long been a champion for the sector. In April 2018, Dick retired from Bath Building Society and took up a position as a Non-Executive Director at Buckinghamshire Building Society.



Bob Pannell

Bob is a professional economist with a long-standing interest in the interactions between personal finance, the housing market and the wider economy. Since leaving UK Finance at the end of 2017, Bob has worked as an independent economic consultant. One of his current roles is Economic Adviser to the Intermediary Mortgage Lenders Association.

Bob spent 26 years with the Council of Mortgage Lenders (CML), where for many years he was the Chief Economist and part of the senior management team. As well as leading the CML's commentary and analysis of the UK housing and mortgage markets, he also supported policy development and PR activities, and represented the mortgage industry with government departments and regulators.



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Executive summary

Key findings

- Young people have been struggling to get on the housing ladder over many years, and this has skewed home ownership in favour of the affluent and the old. This lack of opportunity for younger people is now seen by the general public as one of Britain's biggest problems.
- The Government has not stood idly by, but there is a degree of public scepticism as to the effectiveness of its housing policies, despite the huge "footprint" of its flagship Help to Buy Equity Loan scheme and its focus on first-time buyers.
- There is strong support among building societies for a variety of Government schemes, particularly those schemes that serve the less affluent, such as Shared Ownership and Right to Buy.
- But crucially many building society products also make use of the considerable financial resources vested in the Bank of Mum and Dad (BOMAD) – a term that encompasses financial help from parents, grandparents and wider family members. Even conservative estimates place the BOMAD alongside the largest ten mortgage lenders in the UK.
- Building societies have shown a high level of innovation in supporting the BOMAD with a rich tapestry of niche products designed to address the key problems faced by first-time buyers of raising the deposit and satisfying affordability criteria.
- More than a third of first-time buyers rely on the BOMAD to get on the housing ladder, normally via help with the deposit, dwarfing the number supported through the Help to Buy Equity Loan scheme.
- Although the release of housing equity via inheritance, downsizing and lifetime mortgages all make a contribution, most financial help channelled via the BOMAD comes from the savings and wider financial holdings of family members.
- The unequal distribution of wealth and incomes means that the majority of gifts, loans and other forms of support, inevitably flow to those who are relatively better off, and so already better placed to get on the housing ladder. As a result, the BOMAD cannot meet the needs of all would-be first-time buyers.
- Building societies expect the role of the BOMAD to increase even further in the coming years, as structural problems in the housing market persist and wealth concentrates yet further in the hands of older households.
- There are also opportunities for the Government to improve the availability and choice of homes for first-time buyers, by making it easier for older households to downsize to smaller homes, or to sub-divide their existing homes. But there is a need to broaden the debate beyond the provision of retirement and specialist housing.
- Fintech firms have begun to explore ways to develop private sector versions of the Help to Buy Equity Loan scheme, largely with a view to offering these to more affluent borrowers looking to buy existing properties. It is early days, and it is not clear whether these first-generation products will prove sustainable, but they potentially broaden the opportunities beyond a reliance on traditional forms of mortgage finance and so warrant close monitoring.

- Meanwhile, we can expect building societies to continue innovating their BOMAD products but, there is no single killer product that will transform the affordability picture for first-time buyers. We can expect societies to push harder in the direction of 100% LTV and interest-only “low-start” products.
- There is a case for the sector to work with its regulators on getting the balance right between stress tests which protect borrowers and the industry and addressing the significant social priority of getting young people into home ownership.

Recommendations

Promotion - improve communication and knowledge

Building societies and other lenders should provide clearer customer information about BOMAD products that is free of potentially confusing or technical jargon, employs a shared vocabulary across lenders and uses case studies that consumers can relate to.

Help show younger households that they can achieve their goal of home ownership. Today many assume that it is beyond their reach without ever exploring the possibilities. Building societies might wish to co-ordinate educational, marketing or social media campaigns in this space.

Lenders should set out clearly the different ways in which the BOMAD can help - it is not solely about gifting cash or a lifetime commitment nor a BOMAD which is cash rich.

Product extension and underwriting innovation

Continue product innovation, building on the support available from the BOMAD. There is a greater role for guarantees, the use of family collateral, and flexible mortgage design specifically addressing the challenge of deposit-raising and demonstrating affordability.

Revisit the case for lending up to 100% loan-to-value ratio mortgages, within appropriate parameters, exploring how technology solutions offered by the likes of Open Banking can feed into more accurate predictive underwriting to support this type of lending

Building societies should closely monitor developments around private equity loans, especially as the Government’s *Help to Buy Equity Loan* product changes focus. Private sector entrants may develop sustainable schemes that attract the wealth of older households and recycle it into equity loan finance for unrelated first-time buyers. Although this could make inroads into the traditional mortgage model, building societies could be attractive partners.

Regulation and Government action

The BSA and other industry bodies should offer constructive challenge to financial regulators as to whether policy sits well with economic reality and social objectives. The obvious case currently relates to the stressed interest rate requirements set out by the Bank of England’s Financial Policy Committee. Such housing tools deliver a form of financial stability, but do so by denying many young households the opportunity to buy a property that they are likely to be able to afford.

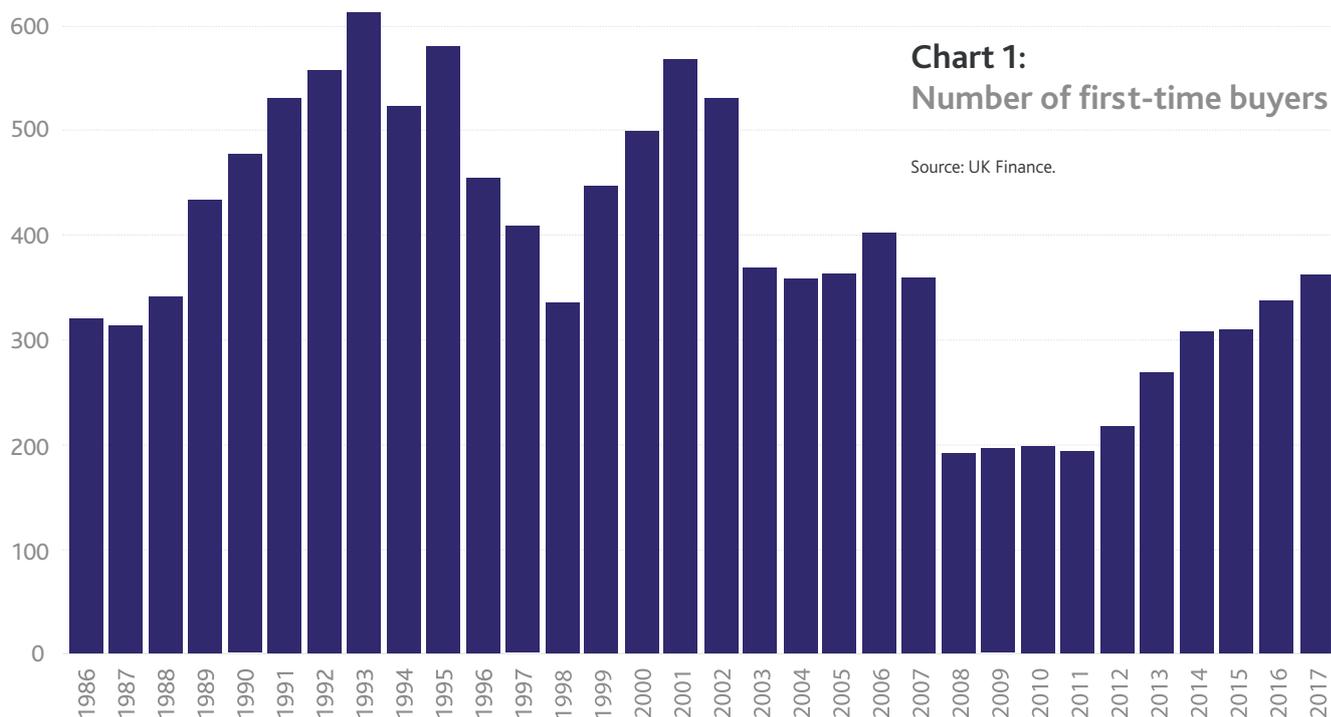
The Government should consider the case for improved fiscal incentives for intergenerational wealth transfer, such as targeted inheritance tax exemptions and Stamp Duty Relief.

The Government should review the factors that discourage older people from downsizing to smaller homes and the contribution that this could make to improving the availability of properties for younger households.

Chapter 1: Setting the scene

It is easy to be gloomy about the housing challenges facing our young people. When the Government publishes a housing white paper entitled “Fixing our broken housing market”¹, that’s a pretty big clue that all is not well.

While it is true that first-time buyer numbers have picked up strongly since the global financial crisis – last year saw 360,000 first-time buyers, almost double the post-crisis lows of the 2008-11 period – this is far from a stellar performance.



The difficult years of the global financial crisis and the UK’s subsequent slow recovery have dulled our sense as to what a strong market looks like.

It is worth remembering that first-time buyers comfortably averaged more than 400,000 per annum for many years preceding the crisis. And, with near-record numbers of under 40s today – comprising the age cohorts most likely to become home-owners – a more appropriate benchmark of satisfactory performance would be a figure in the 400-450,000 range. Put bluntly, not enough people are able to get onto the housing ladder.

This matters.

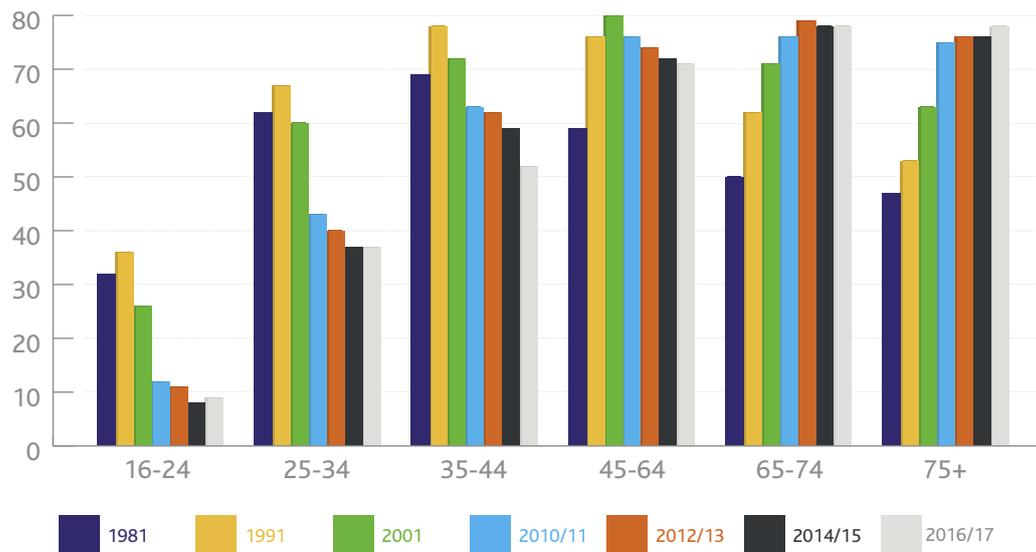
First because the vast majority of the general public would like to buy their own homes - 86% according to the British Social Attitudes Survey.

But also because, in a very real sense, first-time buyers underpin the wider housing market. By purchasing homes at the lower end and enabling vendors to trade, usually upwards, they represent a key source of the fluidity that is vital to the market’s overall health and dynamism.

While it has always been a challenge to afford your first property, we have seen the ability to get on the housing ladder become ever more concentrated on dual-earner households and those with relatively higher incomes.

Chart 2:
Home ownership
by age, England,
% of age group

Sources: English Housing Survey;
author estimates for 2001



Of crucial relevance for this study, is that there are clear signs of a deepening polarisation of home ownership by age. Home ownership rates amongst younger adults have shrunk materially over recent years (see Chart 2). But the problem is not simply that households are delayed from getting onto the housing ladder by a few years. Although the proportion of those owning their homes does continue to rise as age cohorts get older, at no point do they match the ownership rates of their immediate predecessors.

The bottom line is that for the past 15 years or so we have witnessed a hollowing out of home ownership extend progressively into older age groups. So, for example, according to recent English Housing Survey (EHS) figures², the proportion of 35-44 year-olds who are home-owners has tumbled by nearly 20 percentage points over the past decade to 52%, and 45-54 year olds are 13 percentage points lower at 67%.

When asked in the BSA's Property Tracker survey³, fewer than half of all those who want to get onto the housing ladder in the next 10 years now think that it is likely.

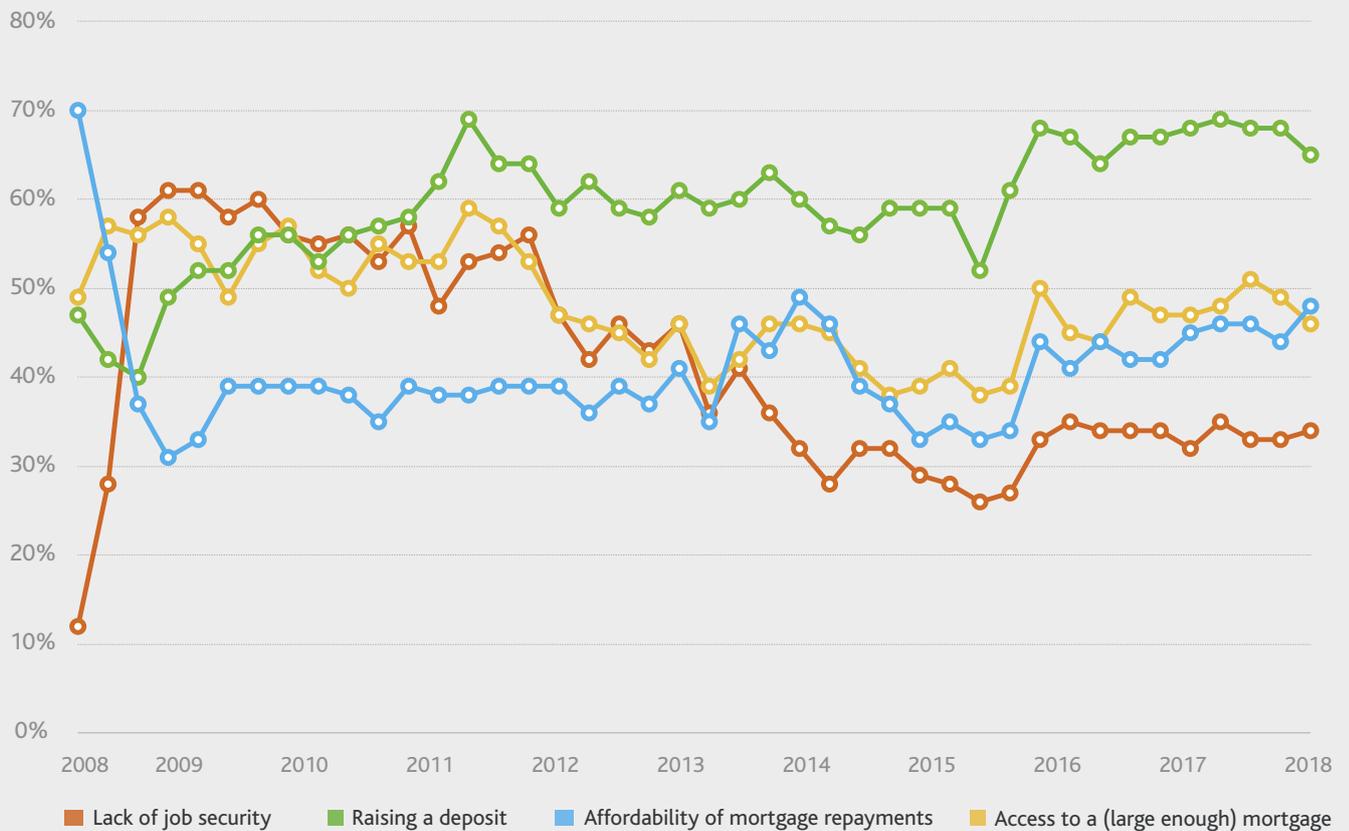
The financial challenges facing first-time buyers

Many of the headwinds facing would-be first-time buyers are financial.

The BSA’s Property Tracker survey has monitored the ebb and flow of factors over the years. Since 2010 raising a sufficiently large deposit has consistently been the biggest barrier, and remains close to its all-time high level. Industry figures indicate that a strong regional dimension is at play here, with an acute problem persisting in London and much of southern England.

Chart 3: Major barriers to property purchase

Source: BSA Property Tracker, September 2018



Obtaining a mortgage has been one of the most common barriers since late 2014.

Worries about having a large enough deposit and being approved are major reasons that deter households considering taking out a mortgage from applying, according to the English Housing Survey.

By contrast, many older households appear to be living gilded lives. Their home ownership rates have never been higher and the majority of older home owners own their property outright. The Institute for Fiscal Studies has also found that almost one in six 55-64 year-olds own a second home⁴.

Over the past few years, the Resolution Foundation has produced an excellent body of work, that paints a much broader canvas about the developing inequalities in housing wealth, pension arrangements and incomes between the 'baby-boomers' and younger households. The final report⁵ offers a broad evidence base that speaks of intergenerational imbalance.

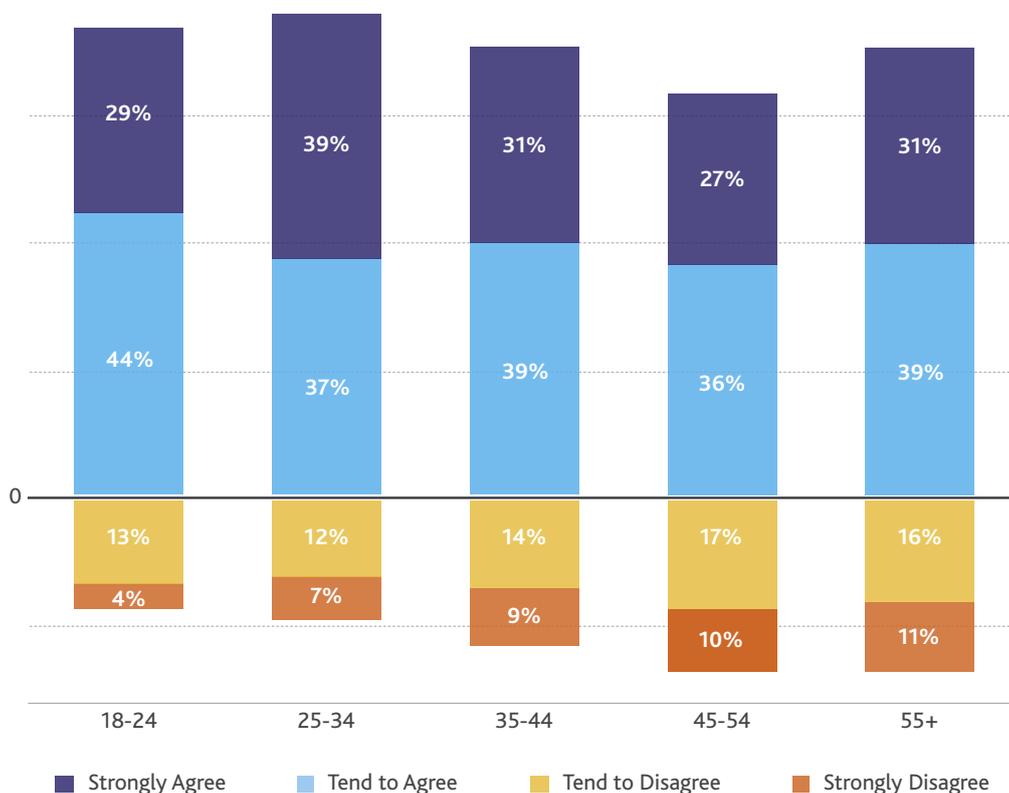
Meanwhile, what is being done to help would-be first-time buyers?

In commissioning this research, the BSA hopes to offer a less gloomy narrative concerning first-time buyers. Whilst it is true that the housing market is not working well for young people, there are positive steps that can be taken to help.

We start with the fact that young people still very much want to get on the housing ladder, and that public concern about this issue has climbed up the public agenda over recent years (see Chart 4). A clear majority of the general public (70% on average), across all age groups, now see it as one of the biggest problems we have in Britain today, according to recent BSA research⁶. This concern can also be seen in more positive public attitudes towards house-building in their local area⁷.

Chart 4:
Views on whether getting on housing ladder is one of Britain's biggest problems, % of respondents*

* Source: BSA Property Tracker June 2018. Note: We have not shown neutral response or don't knows in order to improve clarity.



One aim for this research is to highlight ways in which building societies, very often in tandem with the older generation, are already helping young people to a significant degree. In part, this is to address a commonly held view that mortgage lenders may not be doing all they can to help. But, more importantly, it is to encourage lenders to review what they and their peers are doing, to explore where they might add to their existing product offerings and whether the opportunities available to first-time buyers are being communicated in the most effective way.

We also explore what fresh opportunities the ageing profile of home ownership; growing wealth and housing assets of older households; more flexible ways of accessing housing and pension wealth and financial innovation more generally, offer building societies and other industry stakeholders in their support of first-time buyers.

The following chapters explore these themes. The structure of the report is as follows:

- **Chapter 2** provides a thumbnail sketch of the different government schemes on offer that seek to help first-time buyers.
- In **Chapter 3** we look at what is referred to colloquially as the Bank of Mum and Dad (BOMAD), although in reality refers to all forms of financial assistance from parents, grandparents or wider family members. The accumulation of housing assets and wider wealth among older households potentially enhances the role they can play in addressing some of today's affordability challenges. Our aim is to build a picture of the relative importance of the different sources of funds underpinning first-time buyer activity.
- **Chapter 4** reviews the intergenerational products and arrangements that building societies currently offer first-time buyers, many of which will draw upon the BOMAD.

The next two chapters then look beyond assistance that is arranged within a family context, to evaluate other ways in which the interests of older and younger generation might align.

- With pensioner households now representing more than a third of all owner-occupiers and older households less likely to move home, **Chapter 5** explores schemes in which the homes of older people are re-purposed to some degree, and assesses how significant such activity could be.
- **Chapter 6** explores funding issues beyond the BOMAD, including crowdfunding and innovations around equity loans. How could the opportunities for innovation in our financial sector impact upon first-time buyer needs, if at all?
- In **Chapter 7** we bring together the different strands of research, put those within a wider housing and mortgage market context and suggest a number of ways in which building societies can build upon their existing contributions in supporting first-time buyers.

Methodology

Our research has had a multi-faceted approach.

We began with a literature review, looking at ways in which housing assets, directly or indirectly, and other forms of wealth are being used to help younger households, and how their importance might change over time.

We also undertook a high-level survey of BSA members to generate insights into how the market is evolving around first-time buyer issues, and to identify market opportunities and challenges. In all, 39 of the 43 building society members of the BSA and one of its member credit unions chose to participate, accounting for the vast bulk (about 98%) of total building society mortgage lending. The survey was designed to gauge current levels of engagement with the challenges faced by younger adults; to identify how innovative the building society sector already is and to better understand the perceived constraints to potential market remedies.

Subsequently, we held a Chatham House industry roundtable discussion. Its main purpose was to ensure that we had a rounded understanding of how young adults are faring and the current extent of intergenerational help. It also helped identify areas where more can be done and informed our appreciation of future efforts that might yield extra benefits.

We also sought to supplement some of the key themes, via a small number of interviews/further discussions with policy-makers, regulators and industry analysts as well as representatives from building societies.

Chapter 2: Government support for home ownership

Background

For many decades, governments have directed considerable effort towards promoting home ownership, and for the purposes of this report it is important to understand what such interventions mean for prospective first-time buyers. Indeed, throughout the 1980s, support for home ownership was a totemic political issue, and an era in which home ownership grew dramatically.

The 1980s was a decade of strong house price growth, interrupted by the 1989-92 recession. However, from the mid 1990s to the onset of the financial crisis property prices once again grew dramatically. The 2004 Barker Review⁸ identified that we would need to achieve much higher levels of housing supply over a sustained period, in order to mitigate deep-seated affordability problems. From this time, government housing policy has also focused on boosting new supply.

Reflecting both the gravity of the supply-demand imbalance, and the adverse effects of the global financial crisis, recent years have seen significant levels of government intervention, aimed at supporting new-build activity or first-time buyers or both.

Help to Buy Equity Loan scheme

Government housing policy is currently dominated by the Help to Buy range of initiatives, and in particular the Help to Buy Equity Loan scheme, first launched in 2013.

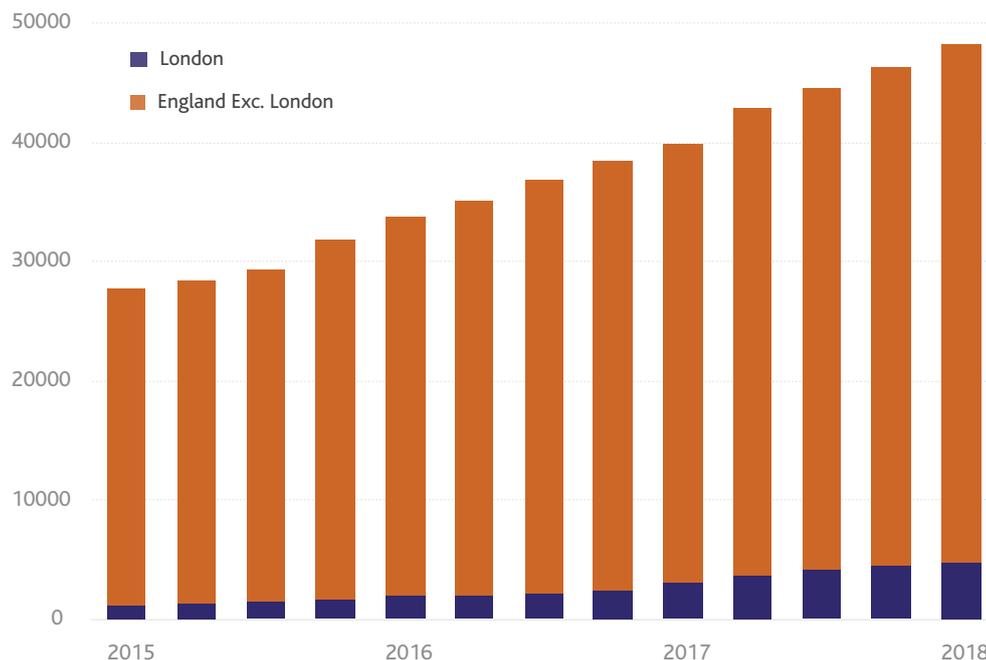
This is a shared equity loan scheme to help those purchasing a new-build property in England worth up to £600,000, and is designed to stimulate building activity and support home ownership. The scheme shrinks the size of deposit needed to as little as 5%, by providing buyers with an equity loan of up to 20% of the property purchase price (40% more recently in the case of London), alongside a mortgage to cover the remaining balance.

The Help to Buy Equity Loan scheme has already enabled 160,000 households to buy new homes in England, and the vast majority of these (about 80%) are first-time buyers.

As Chart 5 shows, activity levels funded by equity loans have moved progressively higher over the past few years.

Chart 5:
Purchases using Help to Buy Equity Loan scheme, 4-quarter rolling totals*

*Source: Ministry of Housing, Communities & Local Government



Two of the devolved administrations offer similar schemes, albeit with different property price caps to reflect lower house prices. To date, the Help to Buy (Wales) scheme and the Help to Buy (Scotland) scheme have helped about 7,000 and 13,000 households to buy homes respectively. Reform of the latter scheme from early 2016 included a reduction of the equity loan portion to 15% of the purchase price. Northern Ireland does not operate a Help to Buy Equity Loan scheme.

There have been two official reviews of the England scheme, although the second one is yet to be published.

The first⁹, published in 2016, highlighted the key role of the scheme in stabilising the new-build housing sector and rebuilding confidence to invest after the financial crisis. It also asserted high levels of additionality – cases where the household would not otherwise have been able to buy the home they did. Lenders at the time were more guarded in their estimates.

Official figures confirm that first-time buyers using the scheme have higher incomes than those buying without Help to Buy, prompting criticism that the scheme favours those who are already able to purchase and that, in some cases, acts to help first-time buyers buy larger, more expensive homes, than they might otherwise have bought.

Contrary to initial expectations, there have been few signs that builders are becoming less reliant on the Help to Buy Equity Loan scheme over time – about 35% of new-build sales relied on this scheme in 2017, little different from in the early years.

Initial appetite for the scheme in London was low, but the introduction of a more generous London Help to Buy which allowed equity loans of up to 40% (from early 2016) has boosted take-up in the capital considerably and accelerated the speed at which the overall England scheme uses up its funding. The announcement of an additional £10 billion last October, to ensure that the scheme can run through to March 2021, brings total gross funding to nearly £23 billion although the net position will be reduced by receipts from the repayment of equity loans.

As the 2018 UK Housing Review¹⁰ notes, this makes the Help to Buy Equity Loan scheme the primary Government means of supporting home ownership by far.

Various concerns have been raised about Help to Buy, for example the dependency of house-builders, the profile of buyers being helped and the extent to which the scheme is still adding to new supply. The English version currently supports about 4,000 sales each month. We now know that this scheme will continue for 2 years after 2021, pared back to first-time buyers only and with regional property price caps. The Help to Buy Equity Loan scheme has also given the government direct exposure to the vagaries of house prices and it will be interesting to see how this impacts on future government housing policy.

Two other direct interventions are worth noting – Right to Buy and Shared Ownership – both of which date back to 1980 or thereabouts.

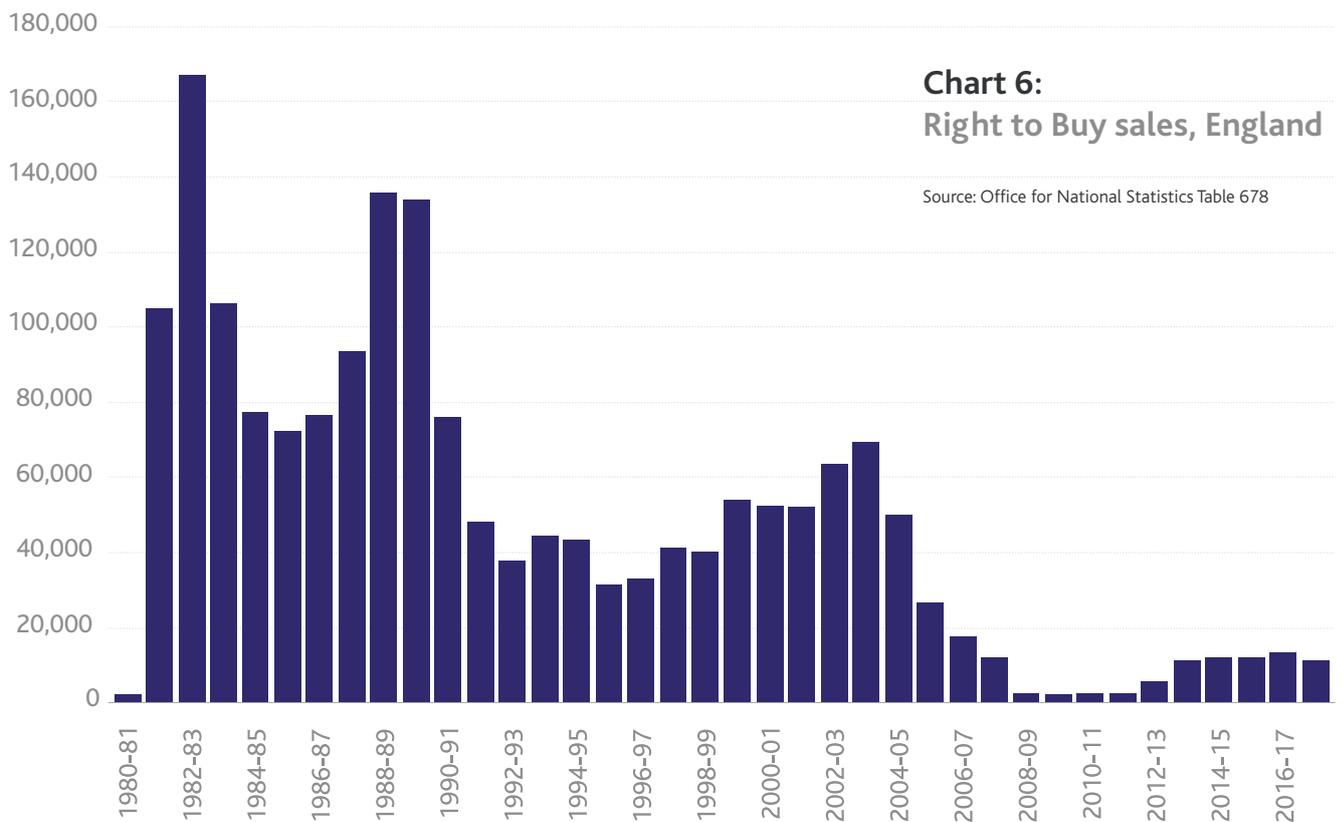
Right to Buy

Right to Buy was a key policy measure, introduced by the Thatcher government, to drive up home ownership levels by offering council tenants the right to buy their home at a substantial discount.

The policy was reinvigorated in 2012, alongside a one-for-one replacement policy. More recently we have seen pilot extensions of the policy to housing association tenants also, so-called voluntary Right to Buy.

Reflecting concerns about the depletion of the social housing stock over time, the devolved administrations have not been the biggest fans of Right to Buy – Scotland abolished the policy from mid-2016, Wales is in the process of withdrawing it and Northern Ireland is currently consulting on its future.

Right to Buy sales in England have picked up from negligible post-crisis levels, but have only averaged 12,000 annually over recent years.



Shared Ownership

Shared ownership, referred to as co-ownership in the case of Northern Ireland, allows households to buy an initial share of a property – at least 25%, but typically less than 50% - and to rent the remainder from a housing association or other provider. Households can 'staircase' up towards 100% ownership in due course, although financial circumstances and up-front fees contribute to the fact that relatively few move into full ownership.

Shared ownership accounts for the bulk of new homes for affordable home ownership that housing associations deliver across the UK. The mix between affordable rent and affordable ownership has ebbed and flowed over recent years. The November 2015 Spending Review & Autumn Statement announced an ambitious goal to deliver at least 135,000 new units for shared ownership, but this has subsequently been diluted in favour of more rented housing.

House-building activity has picked up strongly, although this has been from a low base – new build activity in England totalled fewer than 8,000 shared ownership units in 2015-6, the latest year for which figures are available.

While there are some complexities and challenges around shared ownership¹¹, building societies are strong supporters. Many see it as an important part of their wider offering to first-time buyers. This is in spite of unfavourable capital treatment of the loans, even though the safeguards built into modern standard leases offer security for lenders over the whole value of the property.

Other measures

Elsewhere, the Starter Home initiative – that aimed to provide new-build homes at below market prices to first-time buyers under 40 – has for now gone quiet. Although still formally on the Government’s agenda, few if any units have been built, and the 2017 Housing White Paper marked a dilution in the Government’s commitment in favour of a broader range of affordable housing products.

Rent to Buy, meanwhile, represents a modest revamp of earlier intermediate rent programmes. It seeks to offer a bridge from affordable rent to shared ownership, by offering households below market rents for 5 years. The idea is that the rent saving helps households build up a deposit, which enables them to exercise an option to purchase all or part of the property. The indications from earlier programmes are that relatively few tenants transition to ownership.

As well as all the above direct housing interventions, the Government has also introduced measures to encourage younger people to save for a deposit to buy a home.

The Help to Buy ISA scheme was launched in late 2015. Individuals saving up to buy their first home receive a 25% government boost to their savings, up to a maximum £3,000 when they purchase. Official figures up to the end of 2017 show that Help to Buy ISAs have already supported more than 100,000 property transactions. Many of these early adopters are likely to have been already contemplating house purchase, and so provide little clue as to longer-term effects on savings behavior.

For many individuals, the scheme has effectively been superseded by Lifetime ISAs, which began from April 2017. People under 40 can save up to £4,000 a year towards buying their first home or for their retirement. As with the Help to Buy ISA, the Government will provide a 25% top-up, capped at £1,000 annually, at the end of each tax year. Three building societies are currently the only providers of Cash LISAs. LISAs have recently attracted some adverse publicity, because of the limited opportunities for transferring savings to other providers.

A number of tax measures have also been introduced to help first-time buyers. The most obvious one is the November 2017 decision to permanently exempt first-time buyers from paying Stamp Duty Land Tax on the first £300,000 of purchases up to £500,000. This effectively provides relief worth up to £5,000. The Stamp Duty exemption was enhanced for shared ownership in the 2018 Budget.

Although the move may help those first-time buyers who are cash-constrained, much of the immediate financial benefit from this measure is likely to be capitalised fairly quickly into house prices. Certainly, UK Finance figures provide no obvious signs of a pick-up in first-time buyer numbers in the months following the announcement.

Finally, it is worth noting that recent fiscal measures targeted at private landlords – reductions in interest relief and the supplementary 3% Stamp Duty – have sought to tilt the playing field a little in favour of first-time buyers. Together with the introduction of new underwriting standards by the Prudential Regulation Authority (PRA), the effect has been to make some landlord activity less profitable, and to curtail buy-to-let activity and the overall expansion of the private rented sector. To date, however, there are few signs that these measures are resulting in more properties becoming available for first-time buyers.

The bigger picture

The first point to make is that no-one can accuse the Government of being indifferent to the needs of first-time buyers.

We can see that policy interventions take many forms and are material in scope.

Individual measures are undoubtedly useful, but it is difficult to argue that in aggregate they have transformed the affordability position for first-time buyers. In many respects, it feels like the Government is running hard to stand still.

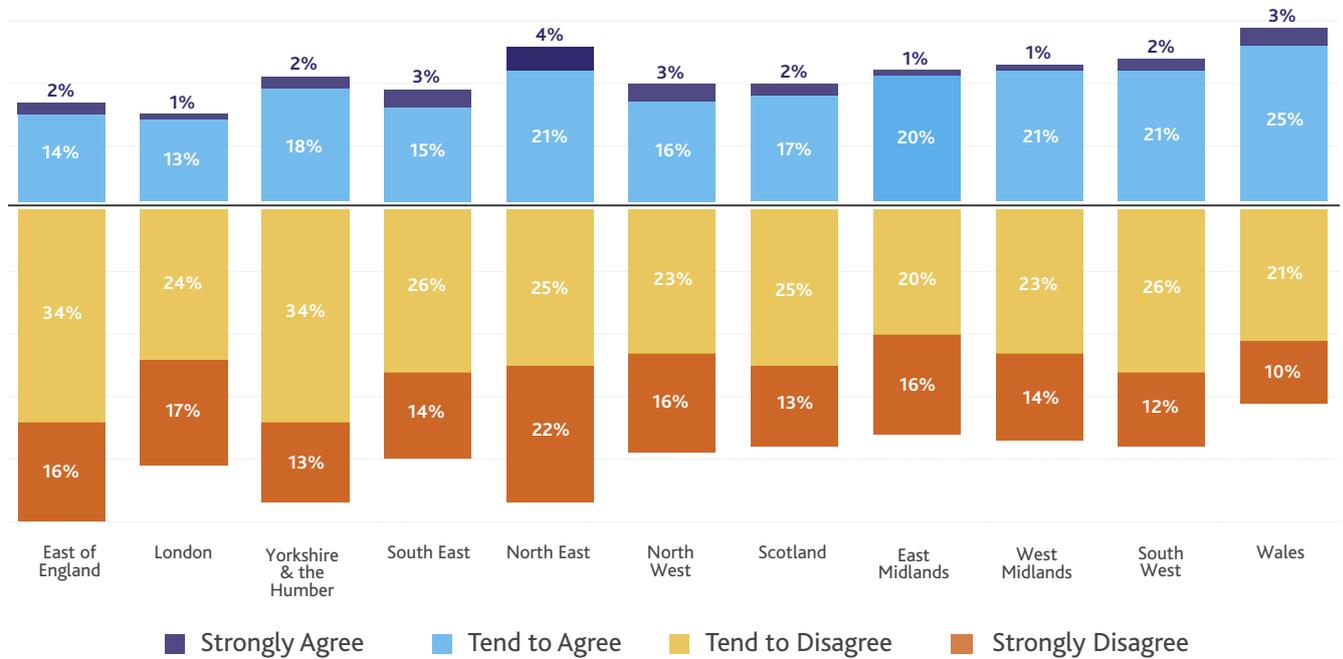
There is also a sense that several schemes – for example, the Help to Buy Equity Loan scheme and the Help to Buy and Lifetime ISAs – primarily help the better off to get on the housing ladder. They also operate at scale. By contrast, Starter Homes, Right to Buy and Shared Ownership – all associated with supporting those on lower incomes – appear to be losing ground.

Taken overall, it is not difficult to understand why the general public is frustrated by the apparent lack of progress. Part of the challenge lies in the fact that monetary policy over the past decade – with interest rates at record lows and asset purchases – has underpinned a range of asset prices including housing. Subsidies and reliefs have fuelled demand and house prices. In consequence, steps which government take to improve the prospects for first-time buyers, risk inflating house prices and ironically making the affordability problem greater for first-time buyers. One of the positive contributions that building societies can make is to focus help in a much more targeted fashion.

Notwithstanding widespread housing interventions by the Government, most adults are sceptical as to whether Government schemes are making it much easier for young people to buy their first homes, with less than a fifth of British adults overall being positive about this. As Chart 7 shows, views differ regionally, with a heavy slew of those in southern England leaning towards pessimism.

Chart 7: Government schemes make it easier to get on housing ladder

Source: BSA Property Tracker June 2018
Don't knows not included



As happens in education, healthcare, pensions and many other areas, when government provision is not seen to be enough, families able to do so step into the gap. The next chapter explores how families are helping young people to get on the housing ladder.

Chapter 3: The Bank of Mum and Dad

Many of the products building societies and other lenders offer to first-time buyers, that we describe in the next chapter, build upon the critical role played by family members.

These are often referred to under the moniker of the 'Bank of Mum and Dad' (BOMAD). Parents have always helped their kids financially where they can and not just to buy a house. Increasingly nowadays, grandparents and wider family members are also part of the mix.

This chapter looks to get a handle on the overall magnitude of help that BOMAD provides and to explore where the money to support such activities comes from.

When we talk about the BOMAD, it is natural that we tend to focus on the gifts and loans that family members make. There is some ambiguity across studies as to when the BOMAD encompasses inheritance proceeds, but we consider them here for completeness.

It is also worth noting that the BOMAD is not just a first-time buyer phenomenon. Last year's Social Mobility Commission's report¹² describes a lesser, but nevertheless growing, reliance on family support from second-steppers and other existing home-owners. Regardless of how we measure it, the BOMAD easily qualifies as one of the top 10 lenders in the UK.

According to the latest L&G report¹³, the BOMAD will underpin 27% of house purchase transactions in 2018, with gifts and loans totaling £5.7 billion. This is likely to include many second-steppers.

It has become commonplace for first-time buyers to rely on the BOMAD, with most (59%) of potential first-time buyers now expecting their parents or other family members to support them in some way. A third specifically expecting contributions towards their deposit according to the latest first-time buyer research commissioned by Yorkshire Building Society¹⁴. This latter figure tallies with recent experience: a recent Social Mobility Commission report¹⁵ notes that about a third of first-time buyers in England get a family gift or loan to help them buy their home, an increase from 20% seven years ago.

In reality, the L&G figure materially under-estimates the full value of financial support that families offer, not least because it makes no allowance for the increasing number of young adults returning to live in their family homes on a low rent/no rent basis.

For example, the ONS estimates that 1.3 million 25-34 year-olds are living at home with their parents (or other family members). One Family research¹⁶ suggests that adult children living at home cost parents about £3,000 per year, despite the fact that many contribute something towards household bills. This implies that, just looking at 25-34 year-olds living at home, the aggregate cost to parents is about £3.6 billion annually.

In reality, of course, parents and wider family members will provide significant help to younger adults, before, during and after any house purchase.

So how do parents and other family members afford such generosity? Where does the money come from?

In reality, the bulk of gifts and loans appear to come immediately from the cash and wealth holdings of parents and grandparents, although these may themselves have myriad secondary sources. We look at several of these next.

Inheritance

When thinking about intergenerational housing issues, the narrative often focuses on the potential trickle down of housing equity to relatives and loved ones, via inheritance and other means.

Sometimes looked at separately from the BOMAD, both the Social Mobility Commission and English Housing Survey¹⁷ estimate that inheritance money has helped about 10% of recent first-time buyers fund at least some of their deposits. This represents a marked increase compared with 20 years ago.

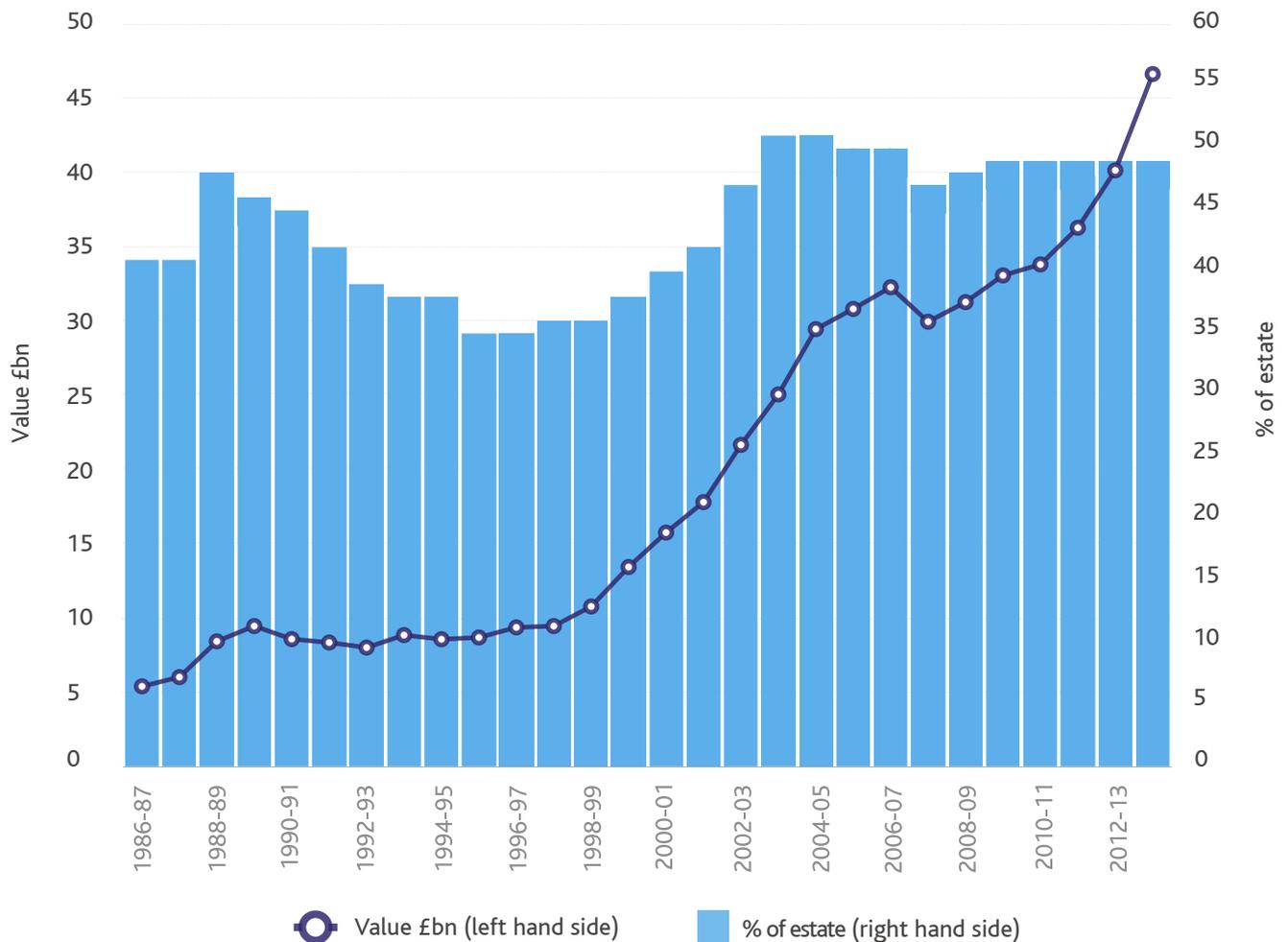
This makes sense.

According to the Office for National Statistics (ONS), the total net worth of UK households increased from £2.8 trillion to £10.2 trillion between 1995 and 2015.

Echoing this, the value of inheritances has grown strongly over a similar period, more than doubling in real terms to £87 billion in 2014-5, according to HM Revenue & Customs. Greater housing wealth, associated with higher rates of home ownership and house price appreciation, has made a significant contribution to this strong upwards trajectory, such that it now accounts for about half the overall value of inheritance (see Chart 8).

Chart 8: Residential dwellings, value and share of inherited estates

Source: HMRC



With today's wealth heavily concentrated in the hands of older households – those 55 and over hold nearly two-thirds of all wealth (65%) – it seems likely that they will have even more wealth to pass on. The Resolution Foundation¹⁸ recently suggested that the value of inheritance may double again by 2035.

This would seem feasible, although any such longer-term projections are necessarily highly sensitive, not least to political risk. These include those associated with the future tax treatment of inheritance, which is currently very benign by international standards, and with social care proposals - a challenging policy area, where a green paper is due later this year.

But even if we presume that the prospects for inheritance are strongly positive, inheritance is unlikely to be a panacea for younger adults wanting to get on the housing ladder.

For one thing, with most wealth passed on to children, increased life expectancy means that the main recipients are typically in their 50s and 60s. Bequests to other family members, if made at all, will often be relatively small. Neither aspect is particularly helpful to those looking to get on the housing ladder at a point where most of the major financial commitments in people's lives have already been made. While some middle-aged recipients may decide to pass on some or all of their inheritance straight away to their children or possibly even their grandchildren, this is an area of considerable uncertainty and one where further research is needed.

Moreover, the Resolution Foundation and others have shown that wealth and inheritance are unequally distributed, and that those with higher wealth and incomes are much more likely to inherit. According to its research, nearly half of today's 20-35 year-olds who do not own their own home have parents who have no property wealth, and so are unlikely to ever get a large windfall.

Despite the broad narrative for inheritance being a relatively favourable one, with impressive-looking financial figures being talked about for the next 20 years, the evidence points to future inheritance playing an increasing, but still rather limited, role in helping younger adults into home ownership.

Equity Release

Another way to access housing wealth for older households is via equity release. The bulk of equity release currently occurs via Lifetime Mortgages, although this may change over time with the recent revitalisation of Retirement Interest-Only (RIO) mortgages.

Echoing several of the drivers that have underpinned inheritance values, equity release via lifetime mortgages has grown strongly in recent years. But this is from a very low base. New lending amounted to just over £3 billion last year¹⁹.

It is widely expected that equity release will grow strongly over the medium to longer-term. The sector is experiencing ongoing innovation and competition, combined with growing property wealth held by older households and less generous pensions. Meanwhile, the memory of mis-selling from a generation ago has faded, and the stigma previously associated with its use by older people is evolving into its acceptance as a mainstream lifestyle product.

There are lots of reasons why borrowers opt for equity release, including home improvements, supplementing incomes, funding social care and paying off other debts.

While different lender surveys provide a range of estimates about the importance of gifting as a motive, all concur that it only features in a minority of cases – 28% of cases according to the latest research from Key Retirement²⁰ - and will rarely be the principal reason. Having said that, plans to help family members financially to get on the housing ladder do seem to have become more evident recently, with the most recent Legal & General Silver Spenders report²¹ suggesting that 15% of its new borrowers plan to use at least some of the money raised in this way.

The total amount currently released and used to support young people get on the housing ladder is likely to be relatively small – in the order of £100–200 million annually, in the view of the authors.

So, even with positive growth prospects over the coming years, it seems unlikely that equity release by older home-owners will have a dramatic influence on future first-time buyer prospects.

Downsizing

Downsizing is not a terribly well-defined concept, as it can refer equally to moving to a smaller property or to a cheaper one. The two are not necessarily simultaneously true, and studies are sometimes a little vague as to what is being looked at.

It is probably fair to say that most people associate downsizing with moving to a smaller home. We will return to this topic in Chapter 6, when we look at how older people make use of the housing stock.

For now, our focus is on moving to a cheaper property, as this will potentially allow the household to release and make use of some of their housing equity.

A 2017 Prudential study²² suggested that 47% of the over 55s, representing nearly 4 million households, plan to downsize at some stage.

Various research reports concur that the majority of such moves are motivated by the wish to have a home that is easier to manage, and lower household bills. The desire to release equity is a less powerful driver, although it still seems to happen – often incidentally – in a significant number of cases. Where the motivation is to withdraw housing equity, equity release providers report that downsizers may simultaneously withdraw equity from their new home where downsizing alone doesn't crystallize sufficient funds.

But, as with lifetime mortgages, even when releasing equity is planned, gifting money to family members seems to rank behind other uses, such as putting it towards boosting pension income or adding to savings. For example, the Prudential study identified only 13% who wanted to do so to help their children buy a home and a further 14% who wanted to give some cash to children.

Although we do not have firm figures for the value of equity release taking place when downsizing, nor on how much subsequently feeds through to younger family members, a back-of-the-envelope estimate is possible.

A recent NHBC study²³ estimates that about 330,000 households among the over 55s move each year. With a substantial proportion of moves by owner-occupiers likely to involve moving to cheaper homes, and one or two surveys suggesting that when housing equity is withdrawn, a typical amount is about £100,000, it is likely that the total amount of equity withdrawn would be £7–8 billion annually.

Even allowing for the fact that much of this money would be prioritized to other areas, it still seems likely that several hundred millions might currently flow through to younger family members each year, and so a much larger figure than via lifetime mortgages.

An interesting question is whether this position will persist over the medium to longer-term. An ILC 2016 study²⁴ indicates that the motivation to release equity via downsizing declines with age.

Meanwhile, the past few years have seen an increasingly competitive, flexible and attractive range of lifetime mortgages being offered, and very recently – following a rule change by the FCA in March – the possibility for firms to offer RIO mortgages.

Case Study

Dudley Building Society and drawing out equity

Dudley Building Society received a joint application from a couple who were looking to re-mortgage to clear their current mortgage, raise some capital for home improvements and to gift funds to their children to support them onto the property ladder.

The applicants had an existing mortgage of £34,000 and requested funding of £39,500 for home improvements and £101,500 for capital raising – a total of £175,500. Their property was estimated to be worth £600,000, giving an LTV of 29.46%.

Both applicants were already retired and a 10-year term took the oldest applicant to 79 years old. The applicants were living in a 4-bedroom property with their daughter. At the end of the term they will be able to downsize to a smaller property based on the available equity of £425,000 at the time the case was underwritten.

Conclusions

There seems little anecdotal evidence to suggest that there is much of a trend for several generations of a family to live together in larger properties. Whilst the 'granny flat' in a larger house owned by middle-aged adults is an option for some households, there is no evidence that the use of this option is growing. Equally, it is understood that many would-be first-time buyers living with their parents do so, not out of choice, but out of necessity, and homes are not often substantially altered to make this a longer-term or permanent arrangement.

For the purposes of our report, it is the financial help provided by families that is the most relevant.

According to L&G, most of the £5.7 billion it attributes to the BOMAD will have come from the cash holdings of parents/grandparents. This tallies with our analysis that the direct contributions from inheritance, downsizing and equity release are likely to be relatively modest in aggregate.

The fact that the greatest level of parental assistance comes from use of their financial savings signals positive action and engagement from older generations, rather than a passive by-product of lifetime events such as downsizing, the move to long term care or death. The younger generation needs help at a specific point in their lives, and this will rarely coincide with the life events of other family members.

Within the financial holdings of parents and grandparents, it is likely that recent pension freedoms will have increased the opportunities for gifting. Currently much of the wealth of the older generation – except for high net worth individuals – will be tied up in illiquid property. The ability of parents to put their hands on cash from their pensions at an earlier age will feed through to first-time buyer purchases, although this will be constrained by the need of older generations to safeguard their own financial futures in retirement²⁵.

According to the BSA member survey, most building societies expect that the role of BOMAD will get bigger over the next 5-10 years. The Social Mobility Commission report²⁶ modelled several different economic scenarios, all of which saw about 40% of first-time buyers benefiting from family gifts and loans over the next decade, up from 34% currently.

The challenge for building societies, and other stakeholders, is to identify products and services that enhance the scope for families to help. The next chapter will explore the wide range of things that building societies already do in this space.

Chapter 4: How building societies help

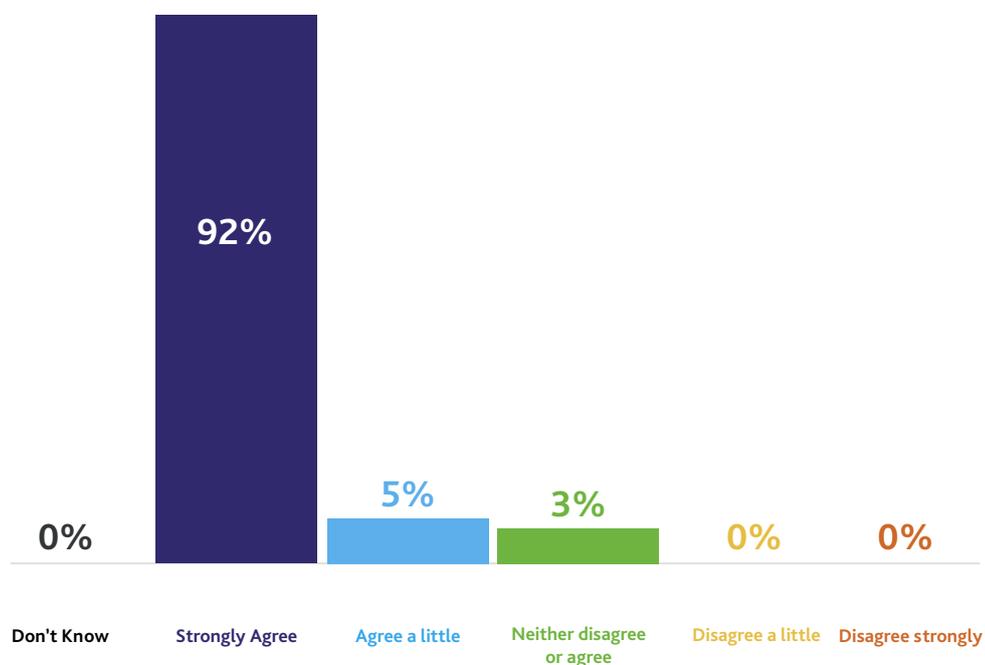
Building societies have long been champions of expanding home ownership, which inevitably brings a focus onto supporting first-time buyers. This is underlined by the fact that building societies' share of first-time buyer mortgages stands at 30%, compared with about a fifth for loans to movers and remortgages.

There are a number of reasons why building societies punch above their weight in the first-time buyer market.

Virtually all building societies subscribe to the view that it is part of the distinctive social purpose of building societies to help young households into home ownership (chart 9). This is part of the strategic DNA of building societies going back to their 18th and 19th century origins. It is sometimes explicit and more often implicit in the strategies of societies.

Chart 9:
It is part of the distinctive social purpose of building societies to help young households into home ownership

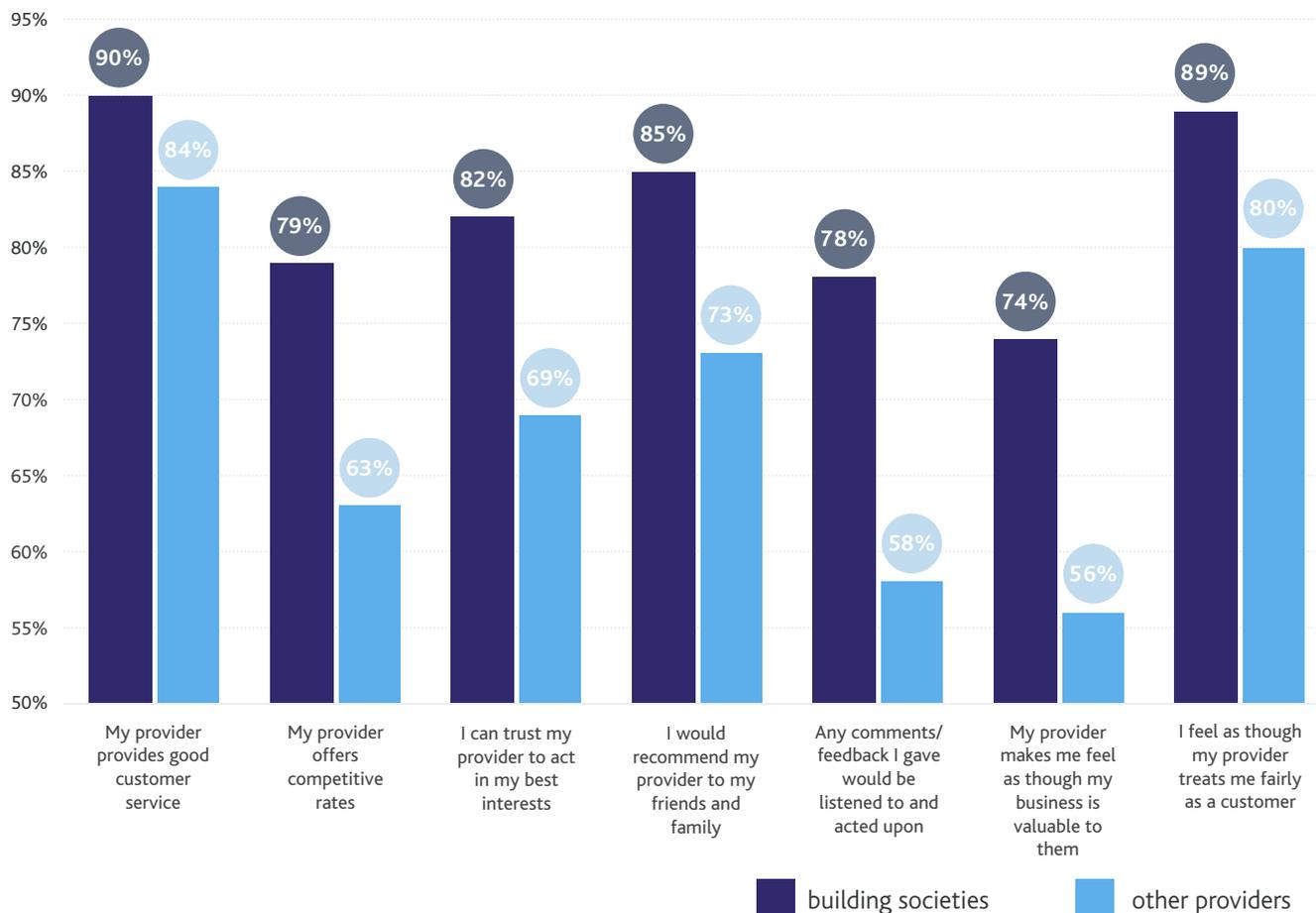
Source: BSA member survey, June 2018



First-time buyers, with no previous experience of buying a home, and the complexities involved, are more likely to approach lenders who they trust, and in many instances will draw upon the recommendations from family and friends. Surveys undertaken by the BSA over many years show that over a raft of measures building societies are more trusted institutions than other providers.

Chart 10:
Trust-related measurement of building societies vs other providers

Source: YouGov for the BSA: July 2018



First-time buyers often need access to a specific product or scheme to be able to overcome the hurdles of home ownership, such as shared ownership or family assistance and many building societies have developed propositions that are designed to meet the specific needs of this target group. Some of these are discussed in more detail later.

In the immediate aftermath of the financial crisis, building societies – having generally employed less risky business models than banks, and being better capitalised than other lenders on the whole – were in a position to continue lending, acquiring a reputation within the broker community and in the media of being ‘open for business’ when others ‘shut up shop’. During the 2008-17 period, building societies accounted for 44% of the growth in the total stock of mortgages outstanding in the marketplace, well above their natural market share.

To sustain this activity, solutions were required to help first-time buyers. Although a variety of measures were employed by different societies, significant amongst them was the use of Mortgage Indemnity insurance, the cost of which was priced into the product rate, allowing societies the opportunity to lend at higher loan-to-value ratios, at a point in time where other lenders would often require very high deposits. Moneyfacts data from 2012-13 shows that building societies provided more than half of the 95%+LTV products in the marketplace.

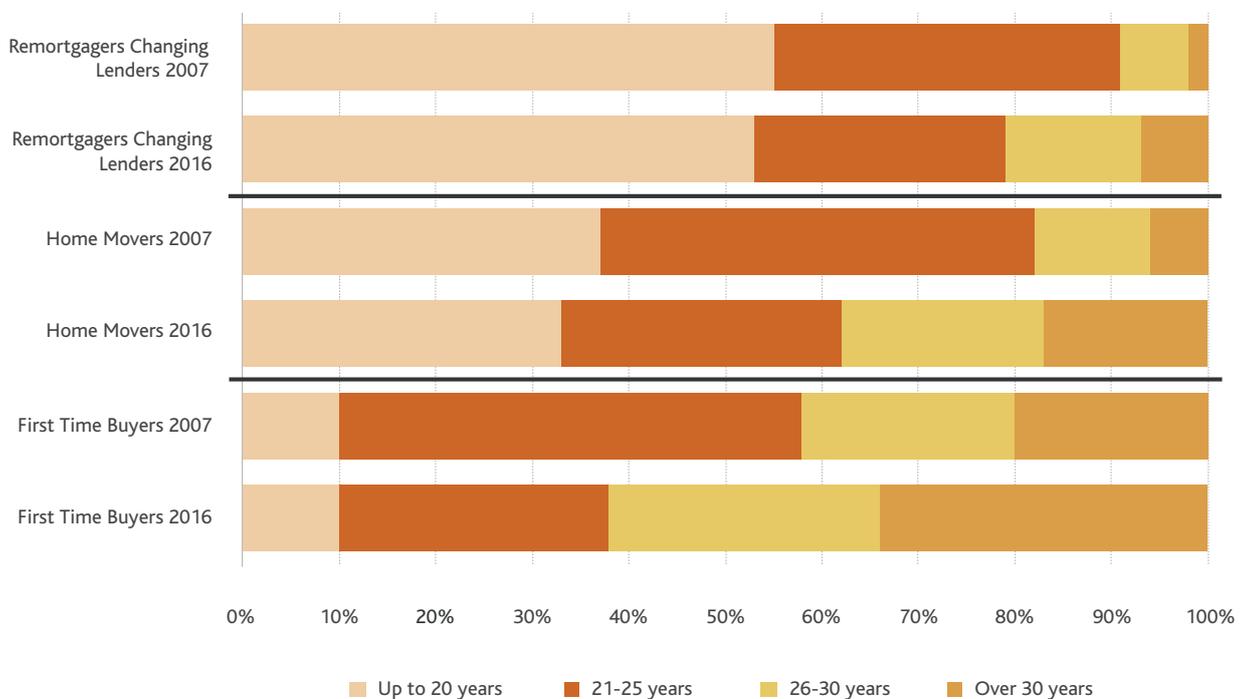
Tweaking the product design

Mortgage Indemnity insurance has enabled lenders to preserve their true 'at-risk' positions at 75%-85% LTV whilst giving borrowers access to loans up to 95% LTV. It was frequently reported in the immediate aftermath of the financial crisis that first-time buyers were required to raise deposits of up to 20% or more of the purchase price. Within a few years 95% lending became available from the vast majority of lenders. Doubtless the Government's Help to Buy schemes have set the benchmark at 95% for others to follow. This does come at a price for the customer, with a 95% loan being more expensive than the same loan at 80%.

Another significant move by lenders has been that of extending loans beyond the traditional standard of 25 years. Terms up to 40 years are now commonplace in the market, and offered by many building societies, to reduce the monthly outgoings, a key concern for first-time buyers, albeit at the expense of increasing the overall cost of the mortgage over the term.

Chart 11: Regulated mortgages by mortgage term, 2007 and 2016

Source: FCA Product Sales Data



Harnessing the support of family and friends

Although reported to have attracted few takers when launched in 2006, Kent Reliance's 'Intergenerational Mortgage' product signalled a desire on the part of lenders to innovate and look for cross-generational mortgage solutions, a desire which has grown markedly over the last decade.

Building societies have generally been willing to flex their underwriting to accommodate the support available from family and friends, whether it be assistance with deposits or maintaining mortgage payments as a means of extending the reach of home ownership.

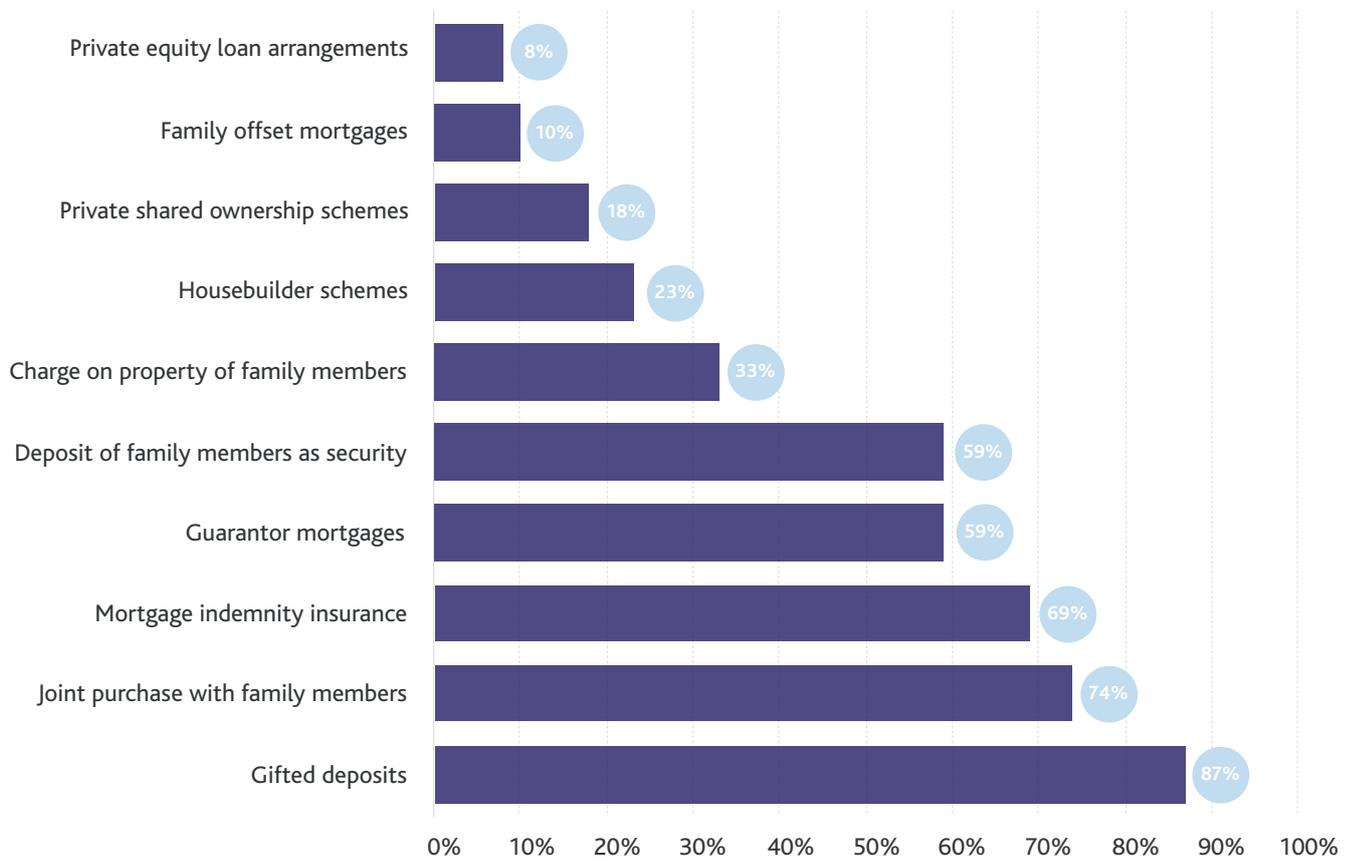
Essentially most mortgage solutions involving family and friends involve shifting risk from the borrowers to other family members. But in doing so the overall risk can be lessened, particularly if the risk is moved from family members that can least afford it, to wealthier family members. The risk calculus involved in this requires a level of appreciation of the

overall family's financial position: smaller lenders using manual underwriting are better able to achieve this than large systematized underwriting operations.

As Chart 12 illustrates, building societies seek to help first-time buyers in a wide number of ways, over and above government schemes. Several of the products or features shown are offered by the majority of societies. And many societies also offer first-time buyers other forms of help, including nil or reduced fees, cashbacks, educational materials, information, and individual underwriting.

Chart 12:
Building societies, % offering additional help to first-time buyers

Source: BSA member survey, June 2018

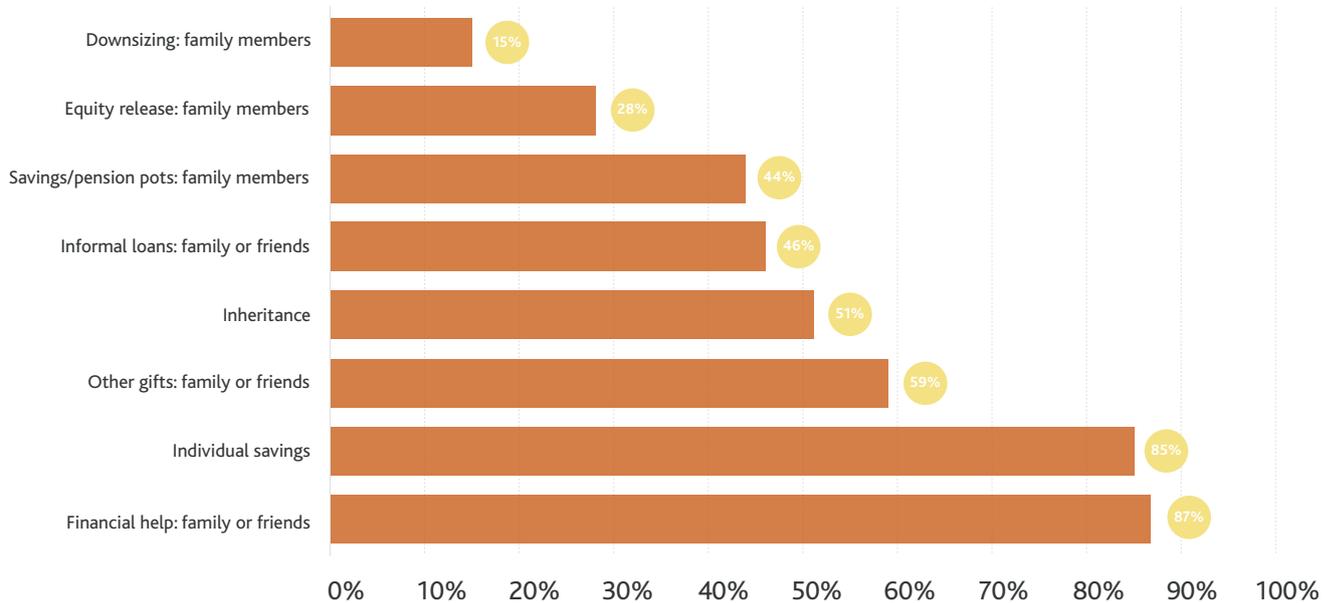


When asked which schemes had been most important in delivering first-time buyer numbers over the past year, building societies most readily cited high LTVs, with shared ownership and the Help to Buy Equity Loan Scheme some way behind. Then came gifted deposits and a range of other approaches involving family support in one guise or another.

However, when considering deposits, building societies confirmed both the major role of the BOMAD and the fact that several different sources will be used in a large number of instances (Chart 13).

Chart 13: Significant sources of first-time buyer deposit, % societies citing as a source

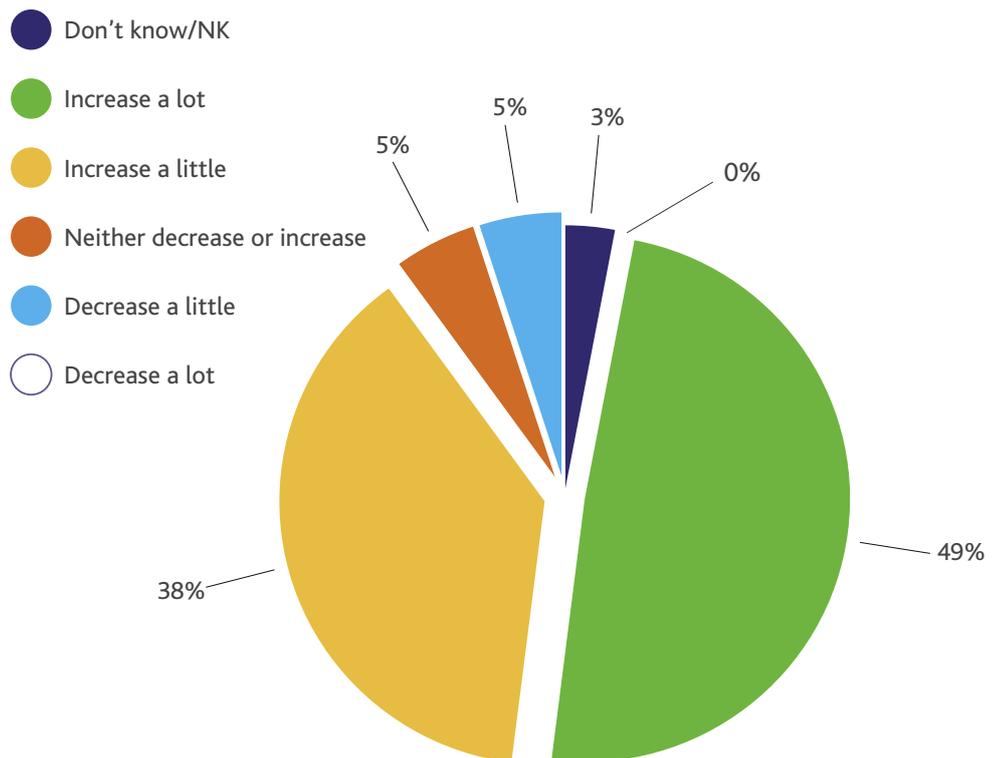
Source: BSA member survey, June 2018



A variety of mechanisms involving family and friends have emerged over recent years and the overwhelming majority of building societies (86%) expect the role of the BOMAD (broadly defined) to increase over the next 5-10 years, largely regardless of whether or not affordability is expected to worsen further.

Chart 14:
How do you think that the role of the Bank of Mum and Dad, broadly defined to include the help from grandparents and other close family members, will change over the next 5-10 years?

Source: BSA member survey, June 2018



Gifted deposits

Discussions with building society lenders shows the importance of deposits being gifted by family members. Historically, there may have been a concern on the part of lenders reflected in underwriting criteria, that home buyers should have the incentive and capacity to save substantial deposits. However, competitive market pressures and the sheer economics of home purchase for first-time buyers have led to a more liberal stance by lenders on the source of deposits.

BOMAD-related case histories profiled in the press reveal a high degree of informality in the arrangement of gifts. Although a variety of potential complexities can arise when a couple receives a gift from one set of parents and the couple later separates, this is generally ignored by lenders. Few recipients and donors of gifts – despite best practice advice to the contrary – make formal arrangements as to what would happen in that eventuality. At least one building society accepts borrowed deposits from parents and grandparents that are protected with a second charge on the purchased property, this being a mechanism to protect their contribution from passing to their child's partner in the event of separation.

Equally, some 'gifts', although perhaps not a high proportion, are effectively loans, perhaps with some expectation of long term payback, but this fact may not be disclosed to lenders. It is likely that some loans may be made with an initial expectation of payback at some future point, but that expectation dissipates over time. The BOMAD may be a powerful 'institution', but it works on the basis of informal agreement and assumption rather than rigorous paperwork!

Building societies generally accept that the familial bond is sufficient to safeguard their interests and have found this to be so in the overwhelming majority of cases. Characteristically, societies working with BOMAD products, advise their borrowers and the families supporting them to satisfy themselves on their legal and tax positions as part of the product terms and conditions.

Nationwide Building Society: Family Deposit Mortgage

Nationwide has created a structured gifted deposit mortgage whereby parents can borrow against the equity in their home and gift that money to a family member as a deposit on a home of their own, again with the Nationwide. This has to be an outright gift with no expectation of repayment and the funds raised have to be used as a deposit on a home. Whilst the scheme is principally designed for first-time buyers, it can be used by other family members including those wishing to help older parents buy a home, to assist with downsizing for instance.

Parental Collateral

As deposit requirements grew in the immediate aftermath of the financial crisis, some lenders developed mechanisms whereby first-time buyers could achieve better terms – lower interest rates and higher LTVs – through making available additional security to the lender in terms of liens over cash deposited with the lender.

Family Building Society

Living up to its name, the Family Building Society enables parents, grandparents and other family members to pool their savings or accumulated housing equity to help younger family members buy their own home or move to a larger one. Crucially without having to give them the money which they may need later in life. In return for this additional security for up to ten years, the home buyer gets a 95% mortgage at a lower rate than would otherwise be available in the market, saving money on each monthly payment.

As younger family members are particularly concerned about being responsible for any adverse impact they might have on their parents' finances, the Family Mortgage includes a unique promise that the building society will pay the mortgage for up to six months if the borrower becomes unemployed involuntarily.

The offset option within the Family Mortgage takes the building society's approach one step further. In this case cash deposited by the family members does not attract interest, but the balance on which interest and repayments are calculated is reduced by this amount. As the parents' funds also act as security, once again better rates are available to the borrower than would otherwise be available at a higher LTV and the monthly payment is significantly lower, boosting affordability. And, because the funds have not been gifted to the younger generation, the Family Mortgage gets round the problem some parents have of 'family money' being lost to a daughter-/son-in-law in the event of a relationship split.

Continuing its innovation, the Family Building Society also allows parents to join in a mortgage with their adult children without being an owner of the property, as well as reversing the arrangement to enable children to help their parents stay in the home they love or move to a more expensive area closer to them. In other circumstances a guarantor arrangement may be relevant and this is available too.

In addition to offering older people traditional mortgages well into retirement Family Building Society helps release housing equity to be gifted to a younger family member as well as giving the over 60s the option of a more active retirement by drawing on housing equity monthly through its Retirement Lifestyle Booster mortgage.

Other lenders have developed products in which a collateral charge is taken over parents' property. This includes about a third of the building societies that participated in the BSA member survey. In principle, loans of up to 100% of the property value can be offered in this way. Whilst this is far from being a universal practice amongst building societies, a small and growing number are prepared to offer this facility.

The same facility, combined with guarantees has been used to enable the purchase of property by students and a small number of societies have 100% "Buy for Uni" schemes. In these schemes, the property is purchased by the student for owner occupation, with rooms let out to friends while they are at university and then either retained as a home, converted to Buy to Let or sold at the end of the university course.

Buckinghamshire Building Society: Family Assist mortgage

This product allows the society to lend up to 100% of the purchase price with the parent/grandparent using their property to provide additional security equal to 20% of the value of the property being purchased.

This is useful if the older generation do not have spare cash resources to put into the younger person's purchase, or wish to keep their savings liquid, or alternatively if there are penalties or tax liabilities associated with converting investment assets to cash.

Also, the proposition to lend up to 100% obviates the need for children to save a deposit and also removes the need to purchase MIG insurance, thereby making the product rate more competitive.

In a similar scheme created by the Bath Building Society (the "Parent Assisted Mortgage"), the collateral charge on the parents' home is removed at the point where the property price has risen to the level where the younger generation's property is less than 80% LTV.

Guarantees

A long-established way in which parents help their children – particularly where income of the applicants may be slightly below the level required by the society's affordability calculations – is through taking a guarantee from the parents.

The facility to accept guarantors has grown in recent years and these days it is widespread practice amongst societies to accept this.

An extension of the guarantee concept is to allow the parents to join into the mortgage.

Despite changes to Stamp Duty rules, in which there are additional charges for 'second homes', some parents find it useful to become joint purchasers of properties, and jointly hold the property title, with the first-time buyer. Most building societies will allow this.

In addition, a few societies are now helping borrowers avoid the additional Stamp Duty charge by offering a joint mortgage where the title is held solely by the first-time buyer but the parents are joined into the mortgage. This is sometimes referred to as 'joint borrower, sole proprietor'. This route also tends to help get around some of the exacting affordability requirements of guarantors, where effectively the loan has to be 'afforded twice over'.

Rent a Room Mortgage

Some young people wanting to get into the property market find it possible if the income from a lodger – usually a friend – is taken into account in the affordability calculation. Although not strictly a financial arrangement involving the BOMAD, this is a way in which friends, or sometimes siblings, can be brought into the first-time buyer equation.

Bath Building Society: Rent a Room mortgage

Some young people might want to become home-owners, but their income is not quite sufficient to get the mortgage they need. Where they are prepared to let a room to a friend (or indeed any lodger), the rent can be brought into the mortgage affordability equation. Under the Bath scheme, the rental income is earmarked to servicing part of the mortgage cost, and this allows the applicant's income to be assessed against the remaining (net) mortgage commitment.

An example on the Society's website explains how it works. Suppose an applicant earns £28,000 per year and wants to buy a 2-bedroomed property for £200,000. The applicant has a 20% deposit, so needs a loan of £160,000. The applicant has a friend who is looking for somewhere to live and is interested in renting the second bedroom. They do not want to buy the property together as they do not want the long-term commitment. The friend is happy to pay £400 per month to rent the spare bedroom.

The society's calculation is that the rent would cover approximately £48,000 of the loan and the remaining £112,000 will be covered by the applicant's income.

The applicant may also qualify for the Government's Rent a Room tax relief.

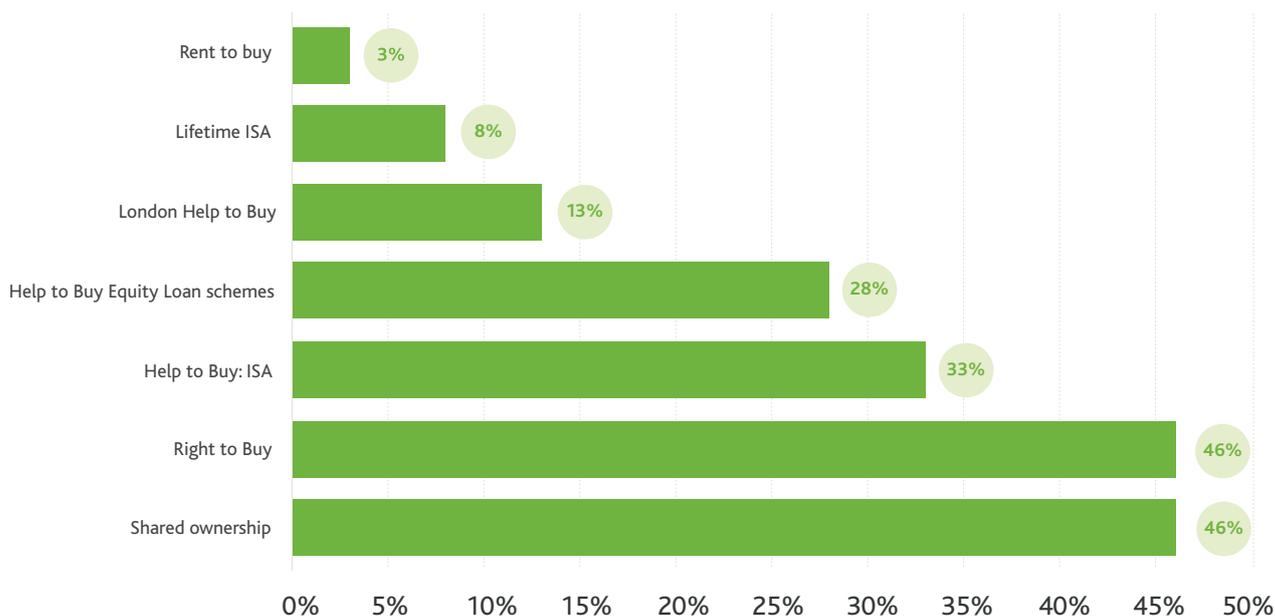
Helping first-time buyers tap into government or local authority schemes

Building societies have been keen to participate in schemes designed by government, local authorities and housing associations.

They participate on a wide front, although it is interesting to note that building societies feature prominently within the niche segments of Right to Buy and Shared Ownership.

Chart 15:
Building societies, % participating in government schemes

Source: BSA member survey, June 2018



Help to Buy

Many of the larger and a few of the smaller building societies have participated in the suite of government products under the Help to Buy banner.

Most significant has been involvement in the Government's Help to Buy Equity Loan scheme, as described in Chapter 2. Many smaller societies have shied away from participation because of the high perceived level of administrative overheads required for participants spread over only a small number of borrowers taking up the scheme.

At a smaller, local scale, in the wake of the financial crisis some local authorities worked with a number of local building societies to assist first time buyers with bespoke schemes akin to the Help to Buy concept. One or two of these persist to the present day.

More commonly taken up by about a third of societies has been the Help to Buy ISA. Again administrative and IT system complexities coupled with a relatively limited desire to increase retail funding have probably discouraged more societies from participating.

Shared Ownership

Where building societies, certainly in comparison with other lenders, have been and continue to be active is in the area of shared ownership lending in partnership with housing associations. About a third of building societies operate in this market and more have entered in recent years as the market has developed.

Whilst shared ownership was once a vehicle for lower income households to enter home ownership, the market has broadened to include above average income applicants. The market has also broadened in the range of organisations looking for lender support. What was once the preserve of housing associations has broadened to include Local Authority and Private Equity providers. This has brought with it a need to standardise guidance and practice across the market which will be to the ultimate advantage of borrowers, housing organisations and lenders. The BSA is already engaged in this standardisation project.

Affordable homes and modern methods of construction

Many building societies have lent on affordable housing schemes in their local areas and more generally into the affordable homes market, there being an obvious linkage between serving their local community and supporting the ambitions of first-time buyers.

Nationwide Building Society has recently taken this further and is building 200 community-led mixed-tenure homes in Swindon – a real signal of the difference that a building society can make.

Building societies have also taken a lead within the lending industry in promoting the opportunities offered by modern methods of construction, likely to be of particular benefit to first-time buyers, particularly where these dwellings can be created at lower cost than standard-construction homes.²⁷ There is growing acceptance of alternative construction methods in the lending policies of building societies as assurance regarding the durability of new materials grows.

How Societies Help

Building societies have therefore been seeking to address the twin problems of raising the deposit and affordability at a time when property prices have been high. Some of the interventions have addressed one or other of these issues and some address both elements.

Figure 1:
Schematic illustration of products offered by building societies



Cumberland Building Society

A young couple with a 5% deposit for their home were looking for a standard first time-buyer (FTB) mortgage. Though they qualified for the standard range, the Cumberland mentioned the availability of the lower rate Family Mortgage in their first appointment. To enable the lower rate, the society takes a collateral charge over a suitable property, such as a parent's, until such time as the security is no longer needed. This is generally when the Loan-to-Value (LTV) ratio falls to an acceptable level through repayments.

One of the borrowers told their mum about the Family Mortgage, who agreed to provide the charge to help secure the lower rate. While a standard 95% FTB mortgage on a 5 year-fix was a rate of over 4%, they took a 5 year-fix with the Family Mortgage at less than 3%.

Chapter 5: Smarter with housing

Our earlier chapters demonstrate that family connections underpin many of the ways to overcome the financial challenges facing first-time buyers.

But we also need to consider if there are other ways in which older people can use their housing assets to help young adults. Some parents may buy a property for their student son or daughter to live in rent-free alongside other rent-paying students, but that is really just another example of the BOMAD.

Are there ways in which older home-owners can benefit young adults to whom they are not related? Something of particular interest to first-time buyers with no access to the BOMAD.

The answer is yes, although examples are not easy to identify and few seem to operate at any scale. We will describe a few later on in this chapter.

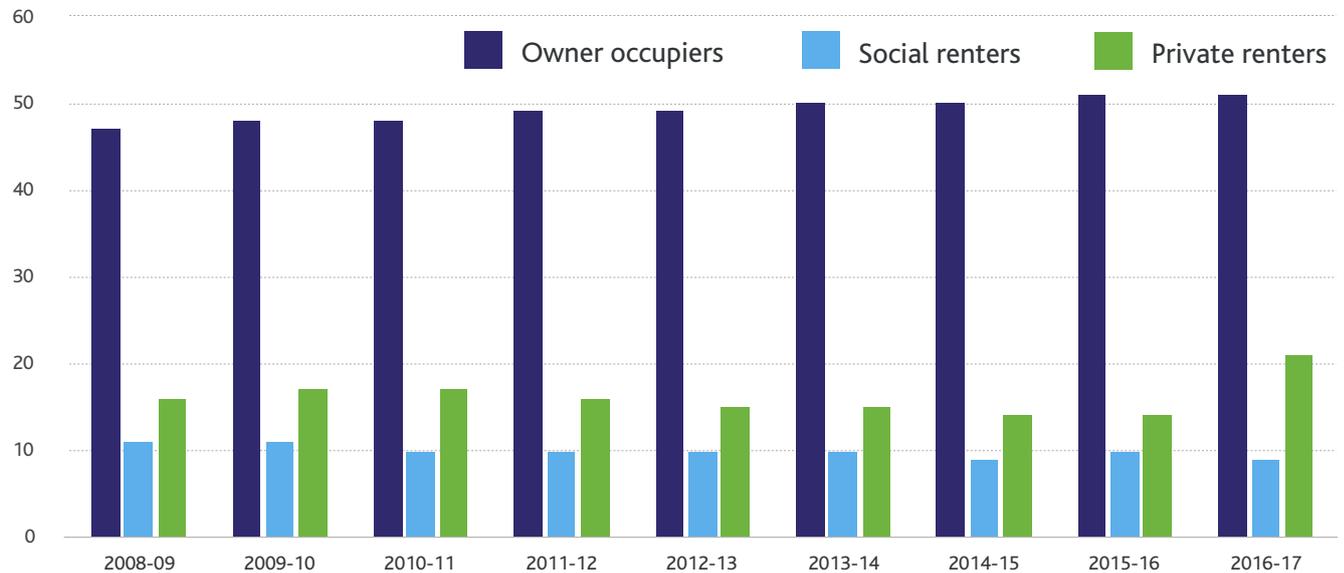
Before doing that, however, it is important to note that, for the time being at least, our ownership of homes and their use are firmly anchored to each other. This is despite the success of AirBnB in disrupting the holiday rentals market, and technology blurring the distinction between ownership and usage in other areas, such as entertainment media (Spotify, Kindle), cars (Uber) and fashion (Hire that Look). When drafting this report, we became aware of early moves²⁸ to launch a marketplace for the buying and selling of parts of homes in the UK, but in the authors' view this looks like a long-term development.

One consequence that flows from use being tied to ownership is under-occupation. Despite persistent policy concerns about the UK's shortfalls in new housing supply over the years, many of our homes are under-occupied and the UK has a greater incidence of under-occupation than most other European countries, including those with similar-sized populations²⁹.

Indeed, according to The Office for National Statistics, more than 8 million homes in England (36% of the total) are under-occupied, based upon official definition of at least two rooms over and above the bedroom standard).

Chart 16: Under-occupation, % of tenure, England

Source: Office for National Statistics Table FA1422



As Chart 16 shows, there is significant variation by tenure. In 2016-7, 7.3 million owner-occupied homes in England (51% of total) were under-occupied, compared with 9% of social housing and 21% of private rented sector.

Although by no means the only factor, demographics and in particular the ageing nature of our population play a significant role, with older households more likely to be treated as under-occupying their homes. In many cases, older households simply choose to stay in the properties where they have brought up their families after their children have left home, often continuing to live alone in such homes after a partner has died.

In aggregate, older people account for just over half of all under-occupation. This provides the backdrop for what has been a less than satisfactory public and political debate about older home-owners and downsizing.

Downsizing

We have looked at downsizing already, in Chapter 3. But our earlier focus was on older people downsizing to cheaper properties in order to release housing equity, some of which might then be given to younger family members and so help them onto the housing ladder. We are raising it here in another context, and specifically thinking about moves to smaller homes.

Downsizing to smaller homes has the potential to enhance the lifestyle and living conditions of older households, for example where it is more manageable, modern or energy-efficient, and at the same time improve the functioning of our broken housing market. With new housing supply adding only slowly to the overall UK housing stock, even modest changes in the behaviour of older home-owners – given their large number – would improve the mix and choice of properties for second-steppers and first-time buyers.

To our minds, downsizing offers significant opportunities to use our housing stock better over the longer-term.

We often read about the reluctance of older home owners to move – behaviour that is often explained in terms of the strong emotional appeal of staying in what was the family home.

In reality close to half express an interest or desire to move home. Nearly 4 million over 55s have either downsized, or plan to do so at some stage, according to Prudential research³⁰.

A lack of suitable housing is the main reason over-55s believe downsizing is not more popular, followed by the cost of moving and high house prices. Much of the property being developed that is positioned as "retirement living" is, in fact, designed for an elderly population, with mobility or other health issues, rather than younger and more active cohorts.

This lack of suitable properties for older people to move into is exemplified by the demise of the bungalow. Developers are loath to build bungalows, often considered ideal retirement properties because of the lack of stairs, as the 'footprint' is economically inefficient from their perspective. Some have argued that financial incentives should be introduced to encourage developers to build more bungalows. Now representing less than 1% of new builds, some have predicted their complete elimination within a few years.

Although last year's Housing White Paper recognised the needs of later life households looking to move to smaller retirement housing, the opportunities go very much wider than this. Most moves in later life are likely to be discretionary or aspirational in nature, rather than related to infirmity or the need for care. Moreover, research³¹ underlines that most older people interested in moving wish to buy another mainstream home, and not one that is specifically earmarked for the elderly.

An NHBC Foundation study in 2017 found that house moves by the over 55s divide fairly equally between those moving to fewer bedrooms (39%), the same number (33%) or more (28%). And not all moves to a smaller property will necessarily be cheaper, especially if higher quality or a better location is being sought.

While the Government has sought to ensure that home-owners selling or downsizing their homes are not put at a disadvantage with respect to inheritance tax (following the July 2015 Budget changes), there is at present very little in public policy to encourage older people to downsize. This has prompted various commentators and think tanks to propose Stamp Duty and other concessions for last-time buyers.

The Intergenerational Foundation (IF)³² has put forward an interesting idea with respect to downsizing – 'downsizing in situ'. It estimates that 4.4 million homeowners have properties that could potentially be split into two or more smaller dwellings, with more than 2 million of these owned by retired people. Currently, fewer than 5,000 houses are sub-divided each year, although the age breakdown of the owners is not known. Sub-division would neatly address the reluctance of many older people to move away from a familiar area and sacrifice their local network of family and friends. IF asserts that relatively minor planning and tax reforms could potentially enable thousands of older people to subdivide their homes, in a way that made their living space more manageable, whilst freeing up a housing unit for sale or rent.

We recommend that the Government reviews what factors discourage older people from downsizing to smaller homes, and the contribution which more downsizing could make to improving the availability of properties for younger households.

Other ideas

Although it is understandable that downsizing to smaller homes gets much of the focus, there are other options for making better use of our housing stock.

The most obvious is the Government's Rent a Room scheme. It is reported that take-up has increased over recent years, although firm figures are not available, and so it is not known to what extent this reflects growing popularity among older households. After languishing

for many years, Rent a Room relief now allows individuals to earn up to £7,500 of tax-free income from letting out furnished accommodation in their main or only residence. This scheme is not targeted currently, but provides a relatively straightforward incentive for homeowners, including older homeowners, to offer accommodation to those looking to rent.

There is also something called Homesharing.

This represents a bespoke service for older householders looking for a degree of live-in domestic help or companionship. With Homesharing, a carefully vetted and monitored process pairs an older or vulnerable home-owner with a young person needing cheap accommodation and willing to help out for a few hours each week. Both parties pay a fee to the Homeshare scheme to cover the costs incurred in finding and supporting good matches. The young homesharer does not pay rent to the householder, but may make a contribution to household bills.

By its nature, Homesharing is bespoke and small scale.

Elsewhere, other bespoke solutions will exist, but they are hard to identify.

One, the so-called 'FreeSpace' initiative, and a rare example of a local authority scheme, was piloted by Redbridge Council a few years ago. It entailed elderly home-owners moving into a more suitable property, and their home being refurbished and rented out to a family on the council's housing waiting list. The elderly householder retained ownership and benefited from lower utility bills and a potential boost to their income through the difference in rents. Although the scheme was never intended to be large-scale, in the event funding cutbacks and changes in housing priorities meant that only one person was helped and other local authorities – despite recognizing its potential – did not take up the scheme.

Conclusions

This chapter has looked at how the housing assets of older households might be used to help younger adults, and in particular those to whom they are not related.

Whilst in principle, various initiatives might allow positive outcomes for old and young cohorts, what emerges is that few seem capable of operating beyond an individual, small-scale or local level.

Building societies show some limited awareness of activities at the local level, but it is seen as difficult to engage at local authority level or with specific charities and few societies have become directly involved.

Downsizing to smaller homes by older households stands out as the one activity that takes place at some scale. The emergence of Retirement Interest Only mortgages, a sector in which building societies are strongly represented, and the growing popularity of equity release may facilitate more downsizing. This is especially so in cases when the household needs finance to cover the costs of the move itself, furnishing or improvement of the purchased property.

Although family members looking to get on the housing ladder may benefit in cases where housing equity is released (see Chapter 3), there is also likely to be a more general, indirect benefit where downsizing by an older homeowner frees up family property for sale. Incentives for downsizing to smaller homes would clearly spur such activity and improve the functioning of, and turnover in, the wider property market. A shortage of suitable homes to downsize to also suggests an opportunity for house-builders to satisfy unmet demand.

Subdividing homes through 'downsizing in situ' offers some scope for improving the supply of small first-time buyer homes.

Chapter 6: Beyond mortgages

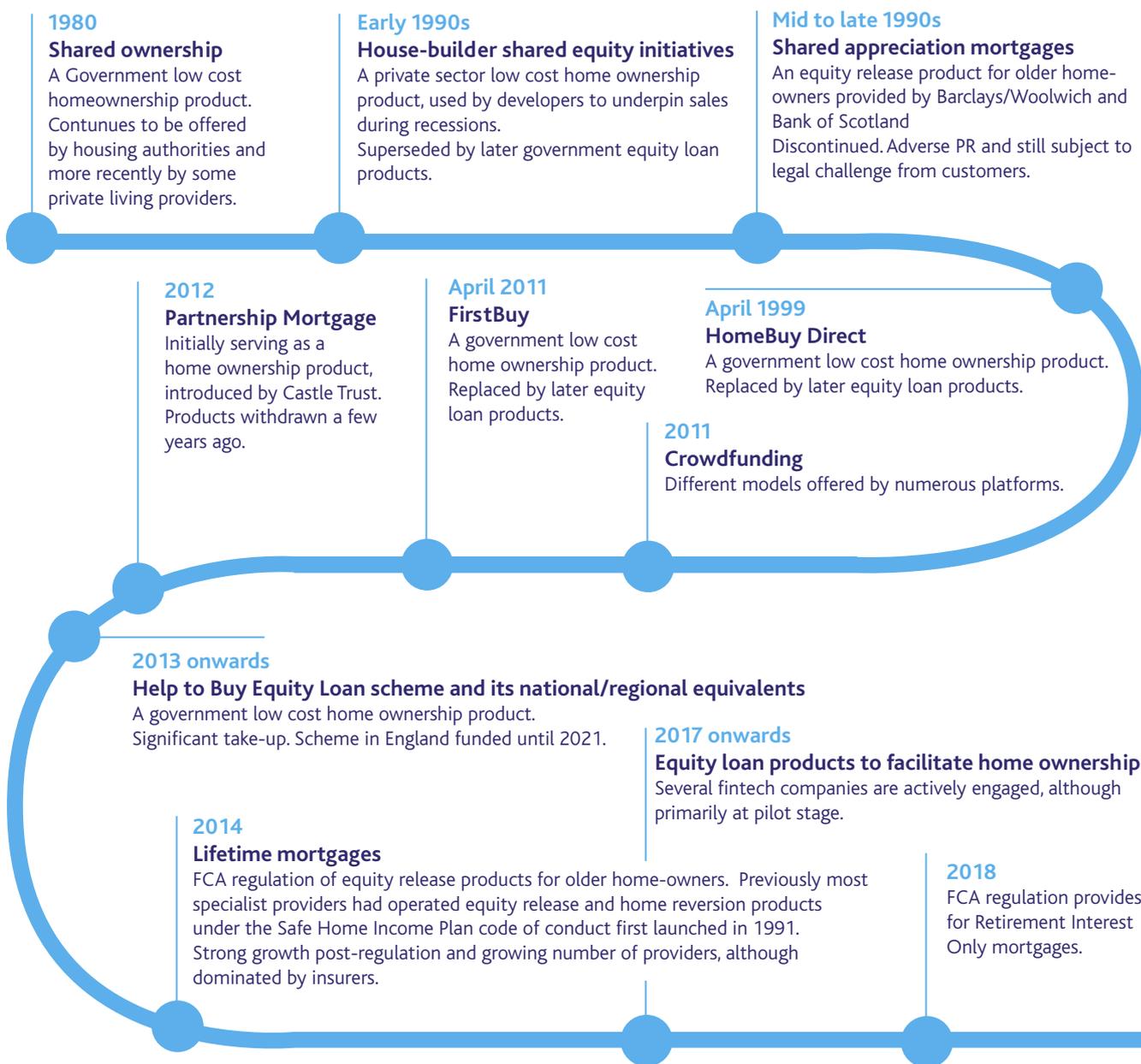
Although mortgages have been the dominant source of housing finance for well over a century, there have been numerous efforts over recent decades to diversify away from mortgages with equity finance of one sort or another.

Many have been associated with helping first-time buyers, although we also see examples of equity release products for older home-owners.

The association with first-time buyers is easy to understand, as financing some of the cost of house purchase via an equity loan, on which little or no interest is payable, serves to increase the purchasing power of the buyer. Figure 2 provides an outline chronology.

Figure 2: A timeline of UK equity loans

Source: Office for National Statistics Table FA1422



It is interesting to note that, whereas private sector schemes have been something of a mixed bag, with some earlier schemes proving unsustainable, government has a strong track record in underpinning equity-financed schemes. We looked at Help to Buy and Shared Ownership in Chapter 2.

Importantly, government efforts can also act as a game-changer. This has certainly been true in the case of its Help to Buy Equity Loan scheme, which has both served to bring shared equity arrangements into the mainstream but also to shape their future parameters.

The innovative shared equity product introduced by Castle Trust a year or so prior to Help to Buy included an asymmetric equity treatment that gave it more upside gain than downside loss – a 20% equity loan would allow it 40% of any upside but share only 20% of any downside movement. The Help to Buy Equity Loan scheme, with its balanced upside and downside, has very quickly become the de facto standard (not least because it poses far fewer regulatory conduct risks for the provider).

Crowdfunding

Crowdfunding has become well-established in just a few years, with huge innovation in crowdfunding platforms and a variety of models.

Hard data is difficult to come by, but research³³ suggests that funding the development of residential property, notably in the private rented sector, has been one of the strongest growing sectors in recent years. Investors appear confident that housing assets will increase in capital value over time. And the growing regulatory hassle and tax complexities associated with landlord activity in recent years may have added to the appeal of indirect investment.

With the exception of commercial landlord activity, there are examples of crowdfunding for social housing, but these seem to operate on a relatively small scale.

Housing associations have shown some interest in crowdfunding, see for example Allia's Retail Charity Bonds, although these tend to be for niche activities rather than large-scale developments, where conventional loans or secured bonds are more cost-effective. To date, the majority of housing association funding appears to have come from social responsibility investors, rather than the general public.

Abundance, an ethical crowdfunding platform, has recently tested the waters in the social and affordable housing sector, with a call to raise £4.25 million to fund the construction of 30 homes in the Liverpool area.

Elsewhere, there have been isolated efforts to gain funding for ethical landlord activities and even a few optimistic attempts to raise deposits for first-time buyers. None of these appear to have gained even modest traction.

Private sector equity loans

A number of fintech companies are in the process of developing private sector versions of the Government's Help to Buy scheme. Such schemes are unlikely to compete against the Help to Buy product – although opportunities may now emerge as the Government has revealed its intentions beyond March 2021. This activity could usefully extend equity loans to the purchase of existing homes.

Details of the fintech products tend to be sketchy, although some are known to be piloting their products and systems currently. According to the BSA member survey, a small number of societies state they have actively considered participating in privately-funded equity loan schemes, and at least one building society is understood to be involved in pilots. At the time of drafting this report, it is far too early to know how these pilots will fare.

For the most part, the fintech companies appear to be focused on exploiting the differences in mortgage rates charged at higher LTVs.

So, for example, let's assume that the typical rates currently charged for a 5-year fixed rate mortgage with LTVs of 80% and 95% are 2.25% and 4.25%. If we think of the 95% mortgage as comprising two elements – an 80% tranche and an additional 15% tranche – then we can think of the 95% loan as one that charges 2.25% on the lower 80% tranche and a higher rate of about 12% on the upper tranche.

In principle, the higher rate of interest associated with the top tranche can reward institutional investors for the risks associated with symmetric upside/downside equity sharing and the capital-intensive nature of such activity, and provide a monthly cash saving to the borrower.

How building societies view private equity loans

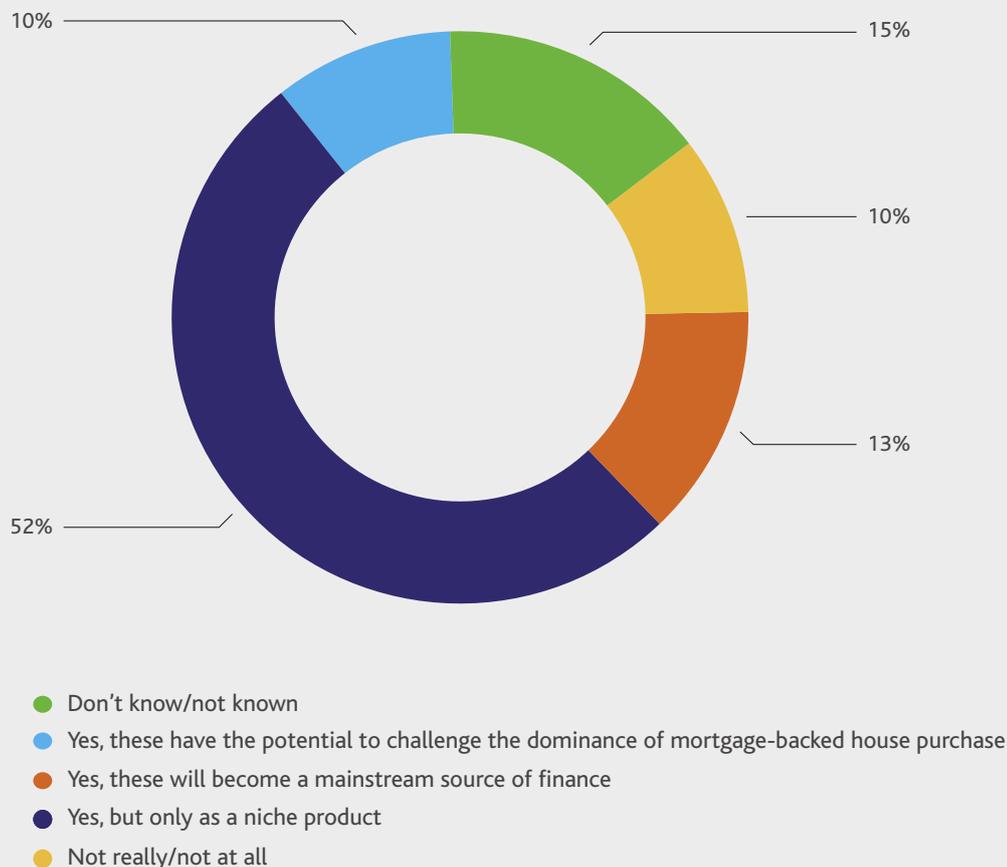
We asked members of the BSA a number of questions with respect to privately-funded equity loans. A small proportion of societies (16%) report that they have actively considered participating in privately-funded equity loan schemes.

When asked what potential such schemes have to develop over the next 5-10 years, very few societies dismissed them as irrelevant. Indeed, although responses were mixed, a slight majority expect equity loans to feature at least as a niche product over the medium- to longer term.

Despite challenging questions about customer understanding, risk, regulatory treatment, investor returns and sustainability over time, it is interesting to note that more than a fifth of societies think equity loans capable of evolving into a mainstream source of housing finance or challenging the centuries-old mortgage product.

Chart 17:
How equity loans will develop over 5-10 years

Source: BSA member survey, June 2018



A number of academics have been enthusiastic advocates for equity loans, including David Miles³⁴, a former member of the Bank of England's Monetary Policy Committee. Miles notes the theoretical advantage for younger first-time buyers in purchasing with lower initial leverage and upfront monthly costs, and also raises the possibility that equity funding might prove more stable over the economic cycle.

Clearly, this is a market in the early days of its evolution, and one where we are likely to see considerable innovation over the next few years. By way of example, as we were drafting this report, we became aware of one FCA-regulated fintech firm – HIP Interactive Property UK – that aims to create a tradeable market for buying and selling percentages of a home.

Equally, a number of industry commentators question whether fintech firms can identify and deliver a model that is both simple and fair for borrowers, and at the same time provide a future funding stream that is scalable and sustainable.

In some ways, the holy grail might be seen as a product that appeals to retail savers and so to older households – the group who hold the lion's share of financial savings. Such people might be strongly attracted to getting a better rate of return on their savings and one that links back, indirectly, to house prices.

A significant minority of societies (38%) believe that schemes to attract and recycle some of the wealth of older people into equity loan finance will eventually emerge and prove sustainable. We did not ask whether or how societies might engage with such products, but the responses suggest that at the very least this will be a market development to watch closely.

Building societies hold banking licences and have considerable expertise in raising retail deposits, including some limited experience with savings accounts linked to house prices and stock market movements, and so might be viewed as attractive partners/conduits by fintech firms. While the difference in corporate cultures would not necessarily make this an intuitive fit, this could be an idea that some societies warm to over time if a clear customer demand becomes evident.

We recommend that building societies closely monitor developments around private equity loans.

Chapter 7: What more can be done?

Looking ahead, the UK may face significant headwinds over the next few years, with the economy having to cope with Brexit uncertainties, interest rates moving modestly higher and fiscal challenges limiting the Government’s scope for significant interventions. As well as these factors affecting the housing market. The Government’s decision to withdraw the Help to Buy Equity Loan scheme from 2023 may result in a greater need for private sector assistance.

While not the most promising backdrop for tomorrow’s first-time buyers, the good news – as we saw in Chapter 4 - is that building societies are creatively engaged in helping first-time buyers into home ownership, and are already pro-active in many appropriate areas.

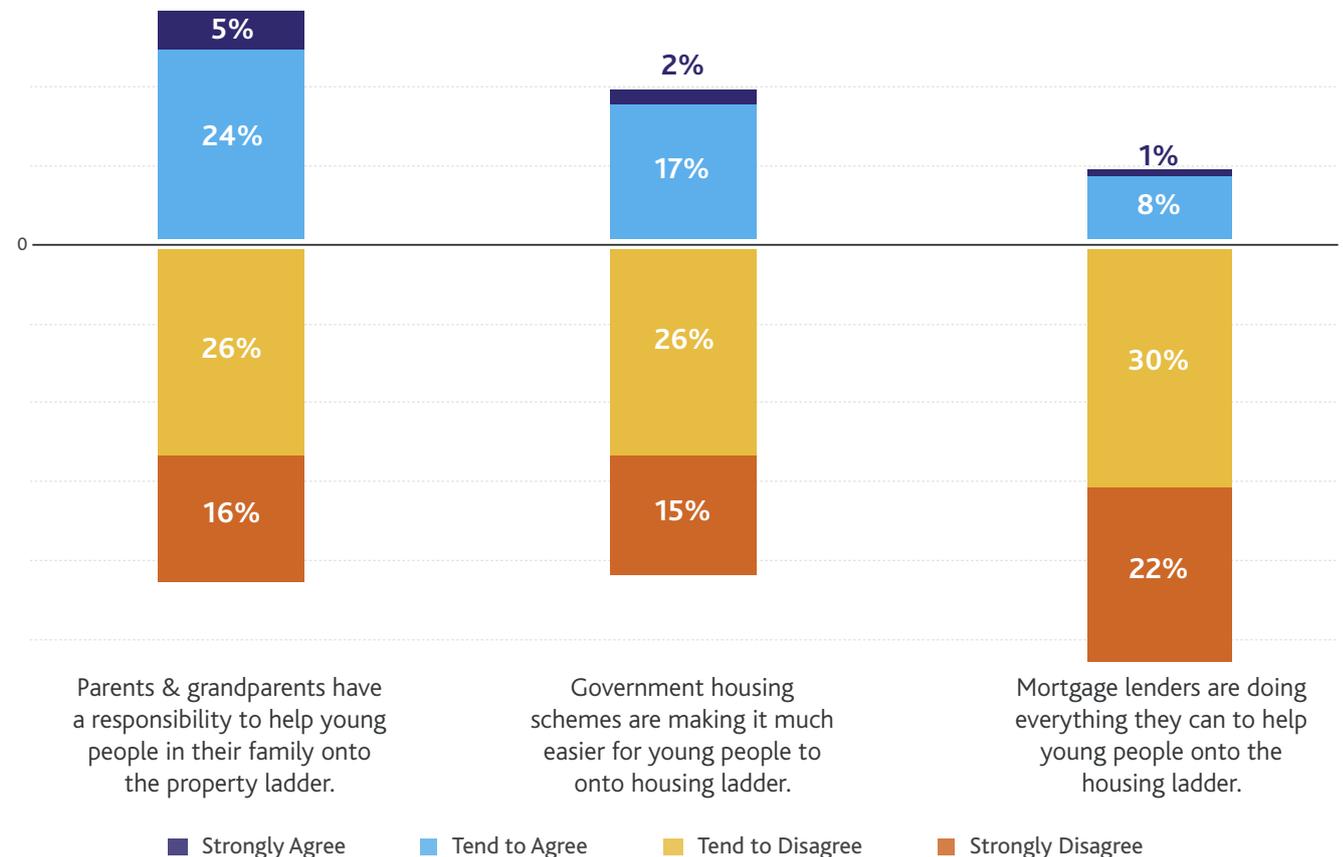
This means that the first part of this chapter is necessarily about doing more of the same, doing it better and ensuring that young people, and their wider family, are more fully aware of their options.

But that is not the whole story.

Responses to the BSA Property Tracker survey make it very clear that the general public does not see it as the sole responsibility of parents and grandparents to help their young, but place high expectations on both government and mortgage lenders (and no doubt other institutions too).

Chart 18: Views on helping young people get on the housing ladder

Source: BSA Property Tracker, June 2018
Don't knows not included



So, while it is absolutely sensible for building societies, and other lenders, to explore how to tap further into the natural willingness of older people to help younger family members onto the housing ladder, they should not stop there.

The scope for building society action is greatly influenced by the state of the wider economy and also by financial regulation. With respect to the latter, there is an opportunity for the Building Societies Association, and other lender groups, to offer more critical challenge to industry regulators and we pick up on this towards the end of the chapter. Finally, we close with some thoughts on the goal of home ownership itself.

Recommendations

Promotion

To improve communications, demystifying vocabulary and providing clearer customer information for first-time buyers using parental help

Despite the huge effort by building societies to help young people onto the housing ladder, often in partnership with the BOMAD, an English Housing Survey report³⁵ notes that households are put off from applying for a mortgage because they think their deposit is not big enough or fear that their mortgage application would be rejected.

This suggests that many would-be first-time buyers are ignorant of the solutions that do exist and so defer or give up on the idea that home ownership is for them, potentially settling for alternative and often more expensive housing options.

What can we do to encourage more of a reassuring “Go on, ask” approach?

It might be helpful for the sector to use more of a shared vocabulary, when describing first-time buyer-friendly products, and to review how easy it is for a potential buyer to assimilate all the relevant product information from websites. So, for example, should information about parental help be shown on the web page showcasing first-time buyer products rather than, in some cases at least, shown separately?

Whilst individual societies are responsible for their own product marketing, some societies with smaller marketing budgets could benefit from a collective approach targeted at both young consumers via online and social media channels. Also, some form of awareness campaign for the broker community - perhaps a collective stand at mortgage trade shows or a well-constructed website targeting mortgage advisers unsure about what products and facilities individual societies offer - could serve the sector and its customers well.

It is likely that this kind of initiative would help position all societies - large and small - as the first port of call for would-be first-time buyers.

Product extension

To increase the number of societies and other lenders offering collateral charges, guarantor mortgages and other relevant products, and for the regulators to revisit the question of fixed-rate lending

There is of course scope for societies and others to more widely deploy the solutions that already exist.

Lenders that do not offer collateral charges or guarantor mortgages could develop the appropriate know-how (and documentation) to offer such solutions. They could take a more liberal view to rental income from lodgers/house-sharers as some societies have done.

The Prudential regulator’s ‘Building Society Sourcebook’³⁶, in practical terms offers relatively few obstacles to those wishing to extend their offering to be more first-time buyer-friendly. The key proviso is, quite reasonably, that societies can demonstrate their ability to understand and manage the risks well.

Many first-time buyers like the certainty offered by fixed rates, not least because they help with budgeting at stages of people's lives when funds are relatively tight. Some medium-sized and smaller building societies are constrained by historic fixed rate Sourcebook limits in fully serving the younger generation's appetite for fixed rate lending,

We suggest that this could be reviewed, to ensure that building societies are able to maximise their reach to first time buyers.

Some smaller societies have been very active in product innovation, as they have sought wider margin lending to offset the high overhead cost of running small-scale operations. But they face something of a 'Catch 22'. It would be difficult for small societies to scale up to service high business volumes. And, without substantial marketing expenditure, the innovative products they have developed tend to be regarded as niche.

But this leaves open the possibility that those product types may have much wider appeal if taken up and promoted by several societies or by larger lenders.

Product innovation

To explore flexible mortgage design, including guarantees, the role of interest-only for part of the mortgage term and considering what opportunities Retirement Interest-Only mortgages could offer for unlocking wealth

There are opportunities for more innovative lenders to find novel solutions which could appeal to the first-time buyer marketplace. Building societies have already shown themselves to be particularly adept at creating innovative products and deploying their underwriting flexibly.

Guarantees at the moment tend to be 'all-or-nothing' contracts in which the underwriting assumption is that the guarantor could substitute as payee of the mortgage in full for the entire duration of the loan - surely a very rare circumstance in reality? There may be scope for more limited or flexible guarantees. Equally, product structures could be designed which have parents on the mortgage at the start but falling away after a period of time, with a re-underwrite of affordability. More flexibility around some of these points is likely to make them more widely attractive, for example to parents keen to assist more than one child over time.

Whilst the Mortgage Market Review understandably requires lenders to ensure a credible repayment strategy for interest-only loans, there may be capacity to develop products which start as interest-only and are therefore more affordable at the start of the mortgage, but which revert to capital repayment structures after a given period into the mortgage. "Low start" mortgages, were quite prevalent in the UK a generation ago, and continue to be common in certain jurisdictions, such as Spain. It is perhaps surprising that they have not come back more strongly in the UK.

There could be products developed where at times of stress in the family finances there is automatically a reversion from a repayment mortgage to interest-only for a period of say 3 or 5 years, with this relief built into the mortgage affordability calculations. Possibly, there is even potential for combining a repayment mortgage in a working lifetime with the prospect of a retirement interest-only (RIO) proposition, once the borrowers come to the end of full-time work.

There may be structures which engage employers to assist with the mortgage - particularly in cases where staff retention or recruitment are important. Could the offer of mortgage assistance be useful in enticing bright graduates into a given profession?

Again, the creation of a new or tweaked product does not have to be the preserve of a single society. Within the confines of competition law, this is a route which some like-minded societies could constructively travel together and maybe again there is a role for the BSA to play in this, in collaboration with the sector's regulators.

Underwriting innovation

To revisit the case for lending up to 100% LTV within appropriate parameters, and exploring how technology can feed into more accurate underwriting.

Few lenders offer more than a 95% LTV.

Most underwriters in the sector that we spoke to are not philosophically averse to lending 100%, although the higher risk factor associated with higher LTV lending and 100% lending in particular is well appreciated.

But there are circumstances in which the risk can be mitigated - borrowers in certain professions, those with high probabilities of substantial inheritance, those with parental guarantees, etc. Building societies might be prepared to take a view that a small percentage of their first-time buyer sales could be 100% LTV, without significant compromise to their overall lending book.

Current low interest rates could also be used - again in selective circumstances - to offer higher LTVs (including up to 100%), using overpayments in the early years to reduce the LTV rapidly over time.

There may also be possibilities for Mortgage Indemnity Guarantee (MIG) insurers to provide cover for loans beyond 95%, particularly if MIG cut in at a higher LTV and where the case profile is suitable.

In our discussions with underwriters, an interesting anomaly arose which illustrates the arbitrariness of the 100% LTV lending taboo. Let us take the case of a borrower wanting a 95% LTV loan who had recently taken out a car loan on credit. As long as there was sufficient affordability, then most lenders would accept that loan, assuming the borrowers' saved funds were used as the deposit. On the other hand, if that borrower had used the saved deposit for the car and therefore asked for a 100% LTV loan, the application would be rejected. The credit position is fundamentally the same, but the stance of lenders would be quite different.

Open Banking together with other technological developments and the skilful analysis of customer's banking records is likely to enhance the accuracy of behavioural scoring and credit assessment and could develop to the point where some borrower traits could be seen as compatible with 100% lending.

Stress rates

To reassess the Financial Policy Committee's housing tools to reflect current economic reality and social policy objectives allowing more flexibility to take individual personal financial situations into account.

The previous section underlines that there is, in principle, no shortage of things that Lenders can do to help first-time buyers. The challenge sometimes comes in the form of what financial regulators will allow.

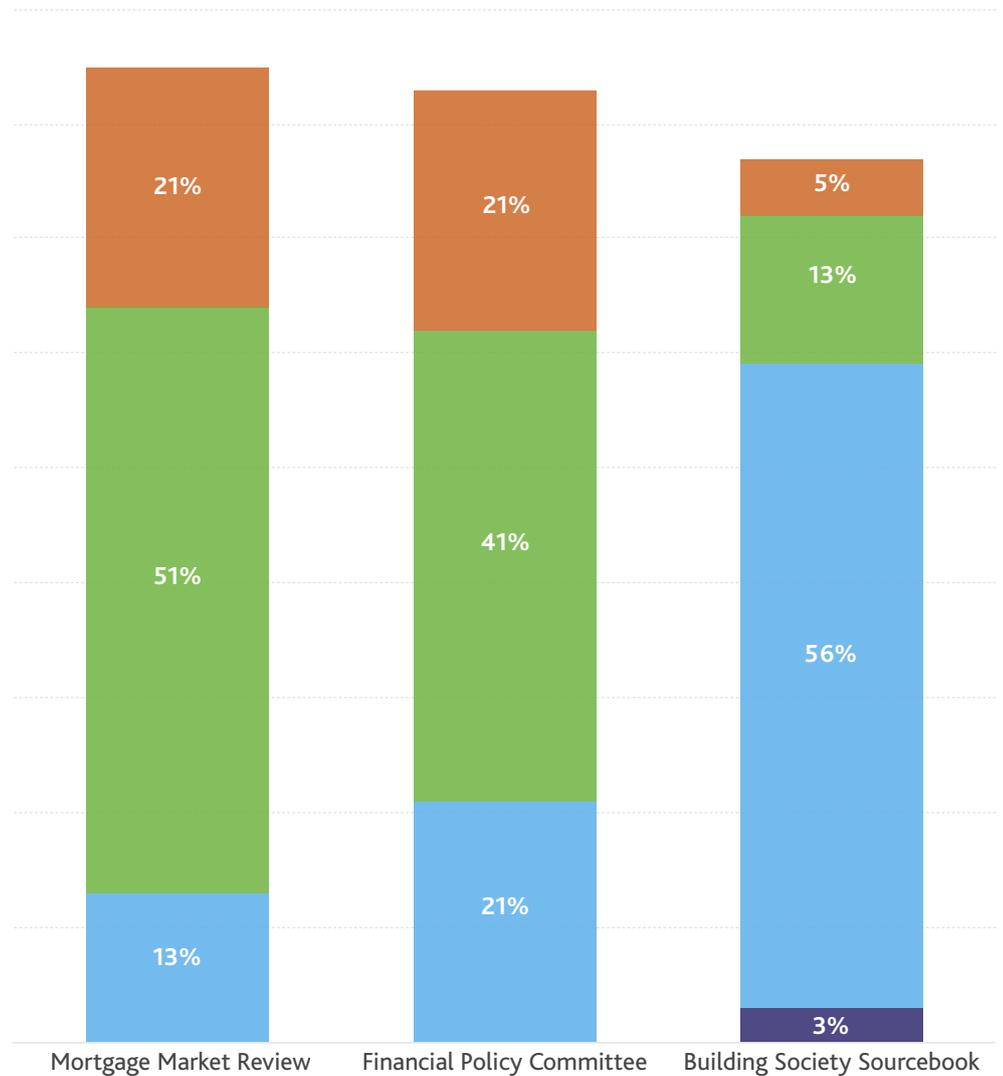
When asked how different regulatory interventions had affected the ability of first-time buyers to get on the housing ladder, building societies were most negative about the Mortgage Market Review (MMR) and the housing tools deployed by the Financial Policy Committee.

Few societies would take issue with the premise embodied in the 2014 MMR of having a stress test, which reflects the capacity of borrowers to afford their mortgage in the context of a higher level of interest rates.

Chart 19:
Regulation making it harder or easier for first-time buyers, % of respondents

Source: BSA member survey, June 2018
Don't knows not included

- A bit easier
- A lot easier
- Neither easier nor harder
- A bit harder
- A lot harder



The main issue is the introduction of macro-prudential stress tests, where lenders are required to assess the affordability of the mortgage when, in a market where most mortgage rates are below 3%, a stress is applied which requires that the mortgage be affordable at rates more than twice this level.

Such a level of prudence risks freezing many would-be first-time buyers out of home ownership, a frustration when the Bank of England continues to reiterate the point that it sees the rebound from the current very low levels of interest as gently incremental, with longer term interest rate projections coming nowhere near the level of currently applied stress rates.

The situation is aggravated by the rules in which no consideration can be given to the likelihood of income growth, even if this is prescribed in certain professions.

One consequence of this are 'rental prisoners', where a young person in rented accommodation who has been routinely paying rent at, say, £800 a month cannot get a mortgage on 'affordability grounds' where the mortgage payment might be only £500 a month. This makes no sense to the general public.

One challenge has been about providing lenders with concrete evidence of rent payments over a sustained period to help assess suitability for a mortgage deal. The Creditworthiness Assessment Bill, currently making its way through Parliament should also help those renting to have their rent payments available to lenders for underwriting purposes. Moreover, with HM Treasury encouragement, this challenge has been taken up by fintech entrepreneurs³⁷ who are developing apps for renters to record and share their rent payment data, enabling them to establish a credit history. Experian has announced that it will now include some of this data in credit files.

Perenna is establishing the first business-to-business covered bond bank in the UK. This will offer capital market access to smaller building societies, enabling them to expand their product offering, including offering their customers long term fixed rate mortgage loans without balance sheet restrictions. Long term fixed rate mortgage loans provide payment certainty to borrowers. This both suits lending into retirement, where affordability is based on pension and other savings income, and makes it easier to lend at higher Loan to Value and Loan to Income levels as it removes the need to stress rates when making affordability calculations.

We would encourage building societies to explore whether such products usefully add to the repertoire of mortgages they can offer first-time buyers.

It is now recommended that the industry and the regulators meet to constructively discuss rule changes and/or underwriting or product solutions, such as lifetime discounts, borrower profiles and longer term fixed rates. The objective is to ensure that there is an appropriate balance between prudential measures, designed to provide financial stability, and the need to assist social policy objectives of bringing more younger people into home ownership. Many lending practitioners currently feel that there are borrowers that should be considered as acceptable risks but who are excluded from home ownership because of over-conservative rules and stress tests.

More generally this particular subject could be part of a forum in which the wider impacts of financial regulation on social policy should be studied and discussed.

Fiscal 'nudges and incentives'

Exploring the case for improved fiscal incentives for intergenerational wealth transfer, such as targeted inheritance tax exemptions and Stamp Duty relief.

We have identified a few measures that could be taken, given sufficient political will, to encourage the transfer of wealth across the generations.

A significant nudge would be given if gifting for specific reasons - such as paying down debts, funding education or deposits on homes - could be exempt from inheritance tax, as has been suggested by one of the larger equity release providers.

Stamp Duty has been subject to much reform in recent years, and the abolition of the slab scheme and relief provided for lower value transactions have been to the advantage of first-time buyers. Unfortunately, the Stamp Duty levied on second homes also applies to the situation where parents jointly buy a property with their children, and this has inhibited this form of intergenerational assistance and should be reviewed. Consideration should also be given to offering Stamp Duty relief for older borrowers who downsize, as encouragement of downsizing would lead to more efficient use of the housing stock.

And finally...

Some thoughts on the goal of home ownership itself

The financial innovation of recent years has begun to disrupt the old order, in terms of the competitive landscape and the mix of products.

The concept of partial home ownership is gaining acceptance at both ends of the age spectrum – low cost routes into home ownership for the young, via shared ownership and shared equity schemes, and lifetime and RIO mortgages offering ways to unwind home ownership in later life.

Fintech may see further inroads by equity investors. Whilst the dominance of the mortgage product is unlikely to change any time soon, building societies and other lenders would be wise to monitor future developments closely. Tomorrow's world may be one in which only a minority of people ever own their housing outright, and then only temporarily. And today's concern about first-time buyer numbers may morph over the coming years into a no less contentious one about broadening the public's exposure to the investment class of housing assets.

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