Where is housing heading?
Social, labour market and demographic changes – what challenges do they pose for housing?

January 2014

Vidhya Alakeson
Resolution Foundation deputy chief executive
Where is housing heading?

CIH begins a new series of policy discussions on the key issues facing housing over the next five years

Two years after the coalition government published its housing strategy Laying the Foundations, and 18 months ahead of the General Election, CIH is taking the opportunity to pause and consider developments since 2010: where we have ended up, what's worked, what hasn't, what we've learnt about the policy positions of the main parties and where things might be heading next.

We've commissioned a series of leading commentators to give us their views on these and other issues across different policy areas over the coming months. In this third essay, Vidhya Alakeson, deputy chief executive at think tank Resolution Foundation, considers the challenges posed by social, labour market and demographic changes.

We hope you will enjoy the essays and that they will stimulate debate over the critical period we are about to enter.
3. Social, labour market and demographic changes – what challenges do they pose for housing?

The UK economy is gradually emerging from the longest economic downturn in history and a severe financial crisis. After five years, the economy is slowly growing again and average wages are expected to increase in real terms at some point next year, easing the squeeze on living standards. But returning to recovery will not be as simple as going back to the way things were before 2008. The downturn has altered longer-term economic prospects with important consequences for housing policy. The growing polarisation of the labour market and decline of state support for working families mean that larger numbers will struggle to meet the costs of housing, not just the least well-off who have traditionally depended on social housing. Greater affordability problems will continue to put pressure on welfare spending as more people get drawn into housing benefit unless government can stimulate greater investment in housing supply, despite constraints on public spending. But this supply will need to be better targeted at those in need and offer greater flexibility of tenure than today’s rigid three-tenure model, to allow people to move from renting to ownership and back again as they age.

A changed world post-crisis

In the run up to the crisis, troubling signs of lower-paid workers falling behind had already started to emerge. During the period of economic growth that preceded the crisis, median wages had already started to stagnate. Of course, wages across the economy were severely hit by the downturn but as we emerge into recovery, it appears that the downturn has exacerbated the trend towards a two-tiered labour market, with jobs growth at the low-skilled, low-paid end of the ladder and also at the top. Between 2008 and 2012, low- and high-skilled jobs expanded their share of employment, while middle-skilled jobs saw a relative decline. The middle-paying third of sectors saw employment fall in absolute terms from 2008 to 2012, while low- and high-paying sectors saw employment rise. The growth of the two-tiered labour market is likely to have different consequences for men and women and vastly different regional implications. More jobs were created in health and social work - which is a predominantly female sector - than in any other sector between 2008 and 2012, and much of the growth in higher-paying, high-skilled jobs has been dominated by London.

As well as being low-paid, many of the jobs being created at the bottom of the ladder offer limited opportunities for progression. One in four (27 per cent) of the low-paid in 2002 remained stuck in low pay for the next decade compared to nearly one in five (18 per cent) who escaped low pay by the end of the decade. Those who remained stuck on average saw no real increase in their wages. Some even went backwards in real terms. Certain sectors offer particularly poor opportunities to progress, notably wholesale and retail and accommodation and food services – sectors where jobs have been created during the downturn. At the sharp end, these low-paid jobs can also be highly insecure, offering work on an ‘as and when’ basis through zero-hours contracts or agency work, rather than a reliable source of income. Under-employment has been a feature of the downturn, keeping some in work who would otherwise have lost their jobs but often providing inadequate income and security to lift families out of poverty, even with two part-time earners.

For the young, the consequences of today’s labour market are perhaps most severe. One in five young people remain unemployed despite the green shoots of recovery and close to a third of this group have been unemployed for more than a year. The long-term scarring effects of prolonged periods of youth unemployment are severe and will change the employment trajectories for these young people for the long term. Among those who have found work, large numbers are working below their skill level, as prospects for graduates also remain limited. Nearly half of
those who graduated in the last five years are working in jobs that require a degree.\textsuperscript{iv} With student debts to pay off, the failure to secure a graduate salary is likely to limit the potential of graduates more than in the past.

For much of the 2000s, wage stagnation for workers on median pay was masked by the growth of tax credits that propped up household incomes and acted as a buffer against the growth of in-work poverty.\textsuperscript{vii} But the protective role of tax credits was sent sharply into reverse by the crisis and the subsequent need to get public spending back under control. This, as much as changes in the labour market itself, means that the recovery will feel different for ordinary people in Britain from the period before the crisis. Between 2010/11 and 2015/16, working-age households with children will see cuts to their state support that will effectively reverse much of the gain in income they experienced in the 2000s. Working-age households without children will lose more substantially, while pensioner households are protected.\textsuperscript{viii} For those dependent on housing benefit, the cuts have been more far-reaching and for a small number of families, the benefits cap has severely limited their options.

The fiscal position of whichever government wins in 2015 will necessitate further cuts to welfare, even if the pace of economic recovery quickens. Cuts to departmental spending have been so severe for some that it is hard to see how further cuts are possible without compromising the ability of departments to do their job. Beyond this, demographic pressures on pensions and the NHS will in themselves put downward pressure on welfare.\textsuperscript{ix} Welfare cuts look inevitable, as does a tax rise of some kind after the election, and both the government and opposition have floated the idea of capping welfare spending.

The combined impact of these labour market trends and cuts in state support is that household incomes for those in the bottom half are not expected to be any higher in 2020 than they were in 1997.\textsuperscript{vi} The level of wage growth required to make up lost ground on pay is beyond what can be realistically achieved, meaning that less well-off families have experienced a permanent loss to their living standards. This has been compounded by the fact that the cost of living has remained high throughout the downturn, putting significant pressure on household budgets.

Poor prospects for living standards sit alongside the looming threat of high levels of debt among many households. As wages stagnated, credit became another route through which to prop up struggling incomes. In the year prior to the crisis, 20 per cent of first-time buyers in the low- to middle-income group bought a home with an interest-only mortgage.\textsuperscript{x} As a consequence of loose credit, 3.6 million households in the UK are spending more than a quarter of their net income on debt repayments and could be described as ‘debt-loaded’.\textsuperscript{xi} Historically low interest rates and lender forbearance have kept these households from default and repossession, in contrast to the situation in the US, for example, where repossessions have been far higher. But interest rates cannot remain as low as they are today for ever. More positive news on economic growth towards the end of 2013 has raised the real prospect of a rise in interest rates. This will place a new squeeze on those who are debt-loaded from before the crisis as well as those who are moving into homeownership through today’s high loan-to-value mortgages.

The implications for housing

The changes to the labour market and the role of government have profound implications for the affordability of housing; for investment in housing; and for the nature of the tenures we will need in the future. These will be discussed in turn.

In the past, finding an affordable home was a challenge for those on the lowest incomes but for the rest, the market was able to provide. But without a major correction in prices post-crisis and with incomes not expected to grow substantially for millions of households in the bottom half, affordability will be a far bigger problem in the coming
five years than it was in the past. The median house price is now nearly seven times the median wage in England compared to three and a half times in 1997, and in inner London it is ten times the median wage. As a consequence, the percentage of working households who are dependent on housing benefit has increased from ten per cent of all housing benefit recipients in 2008 to 19 per cent in 2012. Growing income insecurity for those in work but on low pay will also have an impact on housing, with insecure employment preventing people from accessing mortgages and reliably meeting their monthly housing costs.

It is well understood that addressing affordability depends on vastly increasing the supply of new homes. However, a simple numbers game will not be enough. The balance of tenures that will be required in the future will be different from the past. We have to increase supply of the right kinds of properties to meet the needs of those who currently have few housing options. Residential development in inner London, for example, is now above the levels last seen in 2007 at the peak of the market. That sounds impressive given the depth of the subsequent crisis, but can London’s ordinary workers afford to live in any of the properties that are being built?

There is an excessive focus on homes for sale but even a high loan-to-value mortgage would not give many of those who are priced out access to conventional homeownership in expensive parts of the country. Take a couple with one child on £22,000 looking to buy a two-bedroom home. A 95 per cent mortgage makes it possible for them to save for a deposit but they cannot meet the monthly costs of a 95 per cent mortgage in high-price parts of the country. For example, in Cambridge a 95 per cent mortgage would involve them spending 85 per cent of their net income on monthly mortgage costs and in Exeter, 53 per cent of net income. With first-time buyers now in their mid-thirties and access to homeownership for those on lower incomes out of reach in many parts of the country, more people will require purpose-built rental accommodation offering longer tenancies and more professional management. As the percentage of long-term tenants increases, especially those with families, the need to diversify the offer to tenants in the private rented sector through the development of a UK model for build to rent becomes ever more pressing.

Moving forward, we will also need greater flexibility in tenure. Rigid demarcations between homes for sale and rent are no longer fit for purpose when the gulf between the two tenures for those on lower incomes is vast and when an aging population means that many more people will need to access the equity in their home to pay for care costs. For the last thirty years, shared ownership has sat between renting and conventional homeownership but has formed only a very small part of the housing market – a form of social housing without mass appeal. A more streamlined version of today’s shared ownership product now needs to expand to become the fourth tenure, allowing individuals the opportunity to move from renting to part-ownership and back again as their circumstances and needs change. Tenure needs to stop being linked to an individual property. Properties need to be able to accommodate lifetime tenures in a way that is flexible and responsive to changing needs.

Creating more opportunities for shared ownership will allow more people to build an asset over time, protecting individuals and the state against the costs of old age and reducing significant wealth gaps in the UK. Shared ownership also responds to the enduring aspiration to own a home and enjoy the security and certainty that currently only ownership provides. However, for those who will remain long-term tenants, innovation will be essential to ensure that they also have an opportunity to build a safety net. Two-thirds of low- to middle-income households have less than one month’s income in savings and almost the same percentage have no private or occupational pension or only a frozen one.
Moving forward: A new landscape for housing policy

For many years, the role of government in housing has been largely focused on meeting the needs of those on the lowest income. This is still vitally important. The market will not provide well for those who are most in need and have limited income. However, the nature of housing need is changing. Those in work and on modest incomes also face limited housing options and in some of the most expensive parts of the country will struggle to find suitable housing in close proximity to where they need to be for work, school or to maintain family ties. Lack of access to affordable housing will constrain labour mobility between London and the South East and the rest of the country and act as a barrier to those looking to improve their standard of living through work.

In the face of this, government needs to play a more active role in shaping local housing markets to reflect the needs of the local population rather than relying on the market to drive supply. This is a role that city governments in other countries, such as the United States, have taken on more aggressively than government here since the virtual ending of council house building in the 1980s. At the heart of a more activist stance from government is a role for local authorities to shape land values to support the development of a broader range of more affordable housing tenures. As well as planning conditions, local authorities need to make more active use of public land, zoning and covenants to ensure the right mix of tenures for their local population.

Allied to this is the need for greater investment in housing. In some parts of the market, it is hard to see how needs can be met without greater public support. The market will not deliver for those on the lowest incomes, whatever the model, without some kind of implicit or explicit subsidy. Where subsidy is not available, the bill tends to be met through housing benefit at greater long-term cost to government. But for large parts of the intermediate market and beyond, there are real opportunities to bring in new sources of finance from the private sector and from quasi-public sources such as Big Society Capital and to use more innovative financing approach such as equity funding, tax reliefs and credits to incentivise the right kinds of development.

Alongside a market-shaping role, government also needs to ensure that those who do not become homeowners have ways to build assets that can protect them in later life. House-price linked savings provide a route for individuals to benefit from the housing market without being homeowners. As build to rent develops, there is an opportunity for individuals to gain a stake in the investment vehicle that owns rented development rather than in their individual home. Building confidence in these kinds of investments among the public will take time but without greater attention to these issues, government will face an enormous challenge meeting the housing and pension costs of those without assets in old age.

Housing plays a central role in UK living standards. As well as the most significant cost for families, homeownership is also one of the strongest, more enduring aspirations. The preference for ownership has not waned from one generation to the next, despite the fact that the barriers to ownership are higher than ever. As the economy emerges into recovery, the living standards of less well-off families in Britain remain fragile. Housing policy for the next parliament will need to have a wider focus if it is going to meet the needs of the millions of households at risk of being left behind by the market.

---


