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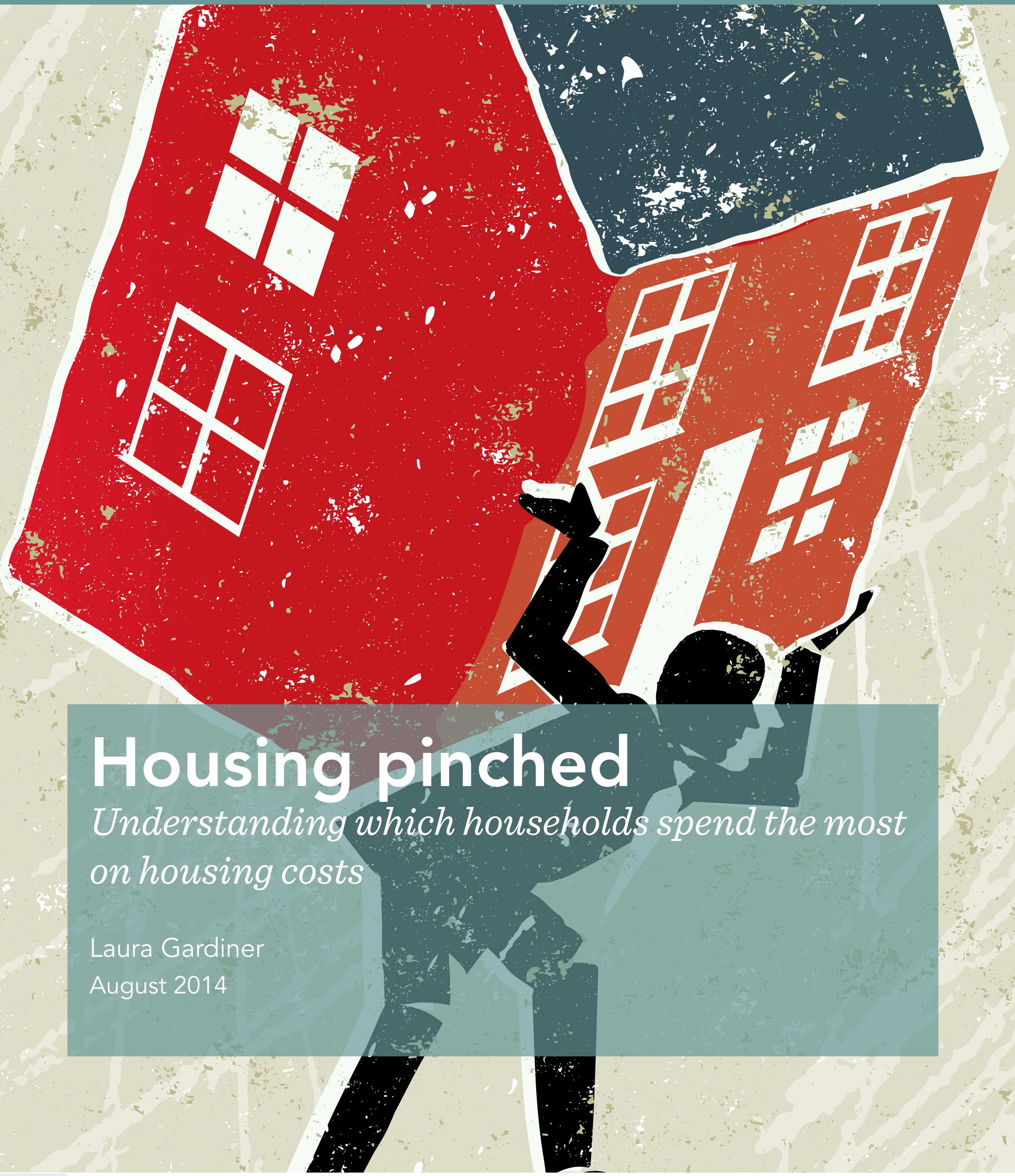

Housing pinched

Understanding which households spend the most on housing costs

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Contents

Section 1

Introduction 3

Calculating housing costs 4

Section 2

How many households spend more than a third of their income on housing? 5

Section 3

How many households are 'housing pinched'? 8

Who, and where, are the 'housing pinched'?...9

Section 4

Conclusion 12

Annex 1: defining housing costs and household incomes 14

Section 1

Introduction

The return of rapid house price growth in some parts of the country has hit the headlines, causing concern about the stability of the housing market and affordability of housing. Long before the economic downturn, the upward march of house prices meant that ownership was out of reach for a significant number of households. The limited correction in prices seen in the immediate aftermath of the financial crisis and the subsequent recovery have served to reinforce this trend.[1] Unable to get on the ladder, many in this group have become reliant on the private rented sector for a home given that social housing is increasingly targeted at the most vulnerable and those out of work. For some, renting privately is a choice that provides flexibility, but for too many there is no choice, and private renting is associated with uncertainty and lack of quality. In certain parts of the country, the growth of 'Generation Rent' is also putting upwards pressure on rents. This, coupled with chronic housing undersupply and an expected slow recovery in household incomes, means that housing looks likely to put pressure on the budgets of this group for some time to come.

For others, the story is very different. Although home ownership is in decline, the number of outright owners is rising. Half of home owners now own outright and, therefore, face extremely low housing costs.[2] Unsurprisingly, outright owners are more likely to be older, while those who are unable to get on the ladder are more likely to be under the age of 35. In addition, many owner-occupiers with mortgages have benefited from a sustained period of historically low interest rates since the downturn, reducing the burden that housing places on household budgets even as incomes and earnings have been stretched.[3] A household with a £75,000 tracker mortgage has saved around £12,400 since 2009 as a result of such a long period of low interest rates (although some of these gains may be reversed by an imminent rise in borrowing costs).[4]

These contrasting pictures of the pressure that housing puts on budgets highlight how diverse the experience can be at any one moment in time. Costs vary enormously by housing tenure, by size of home, by region and within regions, by local area, as well as by family type and income.[5] This variation makes it critical to get below the surface of housing expenditure to identify who faces high housing costs in order to better target policy measures aimed at alleviating this intense pressure on household budgets.

This briefing note looks across a large-scale survey of the settled UK population to discover how many households spend more than a third of disposable income (after taxes and benefits) on ongoing housing costs. Previous research has demonstrated that households spending at or

[1] M Whittaker, *On Borrowed Time? Dealing with household debt in an era of stagnant incomes*, Resolution Foundation, December 2012

[2] Data refers to England only: *English housing survey 2012 to 2013: household report*, Department for Communities and Local Government, July 2014

[3] K Blacklock and M Whittaker, *Hangover Cure: Dealing with the household debt overhang as interest rates rise*, Resolution Foundation, July 2014

[4] 'One in ten mortgagors at risk of being trapped in 'unaffordable' borrowing, finds new study,' Resolution Foundation press release, May 2014

[5] V Alakeson and G Cory, '*Home Truths: How affordable is housing for Britain's ordinary working families*, Resolution Foundation, July 2013

above this threshold are far more likely to struggle to actually make housing payments resulting in arrears and defaults, and are also far more likely to experience material hardship; the effort required to prioritise their housing commitments creates problems elsewhere in their budgets.[6]

Not all households spending more than one third of their income on housing will find this a struggle, particularly those with higher incomes for whom having up to two thirds leftover still represents a sizeable sum of money. We therefore look also at a subset of this group who are even closer to the edge, spending more than half of their disposable income on the ongoing costs of accommodation. We call this group the **'housing pinched'**, a group who are less likely to be able to sustain their position without difficulty. Finding out who these households are and where they live is an important first step in identifying the circumstances in which housing costs bite hardest and who needs most help.

Calculating housing costs

In this note we look at how much households spent on the ongoing costs of housing in 2011-12, the latest year for which appropriate national survey data are available.[7] We look at housing costs as a percentage of income after taxes and benefits. We focus on the ongoing costs of housing rather than the initial lump sum required for access as in this instance we are principally interested in the costs faced by the UK population in their current homes, once barriers to access have been overcome.

While there is no single definition of high cost housing relative to disposable (net) income, there is some degree of consensus that more than 30 to 35 per cent of either gross or net income spent on ongoing costs is a reasonable indicator of difficulty paying for housing, although some social landlords report using thresholds as high as 40 per cent. Recent Resolution Foundation research has settled on a benchmark of more than 33 per cent of net income spent on the ongoing cost of housing as representing a financial challenge.[8]

We exclude Housing Benefit from our measure of housing costs (and also incomes) because it has the effect of reimbursing households for some or all of the cost of their rent, and so effectively inflates both households' incomes and their actual housing costs by the same degree.[9] Constructing housing cost to income ratios 'net' of Housing Benefit therefore provides a truer picture of the imposition that housing costs place on household budgets for low-income and workless households in particular (and therefore a more consistent indicator for looking across the income distribution). See Annex 1 for more information on the definitions of housing costs and household incomes used in this analysis, and the treatment of Housing Benefit.

[6] G Bramley, 'Affordability, poverty and housing need: Triangulating measures and standards,' *Journal of Housing and the Built Environment*, 2012

[7] The English Housing Survey provides slightly more up-to-date data, the latest microdata spanning a two-year period between 2011 and 2013. However, it refers to England only and is based on a smaller sample than the Family Resources Survey used for this analysis, thus providing less opportunity to explore the characteristics of sub-groups in detail.

[8] M Whittaker, *Mortgaged Future, Modelling household debt affordability and access to re-financing as interest rates rise*, Resolution Foundation, May 2014

[9] Our measure of housing costs includes all the other elements in the definition constructed by the Department for Work and Pensions in generating 'before' and 'after housing costs' measures of poverty within the Households Below Average Income (HBAI) series. This includes rent, water rates, mortgage interest payments, structural insurance premiums, and ground rent or service charges. In addition, we include the capital repayments of mortgagor households.

Section 2

How many households spend more than a third of their income on housing?

One in seven (14.4 per cent) or 3.9 million UK households spent more than 33 per cent of their disposable income on housing in 2011-12, excluding any housing costs that are covered by Housing Benefit.[10]

Figure 1:
Growth of the proportion of households spending more than 33 per cent of net income on housing costs, UK

Source: Family Resources Survey, ONS

Notes: Mortgagor housing costs include capital repayments; both housing costs and net income are net of Housing Benefit.

The size of this group grew sharply before the financial crisis of 2008-09. Its share of the UK population more than doubled from the beginning of the century up to the start of the downturn – from 8.2 per cent (2.0 million households) in 2001-02 to 19.3 per cent (5.1 million households) in

[10] Unless otherwise stated, figures in this note are from Resolution Foundation analysis of the Family Resources Survey, ONS

2008-09 (see Figure 1). Given that this was a period of steady growth in household incomes across much of the income distribution, the ballooning of the group experiencing difficulty with housing costs reveals the impact of the long term failure of housing supply to keep up with demand, resulting in higher costs in some parts of the country.

Figure 1 highlights the impact of the financial crisis on housing costs. The prevalence of households spending more than 33 per cent of their disposable income on accommodation dipped after 2008-09 due to the low interest rate environment experienced in the years following the crisis which pushed down the housing costs of mortgage payers. By contrast, private renters saw their housing costs hold roughly constant after a number of years of steady increase. The slight easing of the growth in costs for private renters may, in part, reflect buy-to-let landlords also facing lower mortgage costs, which could have translated into less pressure on rents outside of high demand areas.

Although the proportion of households spending a high share of income on housing costs dipped in the years following the crisis, it is worth remembering that incomes have tended to lag CPI inflation (which ignores housing costs) since 2008. The implication is that even if the proportion of income spent on housing has held constant or fallen for many households, leftover income is effectively worth less than it was.[11]

In the years following 2011-12, for which data is currently unavailable, it is possible that housing costs for those with mortgages have continued to fall as the enduring low interest rate environment caused mortgage interest spreads to narrow sharply from 2011 and many fixed rate deals came to an end. Given the close relationship between mortgagor housing costs and the overall proportion of households spending more than a third of their income on accommodation, such patterns in the mortgage market may have held down the number of households experiencing difficulty with housing costs.

Expected increases in interest rates will inevitably push up costs for mortgagor households and, depending on their timing in relation to household income growth across the distribution, have the potential to return us to the longer-term trend seen since the early 2000s of steady growth in the proportion of households spending over a third of net income on housing costs

On the other hand, the recovery in house prices in the years since 2011-12 may have pushed some households (back) into the group experiencing difficulty with housing costs. Although current mortgage payers are largely insulated, rising prices will have already affected mortgagors who have recently moved and first time buyers, and may also have put pressure on rents in some areas. More pertinently, expected increases in interest rates will inevitably push up costs for mortgagor households and, depending on their timing in relation to household income growth across the distribution, have the potential to return us to the longer-term trend seen since the early 2000s of steady growth in the proportion of households spending over a third of net income on housing costs.

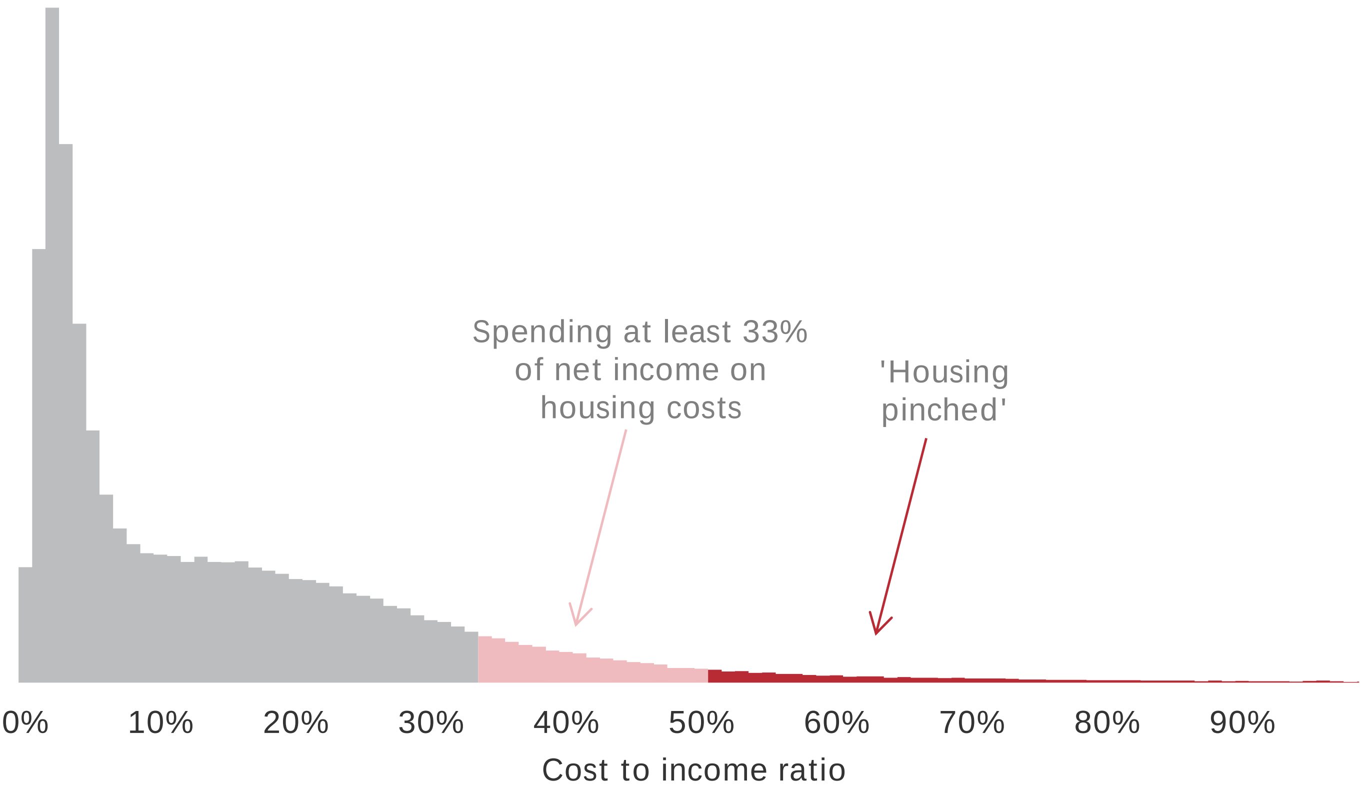
The remainder of this note focuses on a subset of the group facing high housing costs that is particularly close to the edge, spending more than half of its disposable income on housing, a group we call the 'housing pinched'. We focus on this group because they were already in a precarious position in 2011-12,

[11] The flipside of this argument is that in the pre-downturn years, when incomes were generally rising faster than CPI inflation, the value of leftover income was rising as the proportion of income spent on housing rose, which may have eased the pressure that housing costs put on other parts of the budget.

and therefore are most likely to struggle to sustain their position, particularly if the longer-term trends described above are restored. That said, for the most part the characteristics of the 'housing pinched' reflect those of the broader group who spend more than one third of net income on housing.

Figure 2:
Distribution of UK households by housing cost to net income ratio, 2011-12

Distribution of UK households by housing cost to net income ratio



Source: Family Resources Survey, ONS

Notes: Mortgagor housing costs include capital repayments; both housing costs and net income are net of Housing Benefit.

Section 3

How many households are 'housing pinched'?

In 2011-12, 1.6 million households (5.9 per cent of the total) spent more than half of their net income on the ongoing cost of housing. This group is dominated by working-age households, the majority of whom are in work.

Non-working pensioner households make up 22 per cent of the UK household population, but only 7 per cent of the 'housing pinched' in 2011-12. This means that retired pensioner households account for just 110,000 of the 1.6 million in the group.

By contrast, working age households in which no one works were overrepresented among the 'housing pinched' in 2011-12. They make up 30 per cent of this group (480,000 households), but only 13 per cent of the overall household population in the UK. The majority of these working age workless households contain single adults living alone, usually not claiming Housing Benefit. (Workless – and working – households in which rent is predominantly directly subsidised by Housing Benefit are generally not captured in our definition of the 'housing pinched' because the majority of their rent is directly subsidised. This, in effect, means they have very low housing costs, even though their income is also extremely low.)

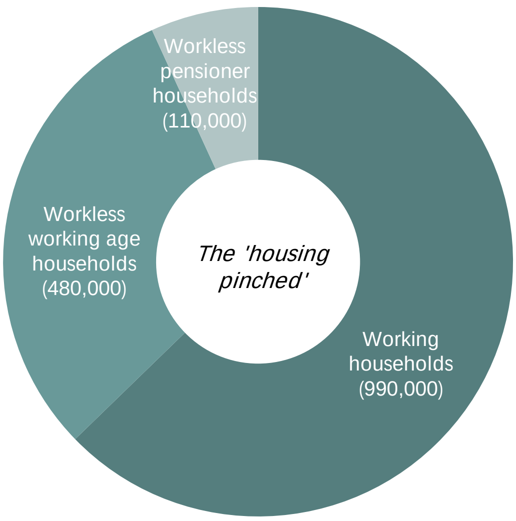


Figure 3:
Characteristics of UK households spending more than half of their net income on housing costs, 2011-12

Source: Family Resources Survey, ONS

Notes: Mortgagor housing costs include capital repayments; both housing costs and net income are net of Housing Benefit.

Excluding these two groups of workless households **leaves just under 1 million (990,000) working households – containing 2.2 million people – spending more than half of their disposable income on the ongoing costs of housing** in 2011-12 – 5.7 per cent of the working household population.

The rest of this note explores the characteristics of this group. We focus on the working households who are 'housing pinched' because we judge them to be most representative of where the housing cost pressures will be in a steady state scenario. The 2011-12 period was one of relatively high unemployment, and the number of working-age workless households who are 'housing pinched' may well have fallen since then as unemployment has dropped sharply. For those 'housing pinched' households remaining out of work, entering employment will be the best route to easing housing cost pressures. By contrast, 'housing pinched' households who are in work likely represent a more structural challenge.

To robustly explore the characteristics of the 'housing pinched' among working households, we group together the most recent three years of survey data (2009-10–2011-12).[12] These years together capture the end of the downturn and its immediate aftermath, a period in which, as we saw on Figure 1 above, the proportion of households spending high proportions of net income on housing was relatively flat.

Who, and where, are the 'housing pinched'?

It is reasonable to assume that spending very high proportions of net income on housing may be as much a choice made by households with high incomes as a constraint that high housing costs place on the less well off. After all, wealthier households have the relative freedom and capacity to live in larger houses in more sought-after areas, and in the case of mortgagors, to pay off debts more quickly. Even if these wealthier households spent a high share of their net income on housing, they would still have a comparably large amount, in cash terms, left over for other things.

However, Figure 4 shows that only a minority of working households who are 'housing pinched' are in this position. The left-hand panel on Figure 4 shows the proportion of working households who are 'housing pinched' *within* different groups, in other words, the 'risk' of being 'pinched'. It shows that only 1 per cent of working households in the top fifth of the income distribution are in this position. The right-hand panel on Figure 4 shows absolute numbers of 'housing pinched' among working households, in other words, the distribution of the 'housing pinched' population *across* groups.

From this we can see that the majority of housing pinched households lie in the bottom income quintiles. Overall, **830,000 working households are 'housing pinched' and have incomes below the national median**. These are the households for whom the high cost of housing is likely to most put pressure on other parts of their household budget and in many cases lower living standards. Indeed, in 2011-12 we estimate that these 830,000 households had an average of just £60 a week left over after paying for their accommodation. This figure rises to £70 for a couple with one child, and falls to £40 for a single person without children. The inadequacy of such residual budgets is highlighted by the fact that in 2012 the average household spent around £60 on *each* of food and non-alcoholic drinks; transport; and recreation and culture.[13]

In 2011-12 we estimate that these 830,000 working 'housing pinched' households in the bottom half of the income distribution had an average of just £60 a week left over after paying for their accommodation

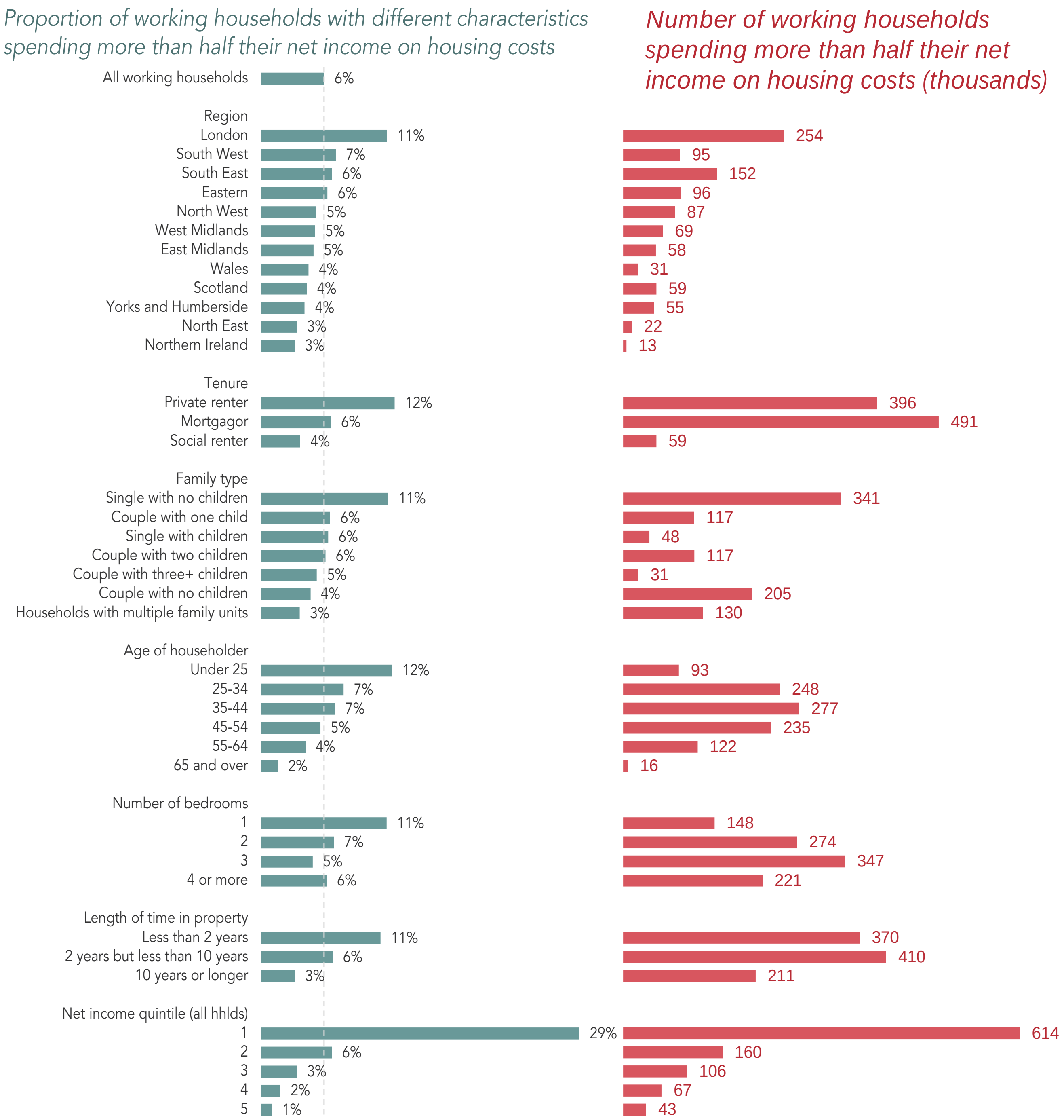
Breaking down the 'housing pinched' group further, Figure 4 shows that **Londoners, households renting privately, single people without children, households in which the head is under 25, households in one bedroom properties and households that have only recently moved were all around twice as likely as the average household to be 'housing pinched'** in 2011-12. The right-hand panel on Figure 4 also shows the number of pinched households by characteristic. From this we can see that, for example, mortgage paying working households,

[12] Specifically, we take the average proportion from the three years of data and apply this to the latest (2011-12) total number of working households spending more than half of their income on housing

[13] *Family Spending in 2011-12*, Office for National Statistics, December 2013

Figure 4:

Characteristics of the 'housing pinched' among UK working households, 2009-10–2011-12



Notes: Mortgagor housing costs include capital repayments; both housing costs and net income are net of Housing Benefit; numbers may not sum to the total number of working households spending more than half their net income on housing costs due to rounding and omission of small categories; proportions are taken from 2009-10 –2011-12 and applied to the total number of working households spending more than half their net income on housing in 2011-12 to generate estimates for numbers; 'households with multiple family units' are any that contain more than one single adult or cohabiting couple.

despite being much less likely to be 'housing pinched' than private renters, still make up the majority of the group (due to the fact that there are far more households with mortgages than households renting privately in the UK).

As Figure 4 highlights, households who have been in their property for less than two years are twice as likely as the average household to spend more than half of their income on housing. This finding bolsters concerns about the long-term upward trajectory of housing costs illustrated in Figure 1. Households who have been in their properties for longer are much less likely to be 'housing pinched' reflecting the fact that they will have secured themselves tenancy agreements and mortgage deals in a more benign housing cost environment. Recall that the latest data referred to here is 2011-12, and so this analysis does not capture the post-downturn recovery in house prices, which may have exacerbated this pattern.

It is possible that some of the characteristics that entail a higher risk of being 'housing pinched' reflect normal housing trajectories, with young professionals who haven't yet formed families struggling in the early years of adulthood before progressing to a more sustainable housing situation. However, Figure 2 shows there are still large numbers of working 'housing pinched' households who would not seem to be in this phase: nearly half have children and more than half are over 35, for example. Indeed, the pre-crisis growth in the number of households spending a high share of income on housing costs was seen across groups, and if the decoupling of incomes and house prices endures it is likely that the 'housing pinched' will encompass an ever broader group of households.

Many of the characteristics shown in Figure 2 that entail a higher likelihood of being 'housing pinched' will interact. For example, the fact that young people are more likely to be pinched may reflect the fact that they often live alone, which is a more financially strained way of living. Or alternatively, it might be that single people living alone are more likely to be 'housing pinched' *because* they are younger, which entails lower earnings and incomes.

Similarly, part of the reason why Londoners are so much more likely to be 'housing pinched' may be that private renting – the most expensive housing tenure in terms of ongoing costs – is more prevalent in the capital than anywhere else. Or alternatively, private renters may be more pinched *because* private renting is more common in more expensive regions like London.

In truth, these kinds of relationship are likely to work in both directions, meaning that there are specific clusters of households that are far more likely than the average to be spending more than half their net income on housing: young people, living alone in rented accommodation in London, for example.

i Spotlight on London

More than a quarter of working households who spend more than half of their disposable income on housing live in London. This equates to **250,000 working households containing 590,000 people.**

- Just over one in ten working households in London (11.3 per cent) spend more than half their net income on housing.
- Nearly one in six working Londoners living alone (16.6 per cent), and likewise nearly one in six working households in which the householder is under 35 (16.3 per cent), spend more than half their net income on housing.
- One in five (20.0 per cent of) working Londoners who moved into their property in the last two years spend more than half their net income on housing.
- And at the extreme, more than one in five (21.2 per cent of) working London households renting privately spend more than half their net income on the cost of housing – equivalent to 150,000 households containing 320,000 people.

Section 4

Conclusion

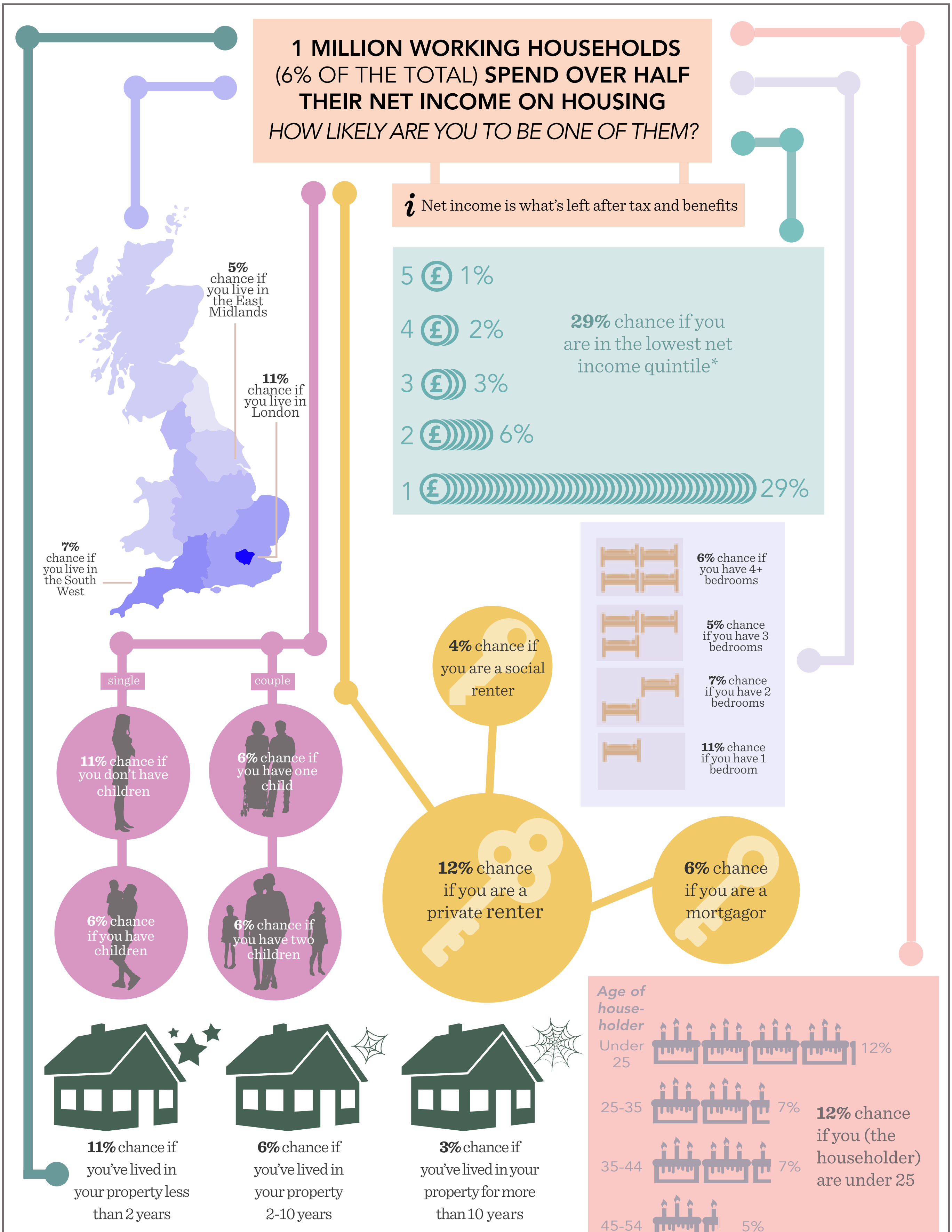
In order to understand those at the sharp end of the high housing cost challenge, this note has explored the characteristics of the 'housing pinched' – those for whom the cost of accommodation takes up more than half of disposable income. We have seen that this group is overwhelmingly not made up of pensioners, and not well off: being 'housing pinched' is something that predominantly affects working age households in the bottom half of the income distribution. Within this group we have focused on the 'housing pinched' who are in work. We have done this because unemployment has fallen sharply since 2011-12, likely reducing the size of the workless 'housing pinched' group, and for those who remain, entering employment will be the best route to easing housing cost pressures. By contrast, the working 'housing pinched' represent the more structural part of high housing cost challenge.

We have seen that characteristics such as renting privately, being young, being single without children, living in London, living in a one bedroom property and having only recently moved all entail a higher likelihood of being 'housing pinched' among working households.

If spending more than a third of net income on the cost of housing can signal challenges for household budgets, then spending more than half is a real cause for concern. The fact that working households who are 'housing pinched' and in the bottom half of the income distribution have so little left over, in cash terms, to pay for other things suggests the sacrifices that many households are making.

We have seen that the rate of households spending a large share of income on the cost of accommodation fell slightly from the downturn to 2011-12. This decrease may have continued for some of the period since as low interest rates were partly passed through to mortgage payers and nominal pay and incomes improved slightly. However, continued house price growth and rises in interest rates in the near future may well return us to the long-term trend of increasing numbers of UK households spending more than one third of their net income on housing. In turn such trends would likely push more households into the 'housing pinched' group.

Despite significant pressure on household budgets from high housing costs, households are currently finding ways to cope with the challenge. This will have come at a cost to the wellbeing of many families as well as their ability to spend and consume within the economy. Looking to the future, as well as highlighting the ongoing implications for our consumption-driven recovery, this analysis has shed light on which households are most at risk of falling over the edge if housing costs and incomes follow their expected paths.



*This chart is based on equivalised income quintiles for all UK households. Percentages show the chance of a working household in each income quintile spending over 50%of their disposable income on ongoing housing costs.

Annex 1: defining housing costs and household incomes

This annex sets out how we define household incomes and housing costs when constructing housing cost to income ratios. It also sets out how we 'correct' for Housing Benefit in these cost to income ratios.

Household incomes:

This analysis focuses on net incomes, that is, a household's income after taxes and benefits have been taken into account. When discussing the distribution of household incomes, we 'equivalise' net incomes. This means we account for differences in household size and composition, for example, adjusting for the fact that a single person would have a higher standard of living than a couple with two children at the same level of net income. But when constructing ratios of housing costs to household incomes, we use actual incomes as our denominator. We also exclude Housing Benefit from net income, in line with adjustments we make to housing costs, discussed and explained below.

Housing costs:

Establishing a consistent measure of housing costs that applies across different types of housing is not straightforward. For example, it is not immediately clear how the costs incurred by a mortgagor who has paid a significant deposit to move into their property and is now making both interest payments and capital repayments to their mortgage provider (as well as service charges in the case of leaseholders), equate to those of a private renter paying a monthly lump sum to their landlord.

This analysis purposefully focuses on the ongoing costs of housing rather than the initial lump sum required for access, which is increasingly a barrier to home ownership for a typical family. The reason for this is that our focus is the costs for the whole UK population in their current homes, for whom the barriers to access have already been overcome.

For this focus on ongoing costs, a fruitful starting point is the definition constructed by the Department for Work and Pensions in generating 'before' and 'after housing costs' measures of poverty within the Households Below Average Income (HBAI) series. This definition of housing costs includes rent (gross of Housing Benefit), water rates, mortgage interest payments, structural insurance premiums, and ground rent or service charges.[14] It is designed to be consistent across different types of housing arrangement.

Because our analysis draws on the Family Resources Survey (on which HBAI is based), we have opted to use the HBAI definition of housing costs. However, we make a couple of amendments. We include capital repayments on mortgages in the housing costs of mortgagors as well as interest payments. While such repayments perhaps do not reflect the cost of shelter so much as the acquisition of an asset, we have chosen to include them because they are a relatively fixed aspect of the regular outgoings of a mortgagor (which remain even as other circumstances, such as income, change).

Housing Benefit:

The other adjustment we make to the HBAI definition of housing costs, when constructing ratios of housing costs to household incomes, is to exclude the portion of housing costs covered

[14] '*Households Below Average Income: An analysis of the income distribution 1994/95 – 2011/12,*' Department for Work and Pensions, June 2013

by Housing Benefit, which we also exclude from net incomes. We do this because Housing Benefit has the effect of reimbursing households for some or all of the cost of their rent, and so effectively inflates both households' incomes and their actual housing costs by the same degree. Constructing housing cost to income ratios 'net' of Housing Benefit therefore provides a truer picture of the imposition that housing costs place on household budgets for low-income and workless households in particular (and therefore a more consistent indicator for looking across the income distribution).

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Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

» *undertaking research and economic analysis to understand the challenges facing people on a low to middle income;*

» *developing practical and effective policy proposals; and*

» *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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