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Resolution Foundation

REPORT



Living Standards 2016

The experiences of low to middle income households in downturn and recovery

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Executive Summary

This is the Resolution Foundation's seventh annual state of the nation report on living standards, and it is testament to the depth of the downturn that has gripped households since the financial crisis hit that average incomes only just appear to be returning to the level they were at when we published the first one in the series.

In this year's report we explore the question of just how broadly felt the early stages of the country's living standards recovery has been, employing a 'nowcast' to provide a timely estimate of trends in income growth across Britain. We go further, undertaking a forecast for incomes that lets us provide some indication of how the distribution of the gains of growth will evolve over the rest of the parliament. And, as ever, we focus on the particular experience of low to middle income Britain – the 5.7 million primarily working households in the bottom half of the working-age income distribution who face a range of often unique pressures during good economic times and bad.

Living standards back on course?

Our starting point is that a welcome, if belated, recovery in family living standards is underway. The return of income growth owes much to the ongoing and surprising strength of the UK's jobs market. The employment rate has reached record levels in recent months and, after falling sharply in the early downturn, full-time jobs have helped to drive the post-2012 surge.

But the flip side of this impressive performance on jobs has been a six year pay squeeze that pushed average wages back to their 2003 level in the middle of 2014. They have since picked-up, growing at above pre-crisis rates briefly in 2015, but the figures have been flattered – for longer than expected, but ultimately temporarily – by ultra-low inflation. Underlying pay growth remains disappointing. Typical hourly pay looks unlikely to return to its peak before the end of the decade and there is very little sign that any of the 'lost growth' of recent years will ever be restored.

Household income trends are best captured in large-scale, authoritative government surveys such as the DWP's *Family Resources Survey* (FRS).

Unfortunately such resources lack timeliness, with the latest FRS relating to the 2013-14 financial year. At that point average household incomes were still some way short of their pre-crisis level.

Yet much has changed in the economy since then. So we roll the FRS forward to 2015 (using other outturn data to 'nowcast' income levels), and estimate that average (mean) incomes have finally returned to where they were before the start of the recession. This is good news, but progress has been much slower than anyone expected. And incomes remain around 1.6 per cent off their 2009 peak. Incomes are moving in the right direction, but the living standards challenge remains in place.

Encouragingly, typical (median) household income has performed a little better. We estimate that median income is roughly 3 per cent higher than in 2007-08, standing at around £24,300.

The winners and losers of the downturn and recovery

The factors that have underpinned the recovery in living standards have – just like those which drove the downturn – been unevenly felt. The traditional concern of income inequality has been less prominent since the crisis hit, with sharp falls in top earnings and incomes producing a slight *narrowing* of inequality. But other divergences have come to the fore – including between generations and housing tenures.

The contrast of protections for pensioner benefits (most obviously via the 'triple lock' on the state pension) and falling wages for younger cohorts (with typical hourly earnings for workers in their 20s remaining 12 per cent lower than they were in 2009) has produced very different outcomes across the generations.

Indeed, these trends have built on a divergence that was apparent even before the crisis struck, with wage stagnation slowing working-age household income growth down to almost zero from around 2002. As a result, our 2015 nowcast suggests that typical pensioner incomes have climbed by around 22 per cent since 2002, while working-age incomes have hardly moved (up just 2 per cent). Median pensioner incomes remain lower than working-age ones by some distance, but the gap has narrowed significantly over recent decades.

Crucially, 'place' has had a big effect on how incomes have evolved post-crisis too. Differences across regions are nothing new – though these patterns have altered since 2008 – but often under-recognised is the importance of housing situations on shifts in living standards. This is particularly the case at the moment, with those with mortgages benefiting from often huge falls in their housing costs while renters (especially in London and the social sector) have experienced big increases.

To understand how important this distinction is, it is worth noting that ignoring housing costs puts London second in the country in terms of post-crisis median income growth; but accounting for them sends it to the very bottom of the pile. Measured before housing costs, median incomes in London appear to have grown by 2.9 per cent post-crisis; measured after housing costs, they remain 3.7 per cent below pre-crisis levels.

The withdrawal of the housing ladder

The issues raised by the differing income performances of working-age and pensioner households and the central role of housing in affecting incomes, come together in the form of drastic changes to homeownership rates.

Successive generations are facing totally changed housing landscapes, with levels of ownership among Millennials being some 16 percentage points lower than those recorded by Generation X at the same ages for instance. As a result, one-third of homeowners are now aged over-64 – up from one-quarter just 15 years ago. In contrast, 16-34 year olds account for just 10 per cent of owners, down from 19 per cent in 1998.

While homeownership has been trending downward since the turn of the century, it is low to middle income households who have recorded the sharpest fall in rates – more dramatic than for either poorer or better-off households. Ownership looks on course to become little more than a pipedream for young working families on modest incomes.

Where more than half of under-35s on low to middle incomes owned their own place in 2000, today it's just a quarter. It's likely to be approaching 1-in-10 by 2025; and more like 1-in-20 in London.

The new living standards challenge

Absent a new global economic downturn – a risk that appears unlikely but more material today than it did at the start of the year – we expect mean and median incomes to continue their recovery across the parliament. We forecast that median incomes will end the decade around 8 per cent above their pre-crisis level, while mean incomes will be just over 4 per cent higher.

This recovery will be supported by the introduction of the National Living Wage (NLW). But the gains from this welcome measure will be more evenly spread across the income distribution than is often recognised. And with further cuts to benefits and in-work support being concentrated in the bottom half of the distribution, our estimate is that growth will be higher in the top half of the income distribution than in the bottom. Indeed, we forecast slight *reductions* in income for the poorest 25 per cent of households between 2015 and 2020.

This pattern is likely to entirely reverse the gains made on inequality in the post-crisis period. Taking 2007-2020 as a single period, our forecast is that incomes will have been found to have grown by roughly 0.5 per cent a year in real terms across the entirety of the income distribution.

There is much to welcome in the UK's recent economic performance, but it is clear that we still face a sizeable living standards challenge. And those on low to middle incomes – where more than two-thirds report having less than one month's income in savings to fall back on and a quarter say they have struggled to pay for their accommodation in the past year – remain at the sharp end of it.

A government focused on the living standards of working people must seek to meet this shifting challenge, ensuring that it places successfully implementing the NLW, rowing back on the most punitive aspects of benefit restrictions and getting houses built on its agenda for the coming years.

Section 1

Living standards in downturn and recovery

2015 provided good news for many UK households. The jobs market continued its impressive recovery, with employment hitting new heights. Ultra-low inflation – in large part a product of falling oil prices – supported living standards, helping to end the unprecedented six-year squeeze on pay and limiting the impact of previously announced benefit freezes and uprating fixes. For those still burdened with debt, or looking to access new credit, the unexpected holding of interest rates at historic lows provided a further boost.

Yet this propitious period followed a deep and protracted downturn in which earnings and incomes fell sharply, leaving much ground to make up. With global growth prospects softening once more since the turn of the year, seemingly reducing the UK's chances of experiencing any 'catch-up' growth, the question of just how the recovery is being shared across the country takes on even greater importance. While the post-financial crisis period has been marked by a slight reduction in income inequality, there is evidence of a growing divergence of experience across generations and different parts of the country.

In this, our annual state of the nation report on living standards, we consider the twists and turns of the recent past and the prospects for the future. In particular, we ask the question 'who is benefiting from the recovery?' using 'nowcast' and forecast techniques to explore differences across income, age and location. We also provide a detailed look at the recent experience of 'low to middle income' households – the group at the core of the Resolution Foundation's work.

- » **Section 2** looks at recent trends in employment, earnings and state support. We use this information to set out a **nowcast for household income data**, identifying whether or not pre-crisis levels of incomes have yet been restored.
- » **Section 3** explores that question in more detail by using the nowcast findings to consider just **how broadly felt the recent recovery has been** across the country and across the generations.
- » **Section 4** builds on one of the key findings of Section 3 – namely **the importance of housing costs** – by looking in some detail at shifts in patterns of tenure and affordability. We focus particularly on the experiences of low to middle income households in the housing market.
- » **Section 5** looks forward, building on the nowcast of Section 3 to produce a **forecast for 2020**, shedding light on the potential distribution of income gains in the coming years.
- » **Annex 1** provides a technical description of the **methodology** sitting behind our nowcast and forecast.
- » **Annex 2** provides a detailed description of the variety of **low to middle income definitions** used in this report.
- » **Annex 3** then provides a detailed **statistical insight into the low to middle income group**, presenting a wealth of data on their characteristics and financial concerns.

Section 2

Earnings and incomes post-crisis: back on course?

In the face of a sustained fall in incomes across large parts of society, the issue of living standards dominated discussion during much of the last parliament. With incomes heading in the right direction again, the topic may appear less pressing. However, there has been significant variation of experience over recent years, with some parts of society enduring a much deeper living standards squeeze than others. As such, attention must now turn not just to the pace of recovery but to its breadth too.

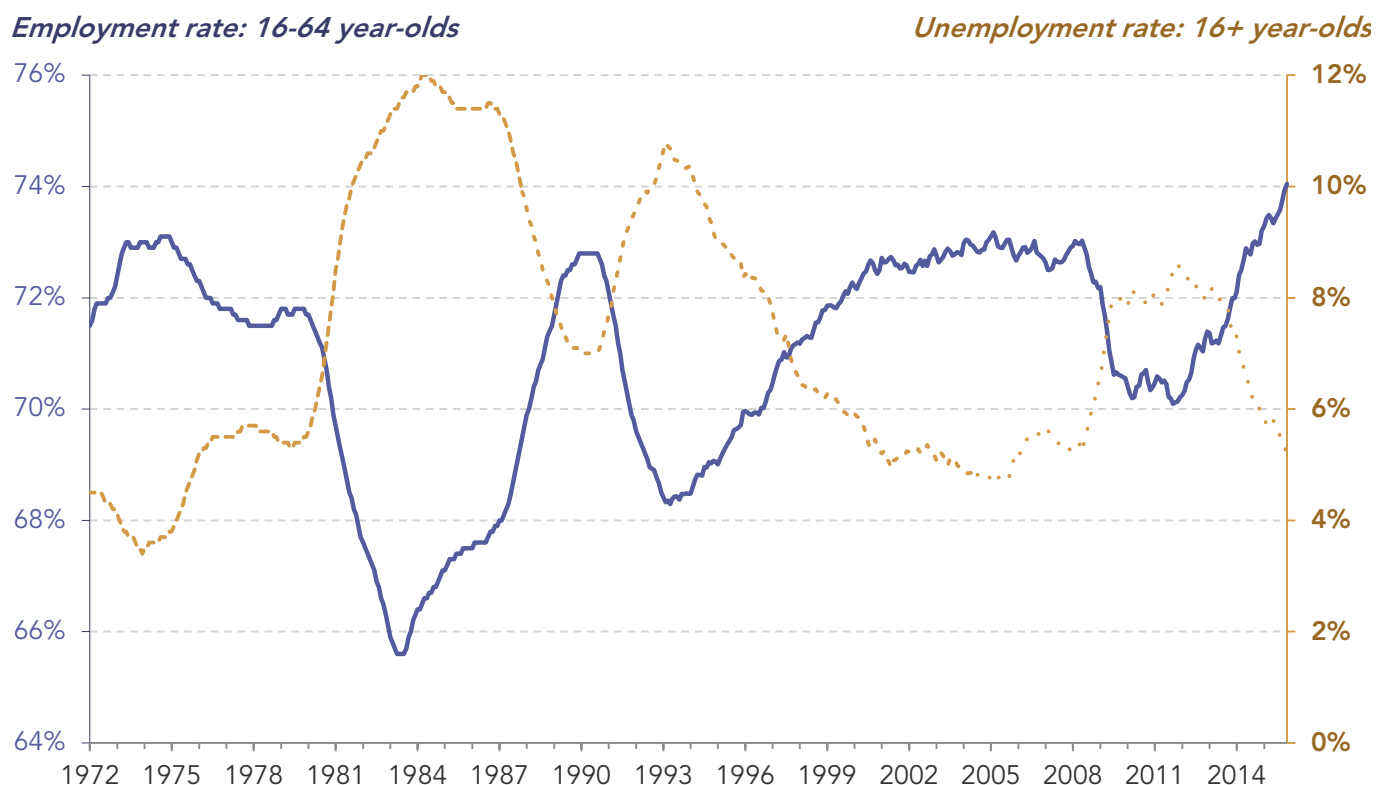
Aggregate data provides only a limited sense of how economic growth is feeding through to households, but detailed household surveys lack timeliness. What's clear however is that the shape of the recovery will be driven – like the downturn before it – by trends in employment, earnings and state support. In this section, we consider each of these factors in turn and use the latest available data to establish a nowcast of household income that lets us explore just how living standards have shifted in recent years. Seven years after the financial crisis hit, we find that incomes have finally returned to their pre-crisis levels. But they remain below peak and there is little sign that the growth 'lost' over the intervening period will ever be restored.

Employment has surpassed all expectations post-crisis

The UK's record on employment since the financial crisis has continued to surprise. Employment fell and unemployment spiked in the immediate aftermath of the crash, but by much less than most economists predicted. And the labour market recovery since 2012 has been rapid.

As Figure 1 shows, the 16-64 employment rate has never been higher. In part, this is due to a rising female state pension age – which appears to have increased employment among older women *and* men – but there is much more at play. Although not quite at historic peaks, the alternative 16+ and 16 to state pension age employment rates are also climbing strongly. Undoubtedly the pick-up in employment has been impressive.

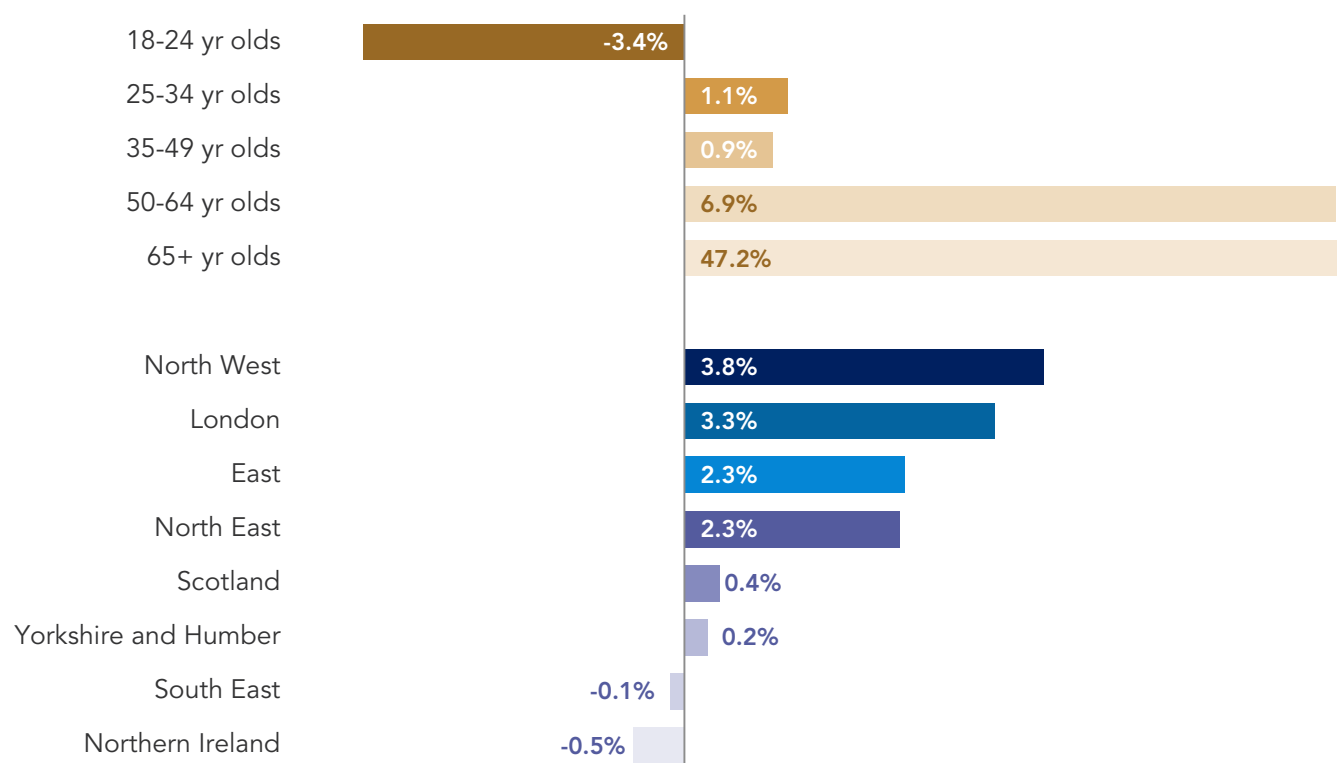
Figure 1: Employment and unemployment rates



Source: ONS, Labour Market Statistics

This apparent employment success has not been uniformly distributed across the country however. Figure 2 details relative changes in employment rates across different age groups and selected areas of the country in the post-crisis period. It shows that the employment rate among those aged 18-24 has fallen by 3.4 per cent, whereas the employment rate among 50-64 year olds is up 6.9 per cent and among those aged 65+ the rate has increased by nearly 50 per cent (albeit from a very low base of 7.3 per cent).

Looking across different regions and countries, we see that the employment rate has picked-up by 3.8 per cent in the North West and by 3.3 per cent in London. In contrast however, employment has been essentially flat in Scotland and Yorkshire and the Humber and remains *below* pre-crisis levels in the South East and Northern Ireland.

Figure 2: Proportional change in employment rates: UK May 2008-Nov 2015*Proportional change in employment rate May 2008 to November 2015*

Source: ONS, Labour Market Statistics

Compositionally, the early downturn hit full-time employee jobs hardest, as set out in Figure 3. The overall depth of the drop in employment was mitigated by continued growth in part-time work and – from 2011 particularly – in self-employment. This trend sparked some concern that official employment figures were masking a deeper problem of underemployment, false self-employment and maybe even exploitation. However, full-time employee jobs picked-up again from 2012, driving just as much of the overall growth in employment from that point forward.

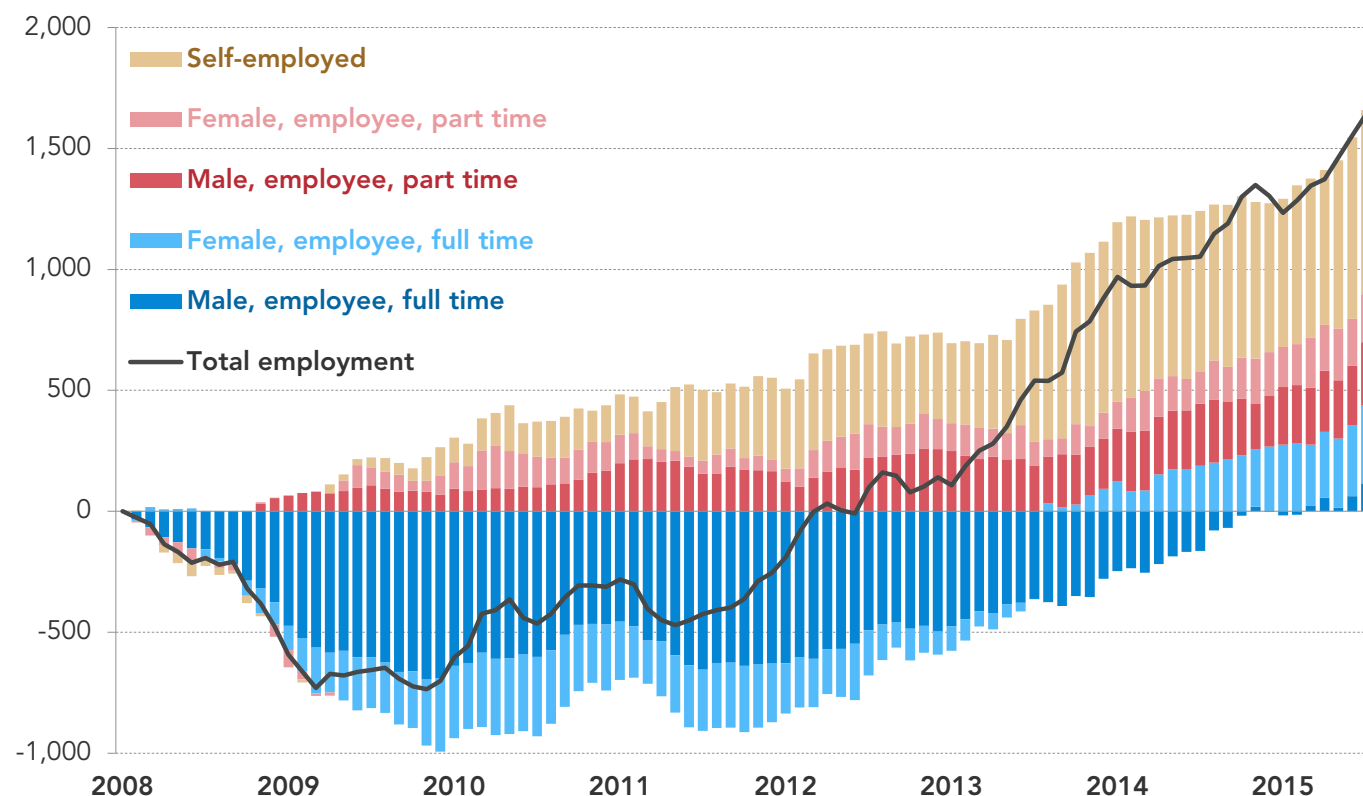
Nevertheless, it remains the case that the nature of work in Britain has shifted a little over this period. Of the roughly 1.5 million net new jobs added between 2008 and 2015, just under half (46 per cent) are self-employed (despite self-employment accounting for just 15 per cent of all jobs in the economy) and 30 per cent are part-time employee roles (despite such jobs accounting for 22 per cent of the stock of all employment).

Concerns remain as to quite how this apparent shift will evolve in the coming years. Encouragingly though, while the UK's increased labour market flexibility appears to have coincided with an increase in the *depth* of job insecurity for a minority, it does not seem to be associated with any change in the overall *prevalence* of insecurity.^[1]

[1] L Gardiner & P Gregg, [A steady job? The UK's record on labour market security and stability since the millennium](#), July 2015

Figure 3: Composition of employment change: UK 2008-2015

000s of adults



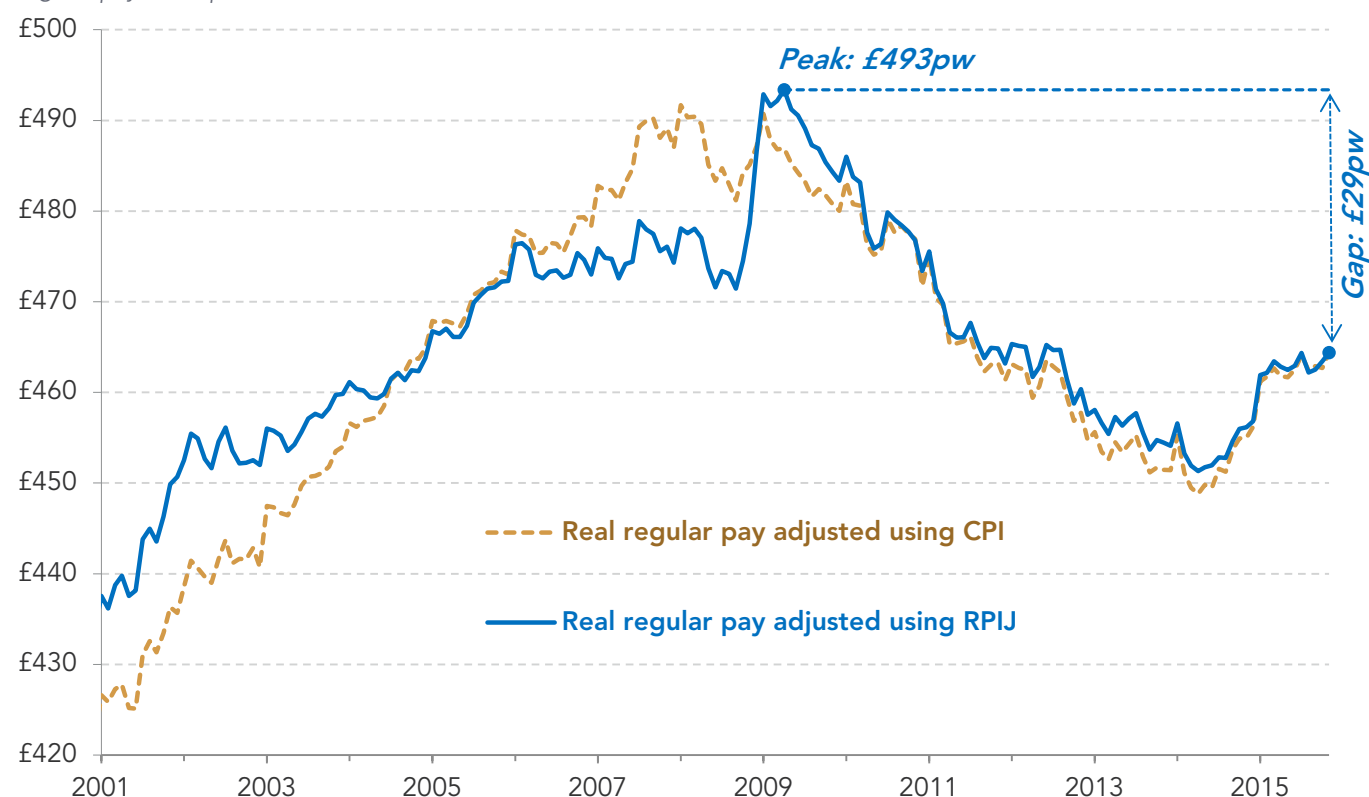
Notes: Total includes unpaid family workers and those on government employment and training schemes

Source: ONS, Labour Market Statistics

But wages have undergone an unprecedented squeeze

Yet, while the story on employment has been one of surprising resilience followed by strong growth, the picture on pay has been much less rosy. In many ways, falling wages may simply be the flipside of the impressive jobs response. And the combination of surprisingly high employment but weak pay is likely to be preferable to the more typical labour market response to a downturn – in which employment plummets but wages hold up – because it spreads the pain of economic slowdown across a greater number of people.

But real-terms pay growth, though it has returned, remains sluggish even as employment hits new heights and unemployment approaches pre-crisis levels.. So far out from the start of the crisis, this outcome is troubling. As Figure 4 shows, average weekly wages remain some way off their peak (see Box 1) and there is little evidence of the ‘catch-up’ growth in pay that might be expected after such a concerted squeeze.

Figure 4: Real-terms average weekly earnings: UK 2001-2015*Regular pay, 2015 prices*

Source: ONS, Annual Survey of Hours and Earnings

And this pay squeeze has followed a generalised slowdown in pay growth that affected large parts of the earnings distribution in the immediate pre-crisis years. As Figure 5 sets out – in relation to full-time workers split by sex – strong pay growth in the 1990s was followed by a flat-lining in real hourly pay from around 2002.

This pattern was most discernible from the 75th percentile down among men and from the median down among women. But even at higher points in the earnings distribution there was clear evidence of a substantial slowdown in pay growth.

i Box 1: Inflation measures and the pre-crisis 'peak'

Inflation and living standards

Trends in real-terms earnings and incomes are of course affected by choice of deflator. Several options exist – with no definitive 'right' choice.

Until the 2000s, the Retail Prices Index (RPI) was the most commonly used measure – in relation to wage negotiations and benefit uprating for instance. However, concerns over the way in which it is calculated led to the RPI losing its 'National Statistic' tag in 2013.

The government's "preferred" measure of inflation (and the subject of the Bank of England's inflation target) is now the Consumer Prices Index (CPI). This was established in 1996 in order to aid international comparison – specifically in relation to the EU's Maastricht Treaty.

In addition to the way in which it is calculated, the CPI differs from the RPI in relation to important aspects of its coverage. Most obviously, it excludes several measures of housing costs, including council tax, mortgage interest payments and house prices. These differences mean that the CPI fails to adequately reflect the inflation experiences of households.

With the RPI discredited and the CPI providing incomplete coverage, our preferred inflation measure is RPIJ. This measure has a similar coverage to RPI, but is calculated in a similar way to the CPI.

A final measure – CPIH – attempts to deal with the deficiencies in the CPI for the purposes of measuring changes in living standards by adding housing costs back in. At the point of publication however, CPIH lacked National Statistic status.

Our default inflation measure in this report is RPIJ. However, we additionally present CPI for comparison in some instances and use the GDP deflator where appropriate (in relation to National Accounts metrics).

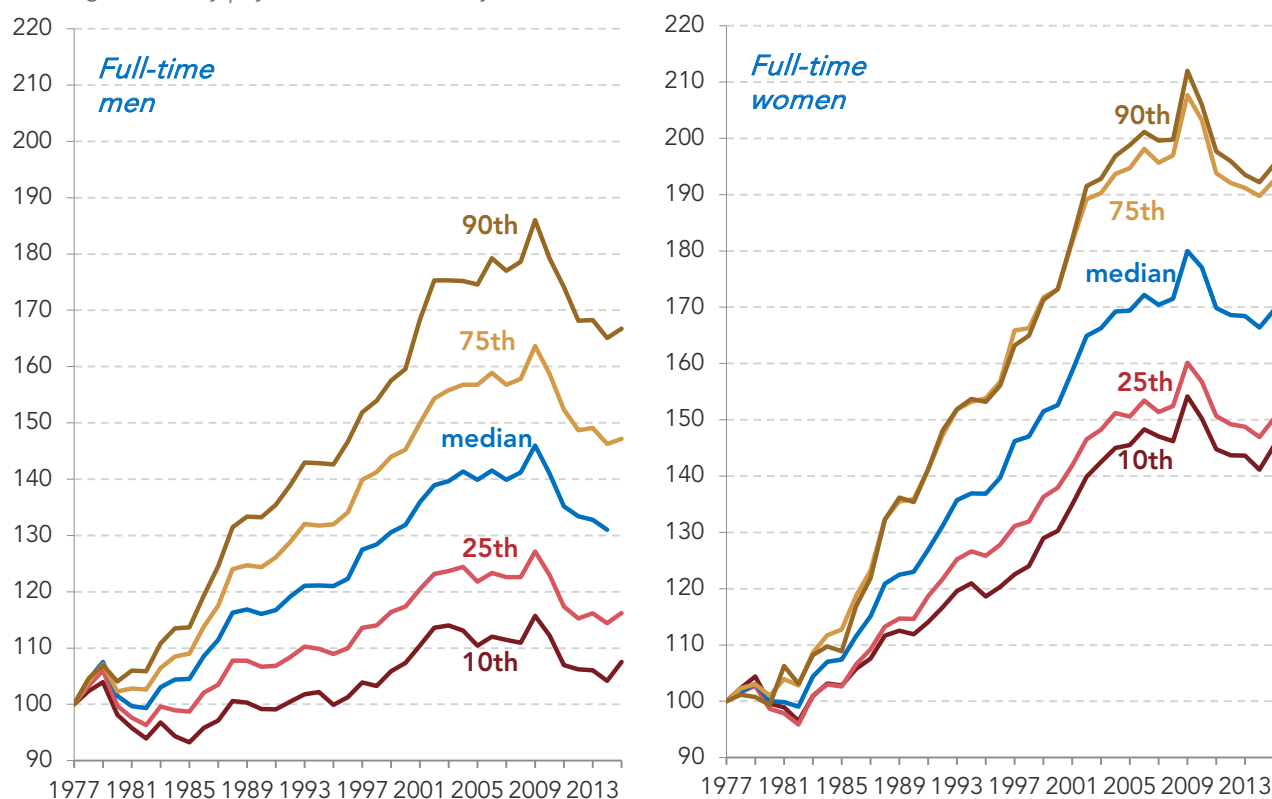
One drawback with using the RPIJ is that the OBR does not provide an official projection for the index in the same way that it does for RPI and CPI (because both are used in relation to the public finances, whereas RPIJ is not). To counter this, we construct our own RPIJ projection by applying historic ratios between RPI and RPIJ growth rates to the OBR's RPI projections.

The pre-crisis 'peak'

Much living standards discussion focuses on whether earnings and incomes have managed to regain their pre-crisis 'peaks' or not. Yet in practice, these measures tended to rise in the immediate post-crisis period, peaking sometime around 2009. This reflects the fact that it took a little time for employment to reach its trough and for nominal earnings growth to drop below inflation.

The picture is further complicated when using RPIJ to deflate earnings and incomes. The sharp reduction in the Bank of England's base rate enacted between 2008 and 2009 had the effect of substantially reducing mortgage interest costs, temporarily pushing the RPIJ into negative territory (it fell as low as 1.9 per cent in June 2009). CPI inflation was largely unaffected, standing at +1.8 per cent in the same month. As a result, deflating earnings and incomes using RPIJ tends to create an additional spike in 2009.

This can make reference to a pre-crisis peak somewhat confusing. In the main, our approach in this report is to focus on the immediate pre-crisis period of 2007-08 when setting out benchmarks for incomes, while acknowledging that real-terms incomes may subsequently have been higher in 2009. We therefore refer to a return to the pre-crisis 'level' and the continued distance from 'peak'. In relation to earnings, our primary focus is on distance from peak.

Figure 5: Gross weekly earnings trends at different points in the earnings distribution: UK 1977-2015*Indices of gross weekly pay, 1977=100 (RPIJ-adjusted)*

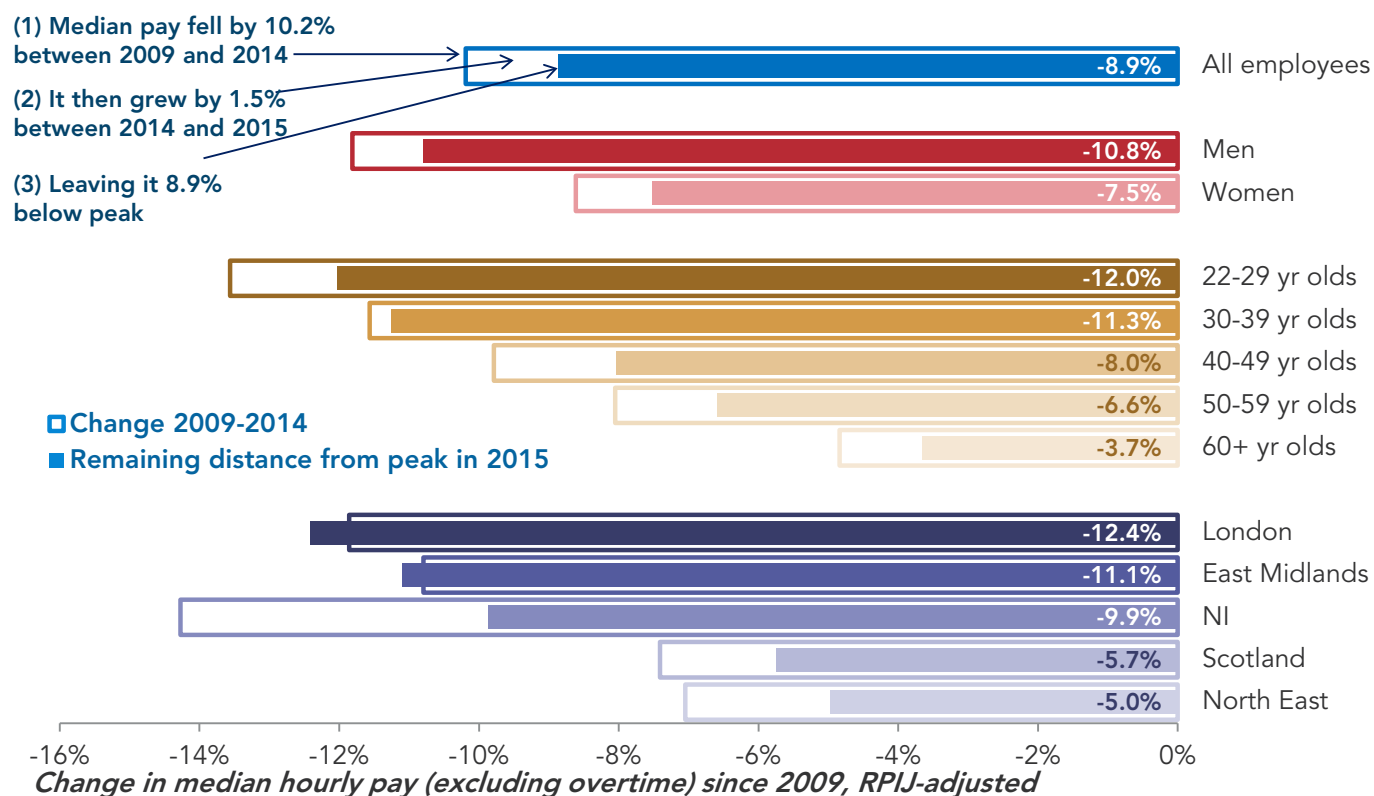
Source: ONS, Annual Survey of Hours and Earnings

Post-crisis, sharp drops in pay have been relatively evenly shared across the distribution – falling furthest at the top and narrowing pay inequality a little. There has, however, been more significant variation in pay trends across age, sex and location.

Figure 6 sets out the scale of the squeeze on median hourly pay for different groups in the period after 2009. It shows the extent of the fall between 2009 and 2014 and the size of the distance from peak still in evidence after a year of growth in 2015 (in most, but not all, instances).

Overall, median pay fell by 10.2 per cent over the course of the squeeze (from £12.89 to £11.57), before growing by 1.5 per cent between 2014 and 2015. As such, median pay is still 8.9 per cent (or £1.14) lower than in 2009. That difference from peak is unlikely to be restored before the end of the decade and comes on top of a seemingly permanent £2.50 pay gap associated with the years of ‘lost growth’.

Figure 6: Fall in typical pay over the course of the earnings squeeze, by selected employee type: UK 2009-2015



Source: ONS, Annual Survey of Hours and Earnings

But the pay squeeze has been deeper still for certain groups of employees, with men, the young and workers in London, the East Midlands and Northern Ireland faring particularly badly. Even within these more disadvantaged groups there is significant divergence: median wages continued to fall in London and the East Midlands in the year to April 2015, but rebounded strongly (while still remaining 9.9 per cent below their 2009 level) in Northern Ireland.

And the generosity of working-age benefits is being cut back

The final element of household incomes discussed here – state support – played a key role in supporting the living standards of those on low to middle incomes in the pre-crisis period. The introduction and development of tax credits in particular appeared to boost employment among single parents and helped to offset a generalised slowdown in pay growth from around 2002.

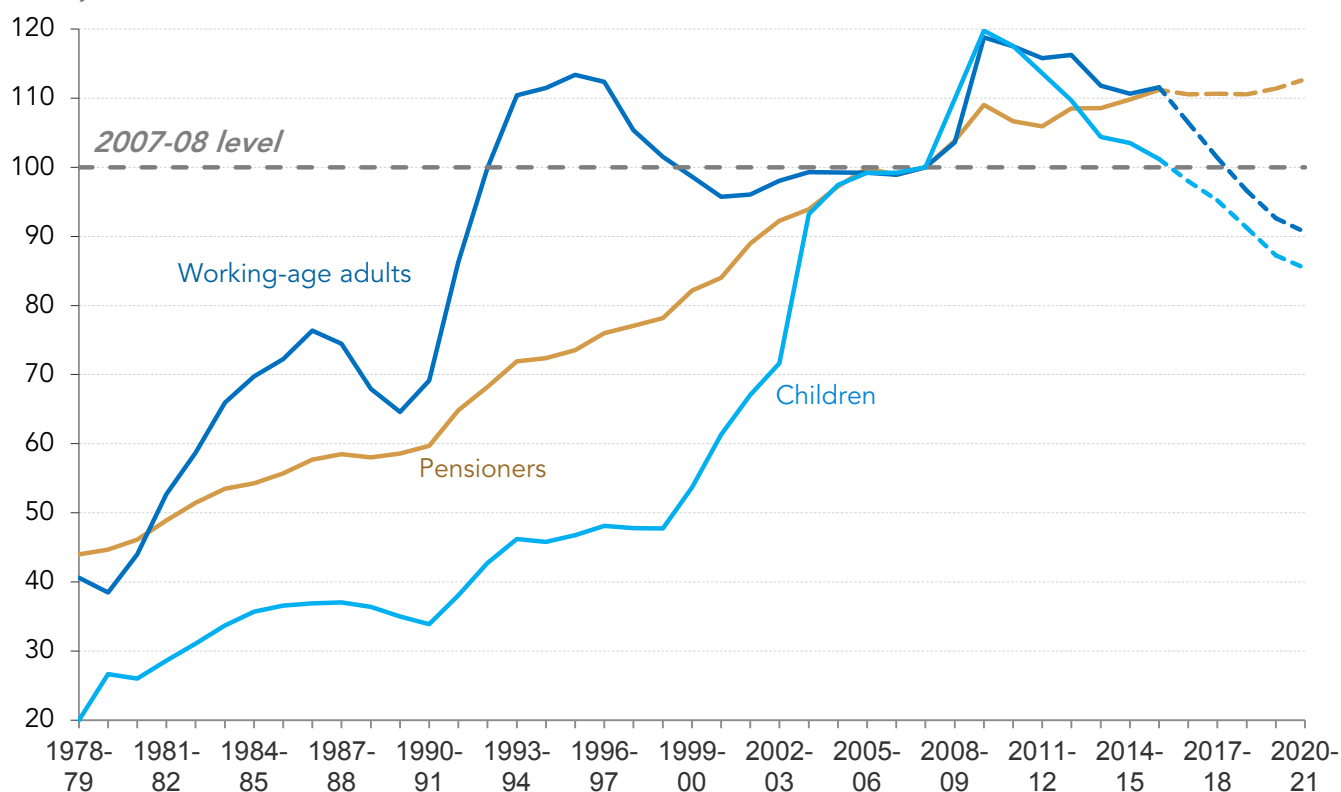
Once the crisis hit, a combination of automatic stabilisers and deliberate increases in generosity provided a vital safety net for those affected by unemployment and falling pay. And a series of income tax cuts have provided some relief for those earning above the personal allowance. But of course VAT was increased in 2011 and many working-age benefits have since been subject to a series of cuts as part of the programme of fiscal consolidation.

The impact of these cuts – largely delivered in the form of cash freezes and caps – have been reduced to some extent by the low inflation environment of the last 12 months. But further cuts are set to follow in the coming years. Figure 7 details the level of benefit generosity across adults, children and pensioners in the period since 1979. In the pre-crisis period, it shows a clear cyclical pattern for working-age adults, steady rises for pensioners and a very rapid increase in payments directed towards children following the introduction of tax credits in the 2000s.

Adult and child benefits spiked post crisis, but have been trending downwards since 2010. By 2021 – at which point all cyclical effects associated with the financial crisis should have dissipated – working-age adult payments per head are set to be 9 per cent lower than pre-crisis and child payments will be 15 per cent down. In contrast, pensioner payments have continued to rise in generosity post-crisis, thanks to the introduction of the “triple lock”, and are set to end the period 13 per cent higher than in 2008.

Figure 7: Indices of benefit spending per person: UK 1978-79 – 2020-21

RPIJ-adjusted, 2007-08 = 100

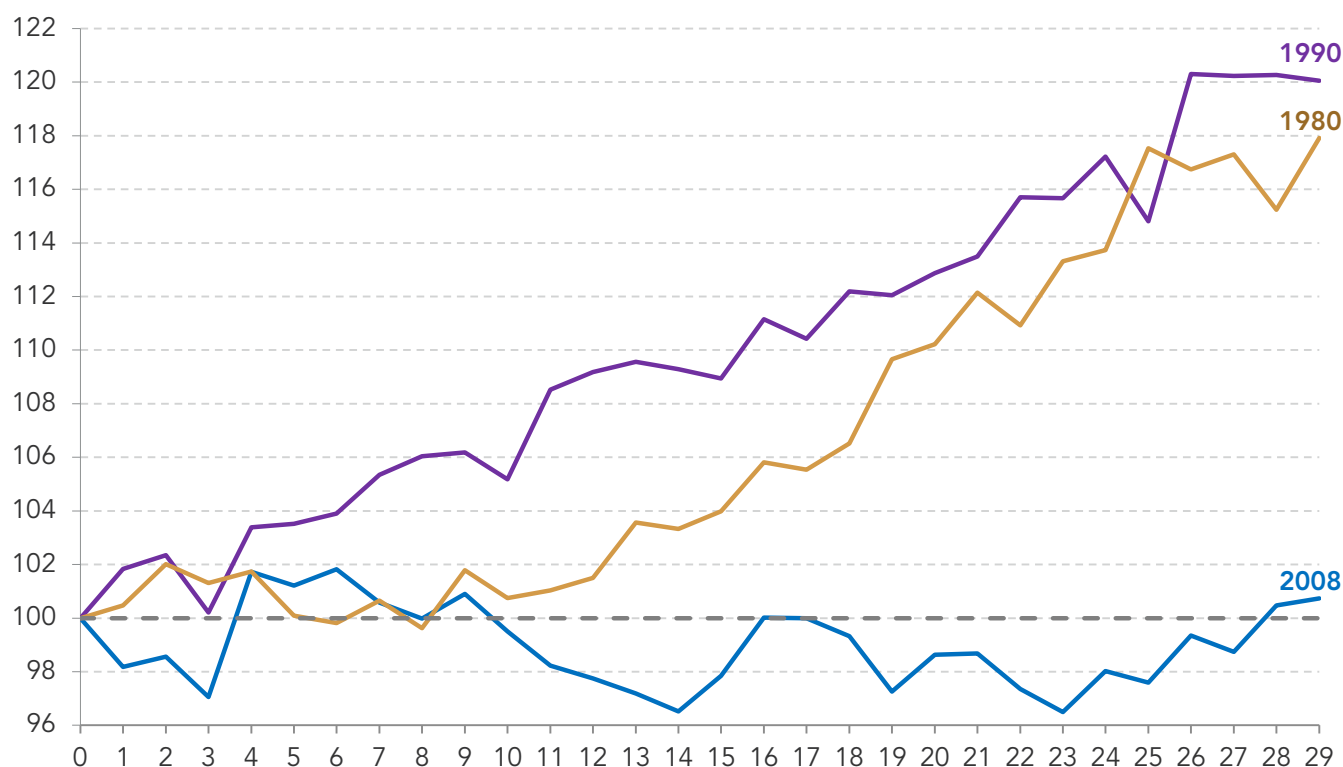


Source: DWP, Welfare Trends

Overall, these drivers have acted to pull down on household income growth

The drivers identified above have tended to push in opposite directions. Employment falls in the early part of the downturn clearly dragged on incomes, but subsequent recovery has supported living standards. Yet the downward force exerted by the wage squeeze has ensured that incomes have remained below their pre-crisis level for a sustained period.

As Figure 8 shows, this is a somewhat unusual outcome. Following the onset of recession in 1980 and 1990, income growth – as measured by the National Accounts metric of real household disposable income (RHDI) – paused rather than fell. And this far out (seven years) from the start of those downturns, real-terms incomes were 18 per cent higher in the 1980s and 20 per cent higher in the 1990s. Yet this time around, RHDI appears to have only just returned to its pre-crisis level.

Figure 8: Real household disposable income measures after selected recessions: UK 1980-2015*Indices of RHDH per head by number of quarters since recession (Q0 = 100)*

Source: ONS, National Accounts

While this is clearly a stark comparison, we should be careful not to draw too many conclusions. The National Accounts measure is an average, and therefore tells us nothing about what has happened across the distribution. And it is converted into real-terms using the GDP deflator, which does not capture the changes in consumer prices that are most appropriate when considering trends in living standards. It also includes various elements of 'income' which would not be recognised as such by most households. As discussed in previous work, the inclusion of 'imputed rents' (the rent that homeowners might receive if they didn't live in their own home) – while important when establishing National Accounts – is particularly likely to mis-state the true living standards picture.^[2]

Helpfully, the ONS has developed new experimental measures of 'cash RHDH' which seek to deal with this problem of coverage by removing imputed rents and other non-cash forms of 'income'. This is designed to produce a closer representation of disposable income as measured by social surveys.

Within this approach however, the treatment of interest paid by households is uncertain. Interest payments (on mortgages for example) might be viewed as an expense that households directly observe, meaning they should be taken into account when establishing a level of 'disposable' income. However, it might similarly be considered that decisions about paying interest (such as deciding whether or not to take out a loan for example), reflect judgements based on pre-interest levels of 'disposable' income. To deal with this uncertainty, the ONS presents its 'cash RHDH' measures on a 'net interest' (including interest paid and received) and 'gross interest' (including just interest received) basis.

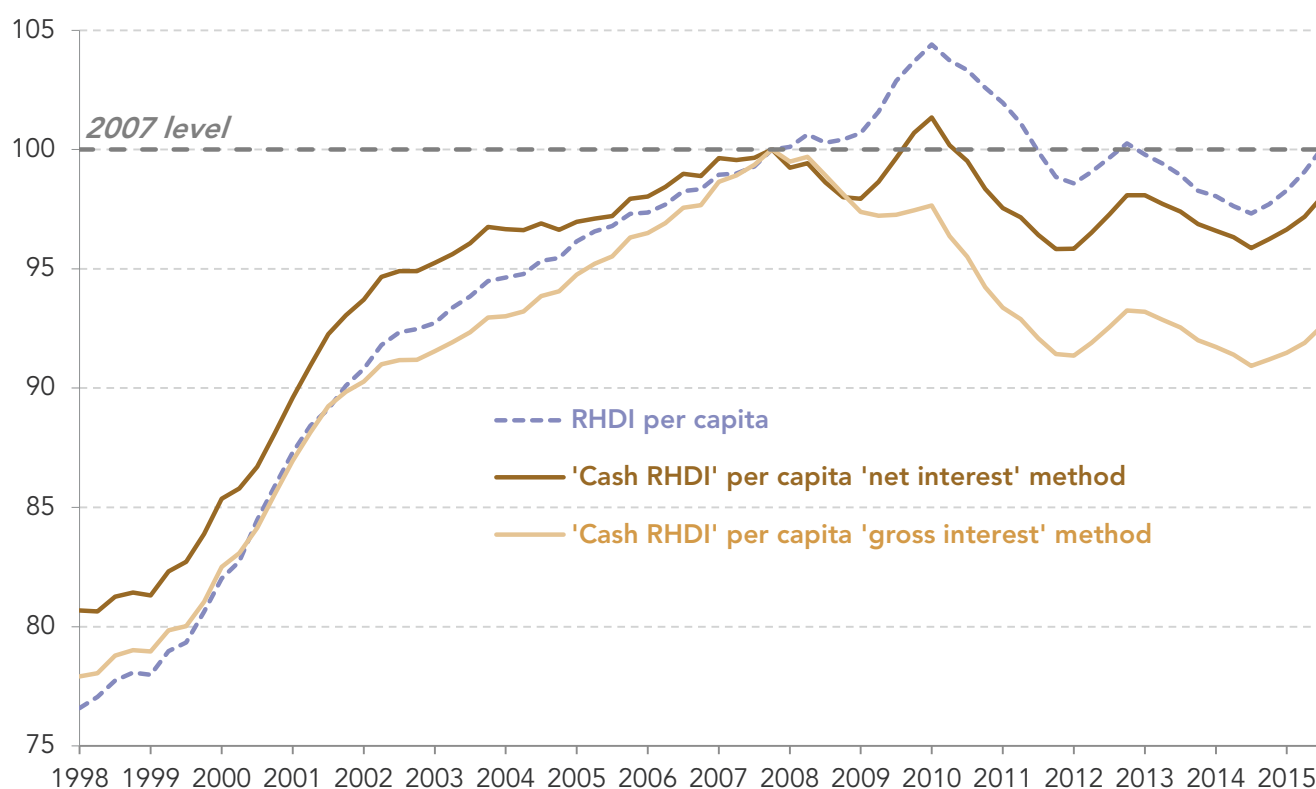
[2] M Whittaker, [How far have living standards recovered?](#), Resolution Foundation, March 2015

Figure 9 compares four-quarter averages of the standard RHDI per capita measure with the two new 'cash RHDI' measures. Taking each measure in turn, we see that:

- » The standard RHDI per capita measure returned almost precisely to its pre-crisis (2007) level in Q3 2015 (the latest period for which data is available), but remained 4.1 per cent below its peak in Q1 2010;
- » The 'net interest cash RHDI' measure is lower than the standard measure from 2008 onwards, reflecting the fact that imputed rents have tended to boost 'income' in this period. On this measure, disposable incomes remained 2 per cent below their pre-crisis level in Q3 2015, and 3.3 per cent below the Q1 2010 peak; and
- » The 'gross interest cash RHDI' measure is lower again because it strips out the positive effects of falling mortgage interest payments that are captured in the standard RHDI and 'net interest' approaches. On this measure, average incomes fell as much as 9.1 per cent between 2007 and Q3 2014. By Q3 2015, incomes were still 7.4 per cent down on 2007 (in this instance, also the peak).

Figure 9: National Accounts measures of disposable household income: UK 1998-2015

GDP-deflated, four-quarter averages, 2007=100



Notes: 'RHDI' (real household disposable income) is the standard National Accounts measure of household income. However, it contains certain elements which, though they are required for compiling a sequence of national accounts, are not directly observed by households. The ONS has therefore developed a 'cash RHDI' measure which removes imputed rental and other non-cash components. The 'net interest' approach includes interest paid and received; the 'gross interest' approach just includes interest received.

Source: ONS, *Alternative Measures of Real Household Disposable Income and the Saving Ratio: December 2015, February 2016*

Though median incomes appear to have performed a little better than mean

Useful though this new ONS release is for more closely reflecting what we might expect directly reported household income measures to show, it lacks the depth of true survey data. Large scale surveys such as the DWP's *Family Resources Survey* (FRS) allow us to dig below the headline average income figure to look at distributions and household characteristics. However, such surveys lack the timeliness of aggregate measures, with the latest FRS covering the period 2013-14 for instance.

To counteract this, we have undertaken a nowcast using more up to date outturn figures on employment, earnings and taxes and benefits to roll-forward the FRS data ending Q1 2014 to the year ending Q3 2015. For shorthand, we refer to this nowcast period as '2015' (see Box 2 and Annex 1).

i Box 2: Nowcasting

In order to assess household incomes more recently than 2013-14, we employ a nowcasting technique. This takes more timely data on employment and earnings, together with our knowledge of how the tax and benefit systems have changed, to predict how household incomes have changed.

We use outturn data from the Labour Force Survey, which is relatively timely. The most recent year of publicly available data is from Q4 2014 to Q3 2015, and this is therefore the basis of our nowcast. We thereby roll the 2013-14 FRS forward by 18 months. For the tax and benefit system we use levels and rates in place in April 2015 (i.e. the 2015-16 financial year) and make use of the IPPR Tax-Benefit Model. For the purposes of recording incomes 'after housing costs' as well as before, we also include adjustments that reflect changes in private and social rents

and in mortgage costs.

We employed a similar approach in last year's living standards report* and have also reflected on approaches made by the ONS** and the IFS***. The results are inevitably uncertain, and all conclusions should be derived with caution.

For more details, see Annex 2.

* M Whittaker, *Time to catch up? Living standards in the downturn and recovery*, Resolution Foundation, March 2015

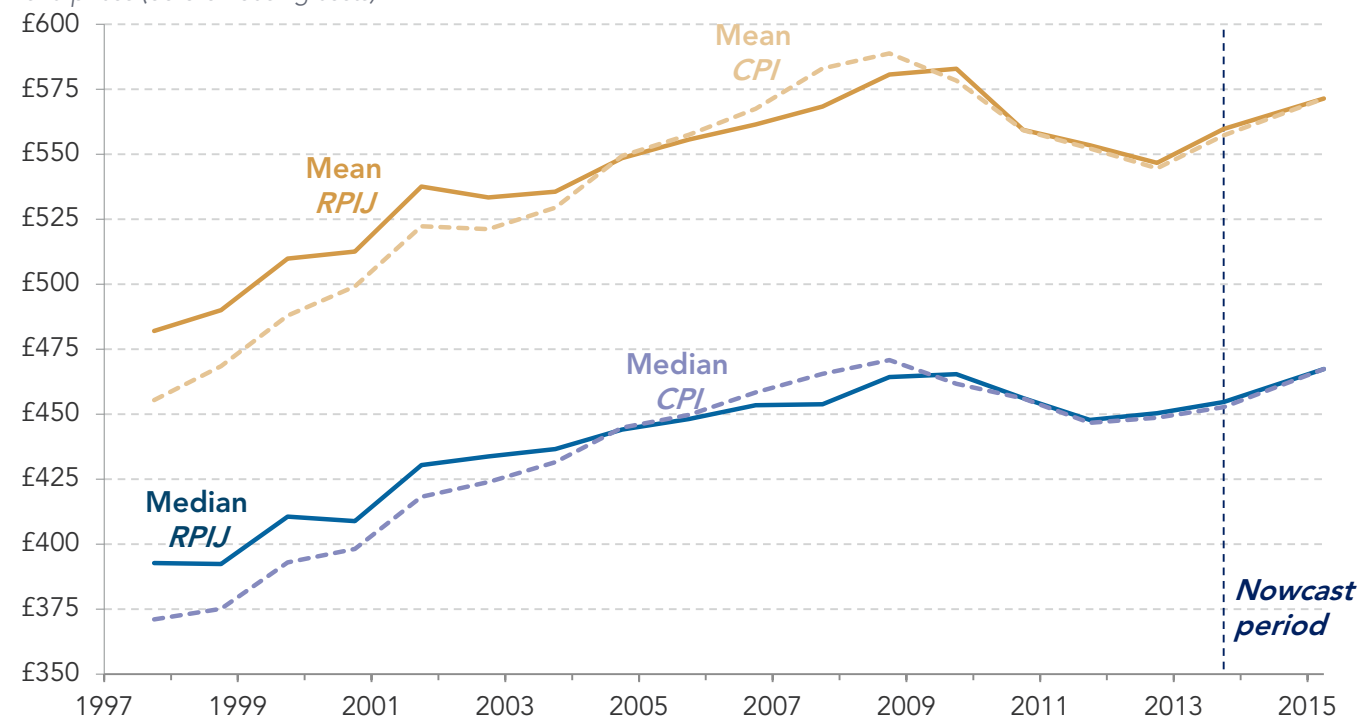
**R Tonkin, *Nowcasting household income in the UK: Financial year ending, 2015*, ONS, October 2015

***J Cribb, A Hood & R Joyce, *Living Standards: Recent Trends and Future Challenges*, IFS, March 2015

We present mean and median household income trends deflated using both CPI and RPIJ in Figure 10 and Figure 11. The former details real-terms cash levels of income, while the latter sets out indices in order to allow comparison over time.

Figure 10: Weekly net household income: 1997-2015

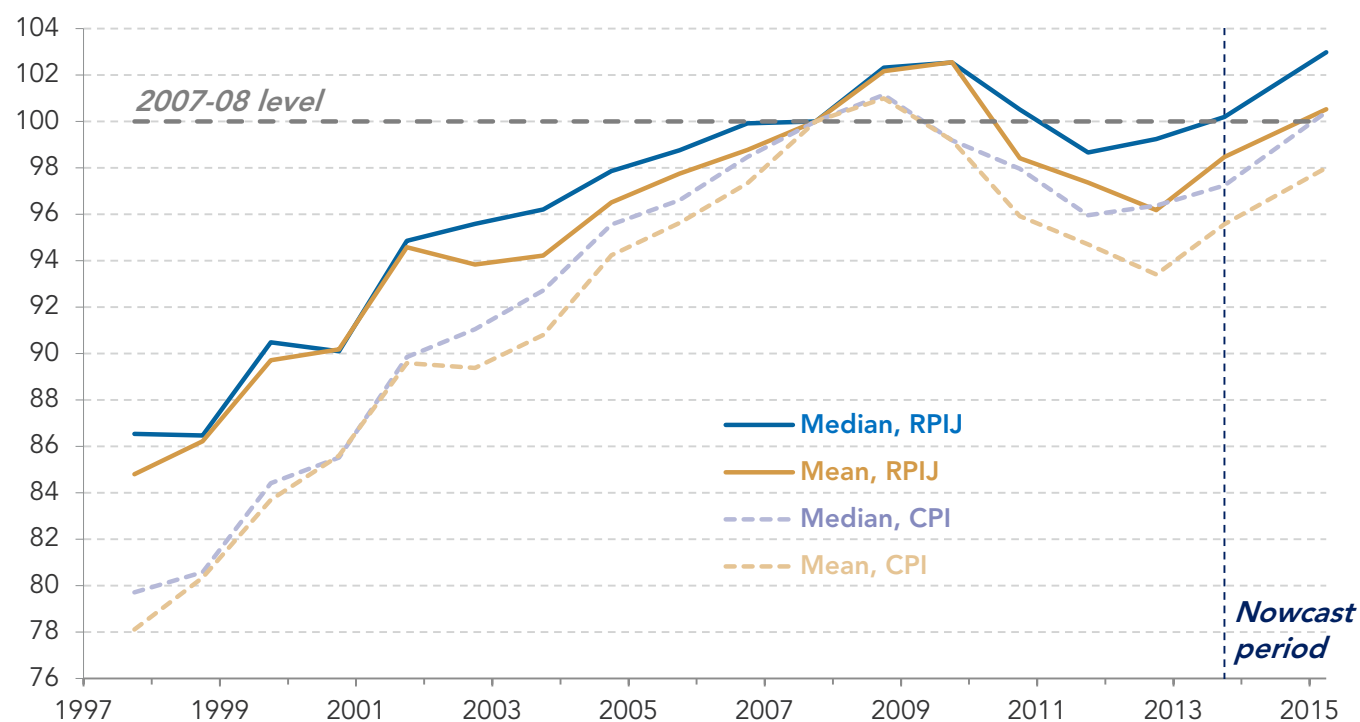
2015 prices (before housing costs)



Source: RF analysis of DWP, Family Resources Survey and nowcasting

Figure 11: Indices of weekly net household income: 1997-2015

2007-08 = 100 (before housing costs)



Source: RF analysis of DWP, Family Resources Survey and nowcasting

Acknowledging the inherent uncertainty involved in the nowcast process, we can draw a number of conclusions:

- » Median household incomes have held up better than mean household incomes in the period since 2007-08. This is likely to reflect the larger drops in earnings experienced at the top of the wage distribution;
- » Incomes appear higher post-crisis when measured using RPIJ rather than CPI. This reflects the important boost to incomes provided by reduced mortgage costs, which is captured in RPIJ but not in CPI;
- » Median incomes measured using RPIJ appear to have returned to their pre-crisis level in 2013 and have passed their 2009 peak in the nowcast period;
- » Median incomes measured using CPI appear to have returned to their pre-crisis level in 2015, remaining around 0.7 per cent below their 2008 peak;
- » Mean incomes measured using RPIJ just reached their pre-crisis level in the 2015 nowcast period, remaining 1.6 per cent below their 2009 peak; and
- » Mean incomes measured using CPI are still 2 per cent below their pre-crisis level and 3 per cent off peak. This measure is the one most likely to reflect the 'cash RHDI gross interest' measure set out in Figure 9, because it excludes imputed rents but also takes no account of mortgage interest reductions in the deflator.

In Section 5, we extend this nowcast approach to *forecast* household incomes in 2020, using assumptions about demographics, employment, wage growth and housing, as well as expectations for the tax and benefit system. But first we look in more detail at the divergence of experience – both in the post-crisis outturn period and in our 2015 nowcast – that is obscured by reliance on overall averages.

Section 3

Whose recovery is it anyway?

Rolling survey data forward into 2015 provides us with the opportunity to consider how income has shifted over the course of the downturn and early recovery across different groups of citizens and areas of the country.

In this section we therefore focus on differences across the income distribution, by area, by age and – crucially – before and after housing costs are accounted for in order to build a better sense of just how broadly felt the current recovery in living standards is.

The post-crisis income squeeze has been tightest towards the top of the income distribution

As noted in Section 2, the earnings squeeze has been felt relatively uniformly across the wage distribution – with the biggest drops in pay occurring at the top. A similar pattern holds when looking at household incomes, as highlighted in Figure 12. It compares average annual real-terms growth in incomes at each percentile point in the income distribution in a selection of periods.

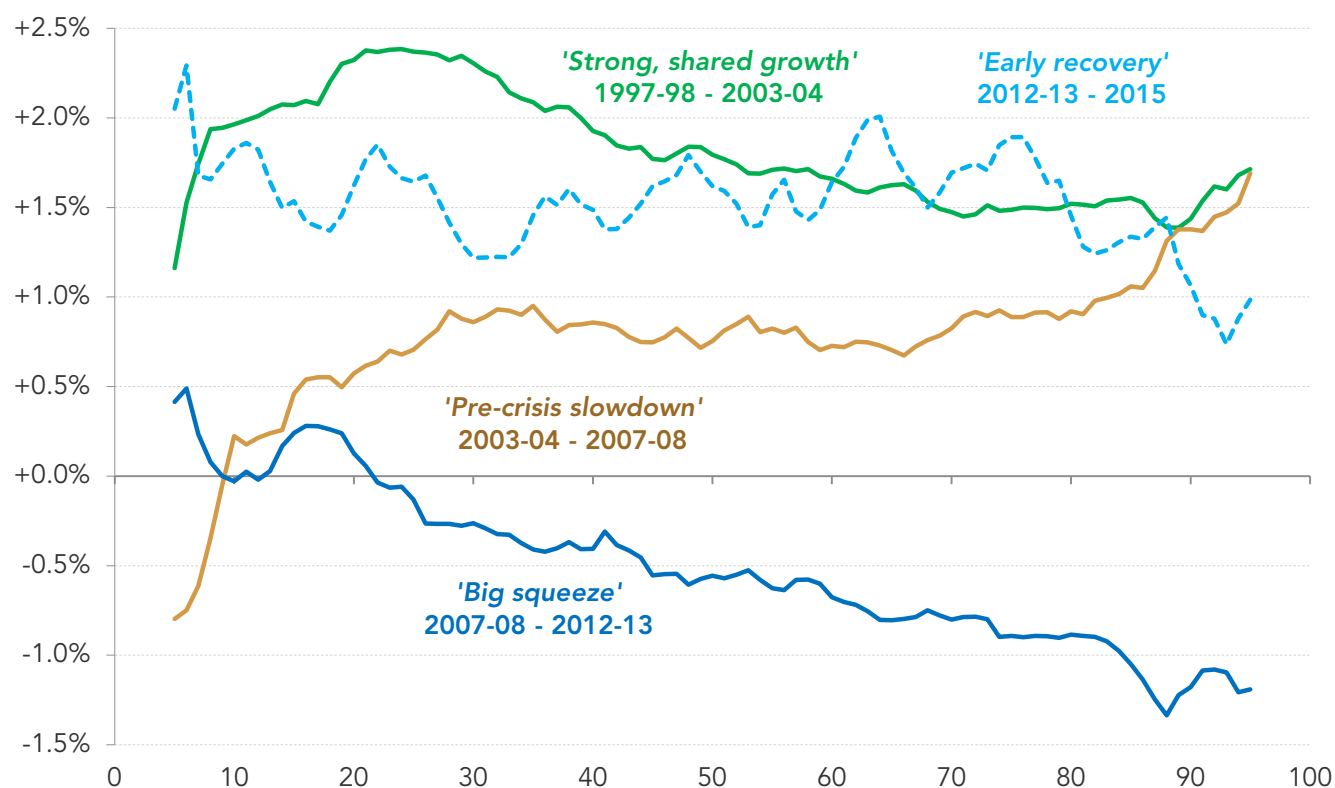
We can contrast the ‘strong, shared-growth’ of 1998 to 2004 (when incomes increased by between 1.5 per cent and 2.5 per cent a year across most of the distribution, supported by strong wage growth and the introduction of the National Minimum Wage), with the ‘pre-crisis slowdown’ of 2004 to 2008 (when growth slowed to somewhere between 0.5 per cent and 1 per cent a year for much of the distribution, with only those at the very top performing at a comparable level to the preceding period).

More recently, the ‘big squeeze’ of 2008 to 2013 was strongest at the top end of the income distribution, where incomes fell by close to 1.5 per cent a year.

The ‘early recovery’ period of 2013 to 2015 (incorporating our nowcast), while somewhat volatile (reflecting the difficulty associated with comparing survey incomes over a relatively short-term), appears broadly flat across most of the distribution. Income growth is stronger at the bottom of the distribution – probably reflecting reductions in wage inequality, the impact of real-terms increases in the National Minimum Wage and employment growth – and a little weaker at the top.

Figure 12: Average annual income growth in selected periods: UK 1997-2015

Average annual growth in real disposable household income, by income percentile (RPIJ-adjusted)



Notes: Percentiles at the extreme top and bottom of the distribution are excluded for reasons of robustness.
Source: RF analysis of DWP, Family Resources Survey and nowcasting

But trends in housing costs mean that outcomes have varied across different households

So far, we have presented all of our results before accounting for housing costs. That approach most closely matches 'income' for most households, with choices about housing costs tending to reflect available income as with any other purchase. However, housing is of course an essential good – and one that can be hard to cut back on. And for those in receipt of Housing Benefit, changes in housing costs feed directly into reported changes in income, even if the household's disposable income remains unchanged.

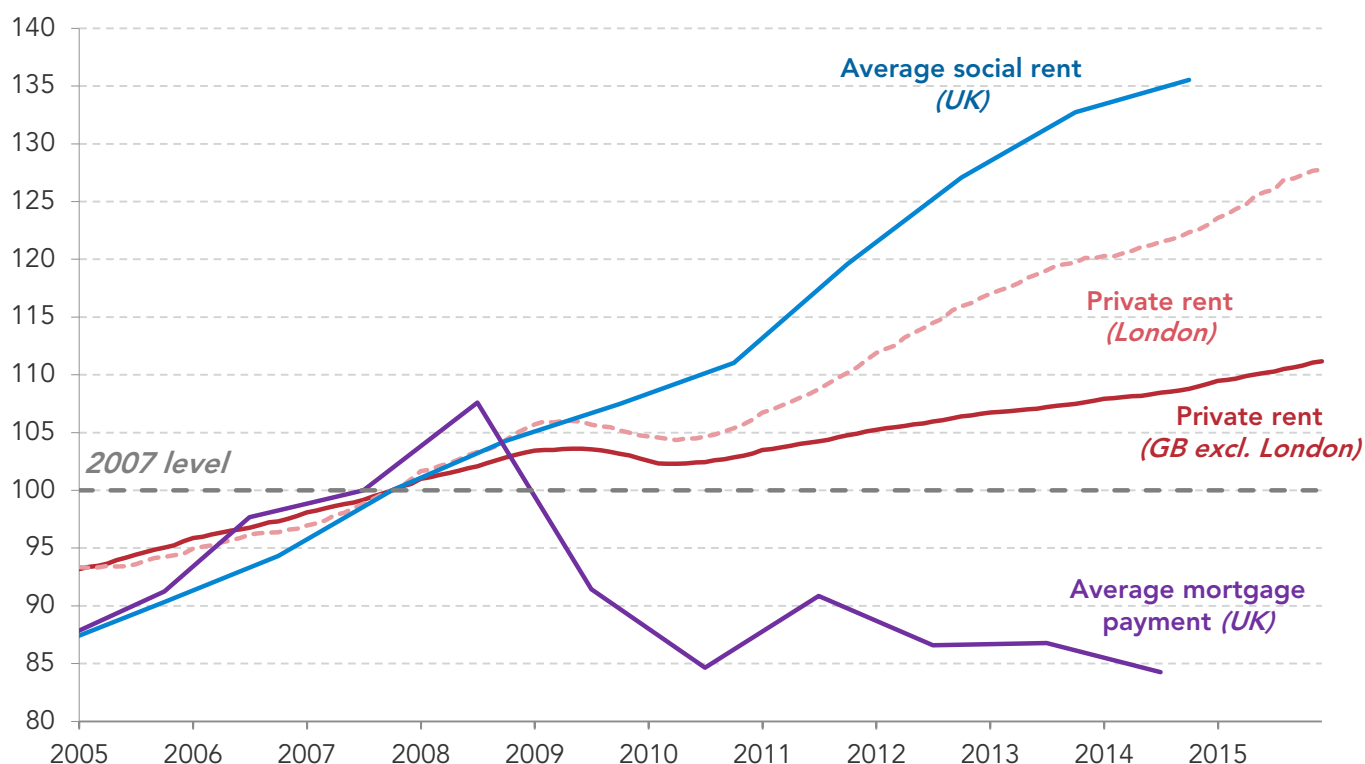
In short, after housing costs (AHC) measures of income might better capture the living standards of those households that pay more for housing than is warranted by the quality of their accommodation. For example, identical households with the same sized property in London and the North East might report the same before housing cost (BHC) income, but higher housing costs in London mean that one of the families is likely to have significantly less disposable income. Adopting an AHC approach would make that difference clear. However, it should also be remembered that AHC incomes might understate the living standards of those living in property of a higher quality than is suggested by their costs.

In determining how the recovery is being shared, this housing cost distinction matters. With that in mind, it's worth considering how prices have shifted across different tenure types in recent years.

Figure 13 sets out indices of nominal housing payments between 2005 and 2015, drawing out the very significant divergence taking place after the financial crisis. At one extreme, average mortgage payments fell by around 16 per cent between 2007 and 2014 – driven by sharp falls in mortgage rates. At the other extreme, average social rents increased by 35 per cent over the same period.^[3] Private rents have tended to rise relatively slowly, no doubt indirectly affected by interest rate cuts, but the picture in London looks very different, with average rents rising by 28 per cent between 2007 and 2015.

Figure 13: Change in average housing payment by tenure: UK 2005-2015

Nominal, Oct 2005 = 100



Notes: Figures capture compositional changes as well as price changes. That is, they reflect actual average rents/mortgages paid rather than the typical change in price.

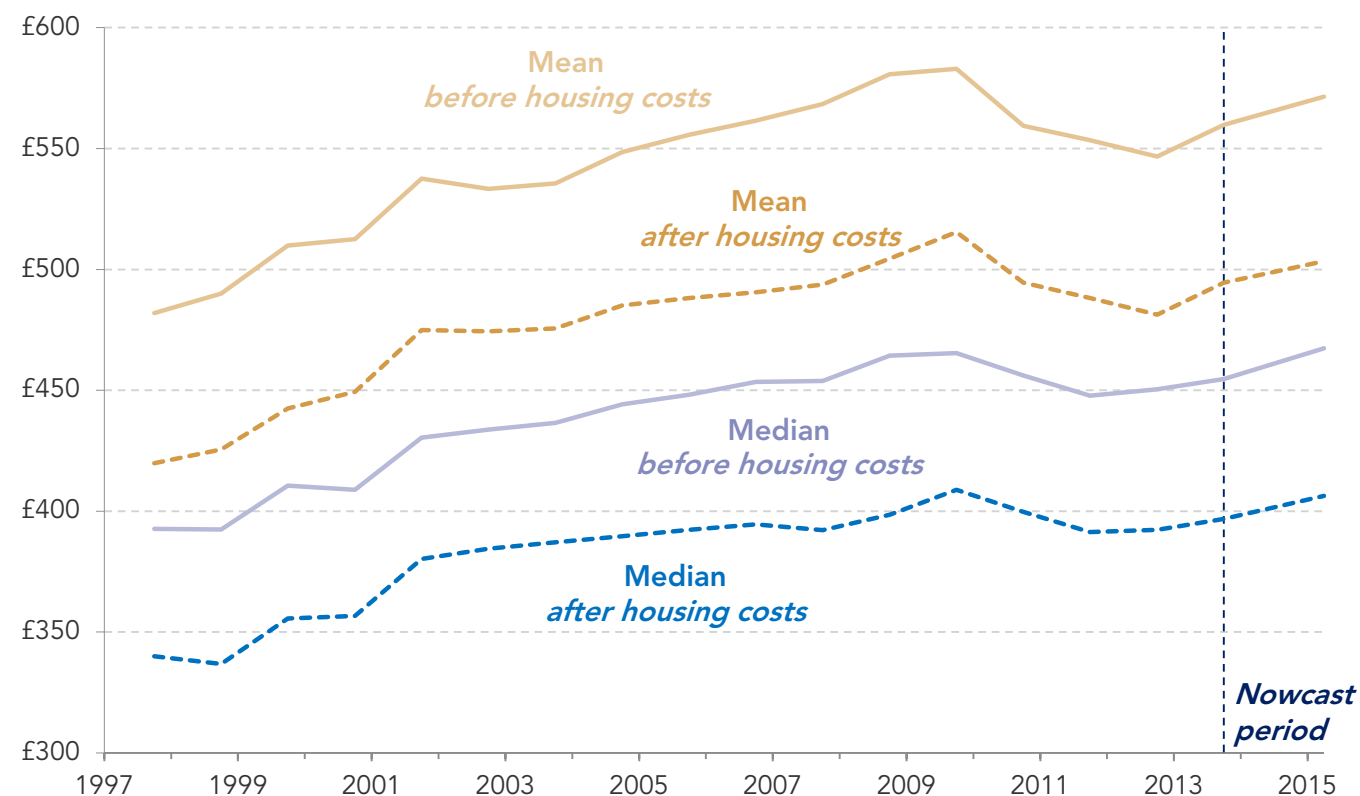
Source: ONS, Experimental Index of Private Housing Rental Prices; ONS, Living Costs and Food Survey; CLG, Live Table 701

Applying these variations in growth to our nowcast and measuring incomes on a BHC and AHC basis has a clear impact on income levels, as shown in Figure 14. Mean household income is reduced from £571 per week BHC in 2015 to £501 per week AHC. Similarly, median household income falls from £467 per week BHC to £406 per week AHC.

[3] Social rent rises were set at a rate higher than RPI inflation in the previous parliament

Figure 14: Weekly household income before and after housing costs: UK 1997-2015

2015 prices (RPIJ-adjusted)

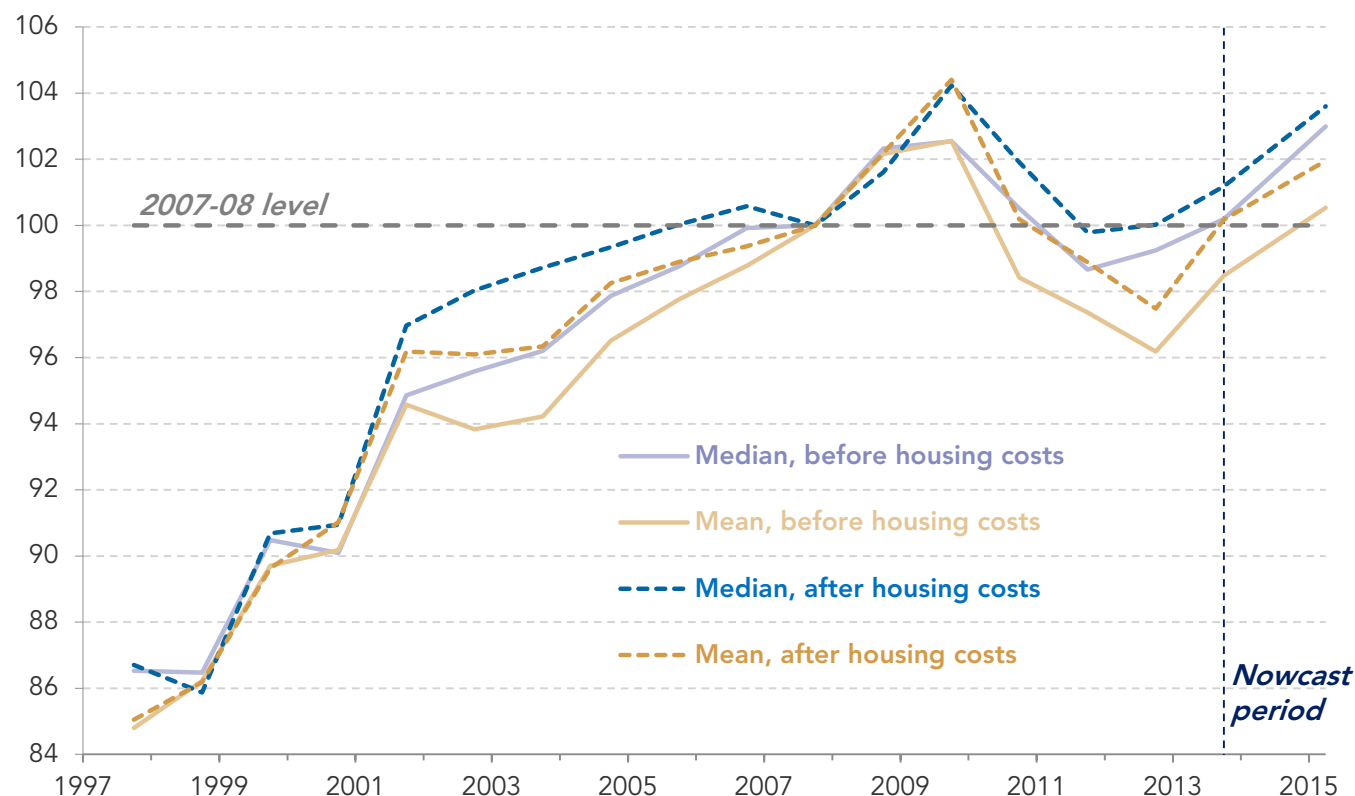


Source: RF analysis of DWP, Family Resources Survey and nowcasting

The housing costs distinction also matters when considering *growth* in incomes. Figure 15 re-presents the data from Figure 14 in index form, highlighting relative changes in the post-crisis period. The dotted lines denoting AHC income are consistently above the solid BHC lines after 2007-08, confirming the importance of relative reductions in some forms of housing costs in this period. On an AHC basis, both mean and median incomes appear well above pre-crisis levels – though both still fall short of their 2009 peak and a long way off where we would have expected them to be in the absence of a downturn.

Figure 15: Indices of weekly household income before and after housing costs: UK 1997-2015

2007-08 = 100 (RPIJ-adjusted)



Source: RF analysis of DWP, Family Resources Survey and nowcasting

With very different levels of growth recorded in different parts of the country

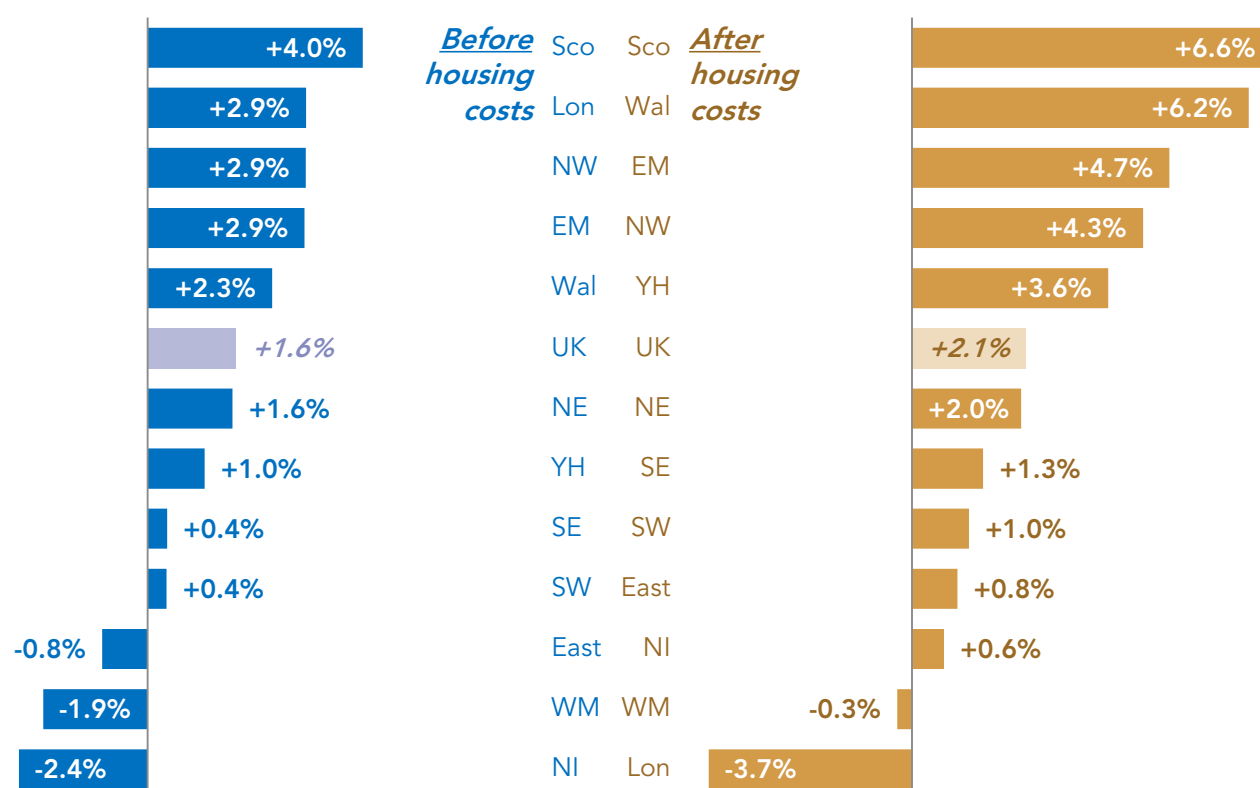
Unsurprisingly, our nowcast highlights significant variation in post-crisis income growth across different parts of the country, on both a BHC and AHC basis. As Figure 16 confirms, moving between BHC and AHC also has a sizeable impact on the ranking of different areas in relation to growth.

Taking three-year averages, it shows that median incomes before housing costs increased by 4 per cent in Scotland and by 2.9 per cent in London between 2008 and 2015, but fell by 2.4 per cent in Northern Ireland and by 1.9 per cent in the West Midlands. These variations are likely to reflect differing records on employment and on pay.

As identified in Figure 6 for example, earnings fell much less far in Scotland (-5.7 per cent) between 2009 and 2015 than in Northern Ireland (-9.9 per cent). Interestingly, despite having the worst record on pay (median pay fell by 12.4 per cent between 2009 and 2015), London does relatively well on incomes because of its very strong employment performance (Figure 2).

Figure 16: Household income growth before and after housing costs by region: UK

Change in median household income 2006-08 to 2013-15 (RPIJ-adjusted)



Source: RF analysis of DWP, Family Resources Survey and nowcasting

Looking at the after housing costs measure, Figure 16 shows that Scotland again comes out on top, with growth of 6.6 per cent in the post-crisis period. However, London shifts from second on the BHC measure to bottom on the AHC one. This reflects the fact that London has much lower levels of homeownership than other parts of the country,^[4] meaning that households have not benefitted from falling mortgage costs to the same extent as elsewhere. Sharp social rent rises – which inflate the BHC measure because it includes Housing Benefit income – are largely stripped out of the AHC income measure, reducing income growth.

Figure 17 provides an alternative presentation, comparing post-crisis growth in BHC income with the level of median income recorded at the time of the financial crisis. This approach allows us to split different parts of the country into four groups:

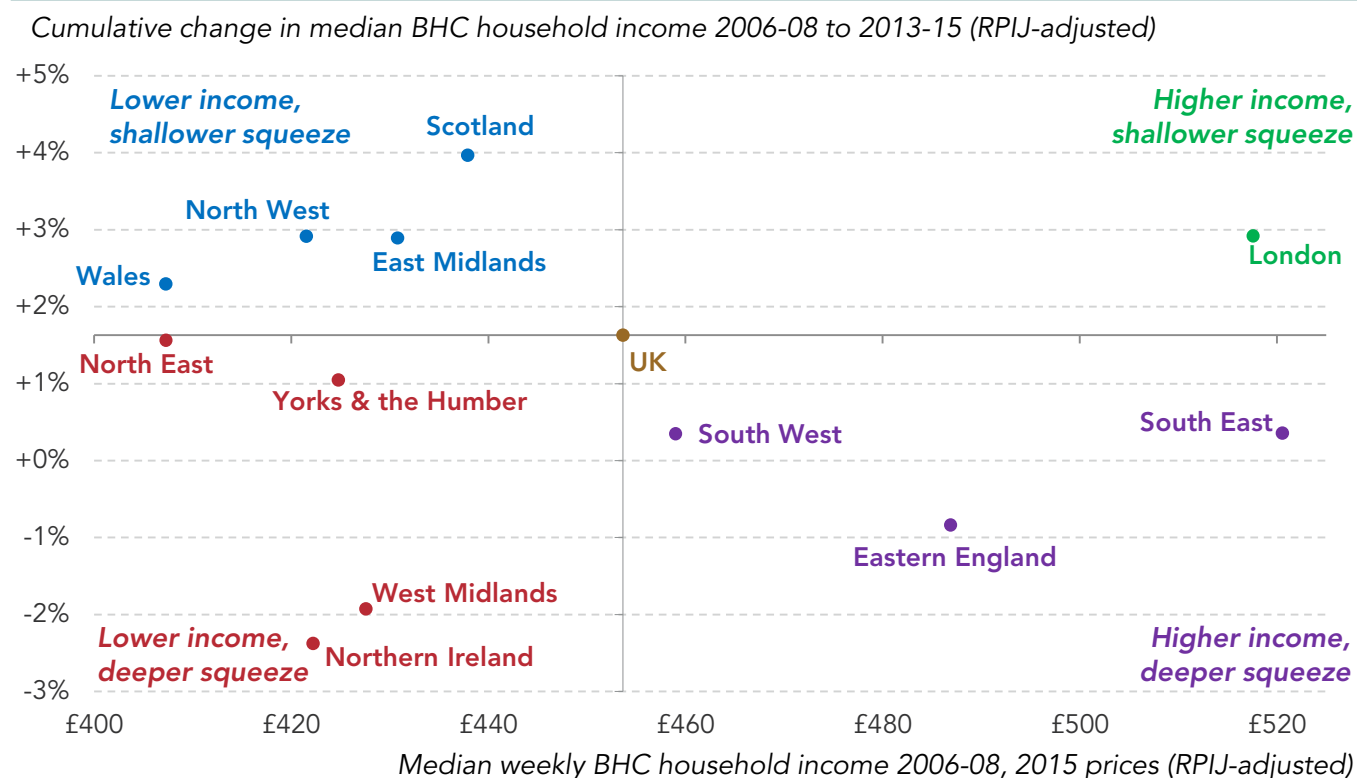
- » In the upper right hand quadrant, London benefits from both having a relatively high starting income and undergoing a squeeze that has been shallower than the UK average;
- » In contrast, the bottom right quadrant contains similarly 'higher income' regions which have subsequently experienced deeper squeezes (the South West, Eastern England and the South East);
- » The top left quadrant covers areas with starting incomes that were below the UK average but which have performed above-average post-crisis (Scotland, the North West, Wales and the

[4] Just under half of London households are homeowners, compared with between 60 and 69 per cent in all other parts of the UK.

East Midlands); and

- » The bottom left quadrant sets out those areas which started with lower incomes and have lost further ground since 2008 (the North East, Yorkshire and the Humber, the West Midlands and Northern Ireland).

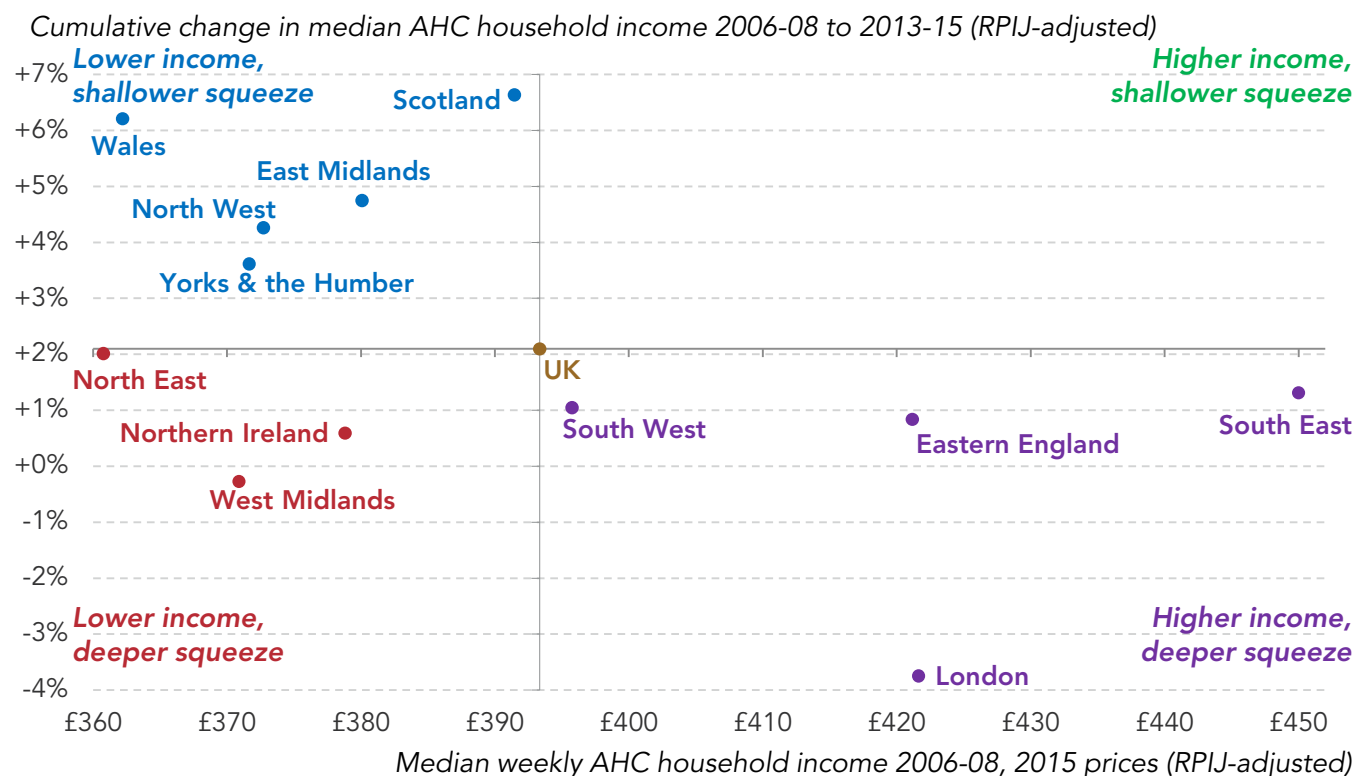
Figure 17: Median household income and income growth, before housing costs: UK



Source: RF analysis of DWP, Family Resources Survey and nowcasting

Repeating this exercise on an AHC basis in Figure 18 produces slightly different results. Most areas remain within the same quadrant as in Figure 17, but London drops into the bottom right quadrant of 'higher income, deeper squeeze' and Yorkshire and the Humber moves up to the top left quadrant, indicating a shallower squeeze than recorded on a BHC basis. While not escaping the bottom left quadrant, Northern Irish income growth post-crisis also looks like less of an outlier when reported on an AHC basis.

Figure 18: Median household income and income growth, after housing costs: UK



Source: RF analysis of DWP, Family Resources Survey and nowcasting

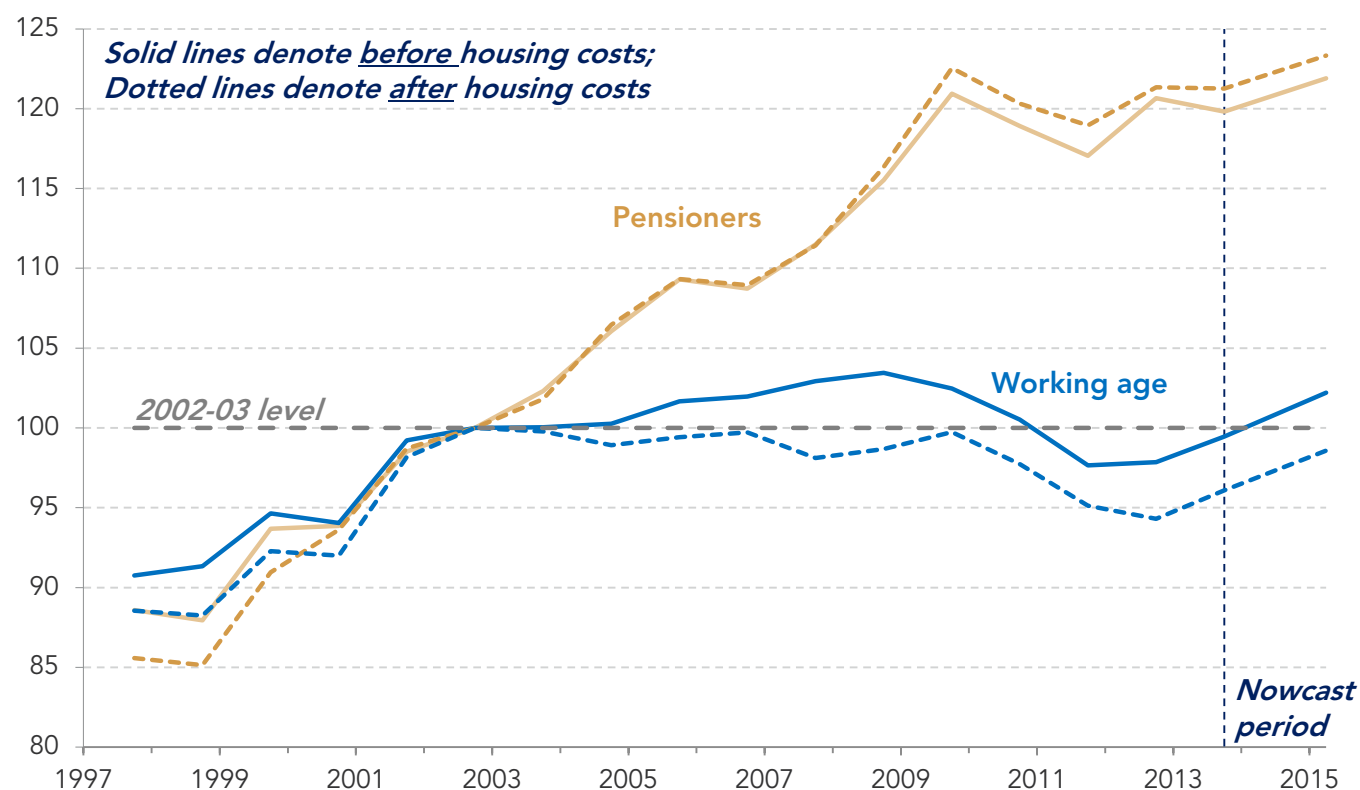
Working-age households have undergone a much tighter squeeze than pensioners

Incomes have diverged especially significantly when looking across age – and not just in the post-crisis period. Figure 19 compares median income growth in working-age and pensioner households from 1997 onwards. Median pensioner incomes remain lower than median working-age incomes, but the much more rapid gains made by pensioner households over this period is obvious.

The divergence is particularly marked from 2002, coinciding with the period of pay stagnation identified in Figure 5. On a BHC basis, median working-age income increased by just 3 per cent between 2002 and 2007, compared with growth of 11 per cent among pensioner households. Post-crisis, pensioner incomes continued to trend upwards, and are now 22 per cent higher than in 2002. In contrast, working-age incomes have only just returned to their 2007 level, leaving them just 2 per cent higher than in 2002.

Figure 19: Household income growth by age: UK 1997-2015

Indices of median net weekly household income, 2002-03 = 100 (RPIJ-adjusted)



Source: RF analysis of DWP, Family Resources Survey and nowcasting

Taking the dotted line AHC measures in Figure 19 instead, the post-2002 divergence is even more marked. Higher home ownership rates among older households – with many owning outright – mean that pensioner incomes have been much less affected by rising private and social rent costs (though of course, many will have been hit by cuts in savings rates which aren't captured in these income measures). On an AHC basis, median pensioner incomes appear to have climbed 23 per cent between 2002 and 2015, while working-age incomes remain more than 1 per cent lower.

Again it is worth noting that pensioner incomes remain at a lower level than working-age incomes, but the £83 a week gap recorded on a BHC basis is reduced to a £27 a week gap when measured AHC.

Pensioner protections such as the 'triple lock' have clearly helped to support income growth post-crisis, and are in sharp contrast to falling wages and working-age benefit cuts. We might expect some of this divergence to unwind as the recovery continues and wage growth builds. However, the experience of the pre-crisis years hints at a structural difference in growth rates.

We use our income forecast to revisit this question in Section 5. But given the apparent importance of differences in housing experiences to trends in living standards in recent years – with homeowners tending to fare better than implied by simple net income measures for instance – we spend the next section considering just how access to homeownership has shifted over recent years.

Section 4

Living standards and housing – the end of homeownership?

As identified in the previous section, recent trends in living standards have been affected by differences in housing situations across households. Falling mortgage costs have provided a boon for many households – easing the pressure associated with the post-crisis earnings and incomes squeeze. The uneven distribution of home ownership across the income spectrum, across age groups and across the country has therefore played a big role in determining the extent to which the recovery has been evenly felt.

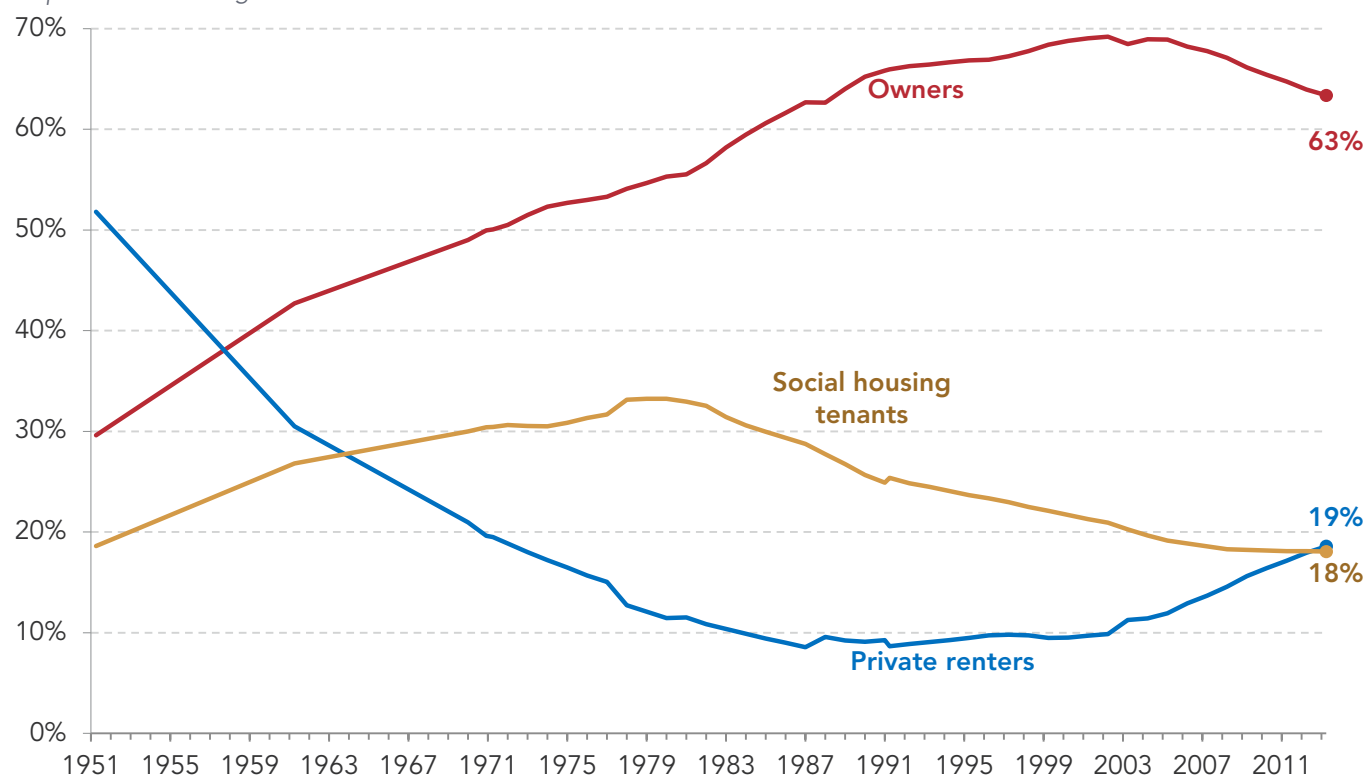
In this section we look in more detail at shifts in home ownership patterns over time, in order to identify which groups are most likely to be benefitting from the continued ultra-low level of mortgage interest rates. We focus in particular on the housing experience of 'low to middle income' households, drawing out the sharp decline in ownership within the group. We start with an overview of how the British tenure mix has shifted over the longer-term.

Homeownership rates have been declining since the turn of the century

In the first half of the 20th century, a clear majority of British households lived in private rented accommodation. As Figure 20 shows however, from the 1950s onwards ownership picked up sharply, accounting for a majority of dwellings by 1969. It grew more strongly again during the 1980s, reflecting government policy (primarily in the form of tax relief and Right to Buy).

Figure 20: Distribution of tenure: GB 1951-2013

Proportion of dwellings



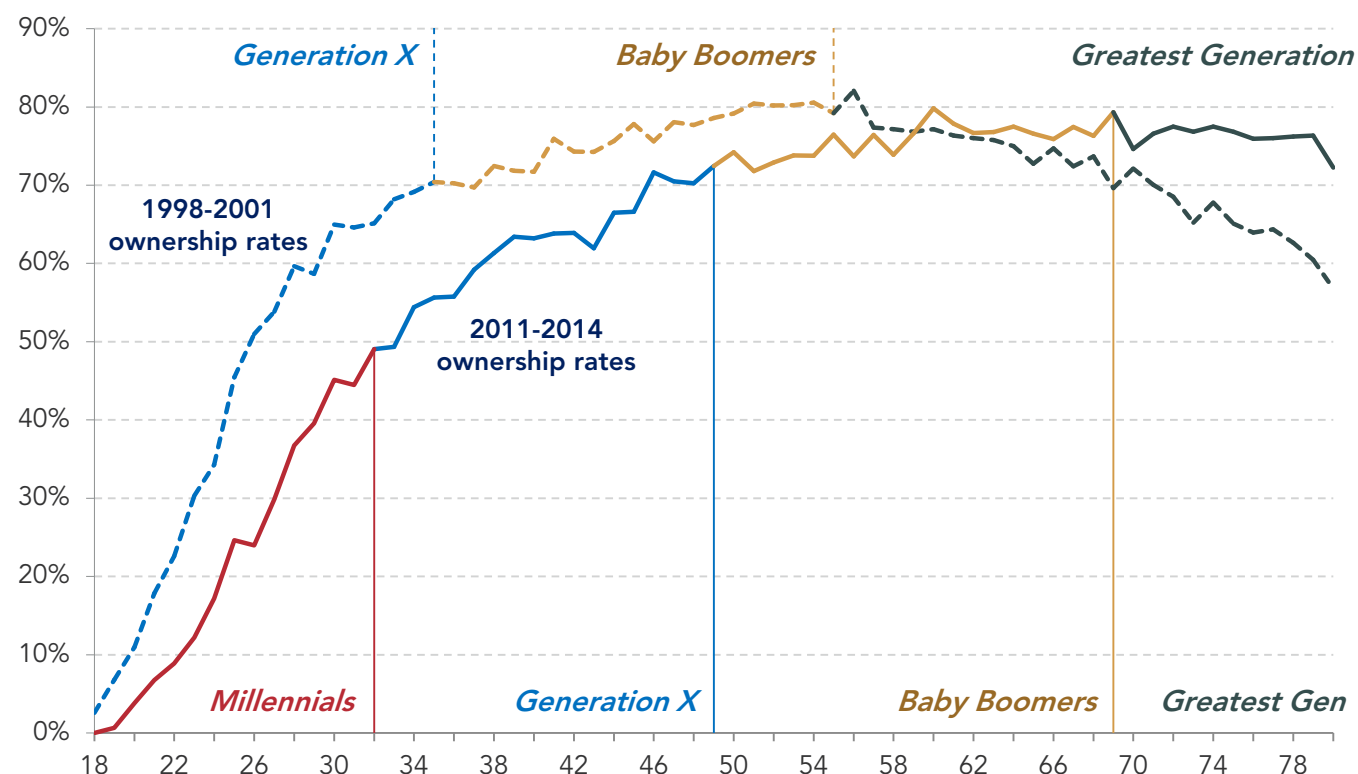
Source: CLG, Live Table 102

Driven by a much sharper decline among younger cohorts

The decline in new entrants to the housing market has been sharper still, masked in the overall ownership figures by rising levels of outright-ownership as those buying in earlier decades reach retirement. As Figure 21 shows, home ownership rates have fallen by an average of 11 percentage points for the under-60s in the period between 2001 and 2014.

Figure 21: Home ownership rates by age of household head: 1998-2001 and 2011-2014

Four-year averages



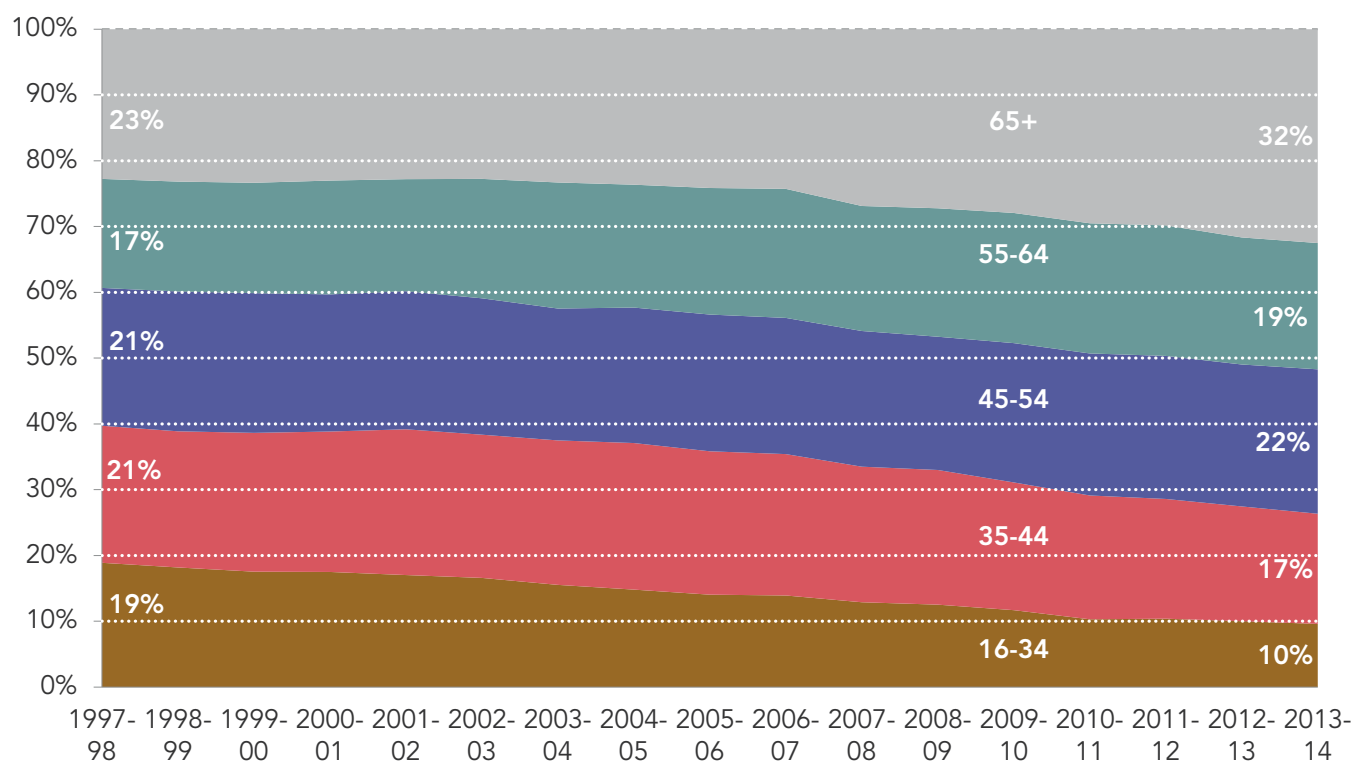
Source: RF analysis of DWP, Family Resources Survey

The solid line shows homeownership rates by individual age in the four years between 2011 and 2014, with the dotted line setting out rates in the period 1998-2001. The lines are then coloured to show the experiences of different generations.

It shows that homeownership rates among Millennials (those born between 1982 and 2004) are on average 16 percentage points lower than those recorded by Generation X (1965-1981) at the same ages. Members of Generation X in turn find themselves with ownership rates that are 10 percentage points lower than the preceding generation of Baby Boomers (1946-1964).

Only the over-60s – comprising older Baby Boomers and younger members of the Greatest Generation (before 1944) – record higher ownership rates than their predecessors. On average, homeownership is 7 percentage points higher among this group than the corresponding age group in 2001.

As Figure 22 highlights, the result of these shifting patterns is that the over-64s now account for around one-third (32 per cent) of all homeowners, up from less than one-quarter (23 per cent) in 1998 – an increase of 43 per cent. In contrast, those aged 16-34 account for just 10 per cent of homeowners, down from 19 per cent in 1998 – a 49 per cent reduction. Taken together, the under-45s account for around one-quarter (27 per cent) of homeowners, down from 40 per cent in 1998 – a 45 per cent decline.

Figure 22: Change in homeownership shares by age: UK 1997-98 - 2013-14*Share of homeownership by age of household head*

Source: RF analysis of DWP, Family Resources Survey

With pressures being felt most acutely among those on low to middle incomes

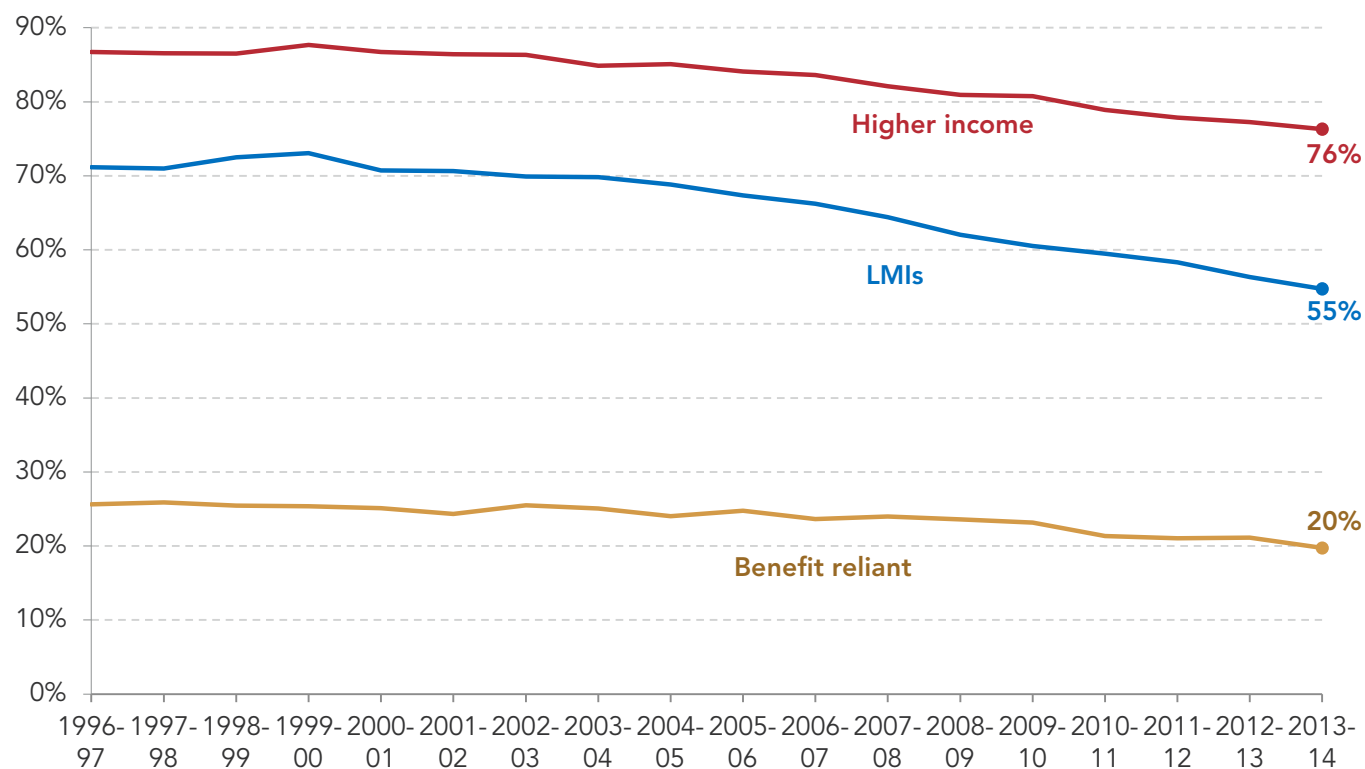
While the reduction in homeownership has been felt across all parts of the income distribution, the decline has been sharpest among those on 'low to middle incomes' (LMIs),^[5] as highlighted in Figure 23.

It shows that LMI homeownership fell from a peak of 73 per cent in 2000 to just 55 per cent in 2014 – a drop of 25 per cent. While 'higher income' ownership also fell – from 88 per cent to 76 per cent – this reduction is smaller in relative terms at 13 per cent. Ownership among benefit-reliant households dropped by 22 per cent over the same period, from 25 per cent to 20 per cent.

[5] The Resolution Foundation has an explicit focus on low to middle income households. We define the group as including those on below-average incomes who remain largely independent of state support. More specifically, it covers working-age adults situated between the 10th and 50th percentiles of the working-age household income distribution who receive less than one-fifth of their income from means-tested benefits (excluding tax credits). We define two other groups in relation to LMIs: 'benefit-reliant' households are those in the bottom 10 per cent of the working-age income distribution and those receiving more than one-fifth of their income from means-tested benefits; and 'higher income' households cover those in the top half of the working-age income distribution. Pensioner households are excluded from this analysis. See Annex 2 for a fuller definition and further statistics.

Figure 23: Change in homeownership by income group: UK 1996-97 - 2013-14

Proportion of households



Notes: Income groups based on FRS definition: see Annex 2. Change in categorisation of benefits and tax credits in 2000-01 means that the composition of the LMI group changed somewhat in that year, meaning comparisons should be made with caution.

Source: RF analysis of DWP, Family Resources Survey

Table 1 provides a more detailed split of tenure within each income group in 2013-14. It shows that roughly one-in-five (19 per cent) LMI households live in social housing, with just over one-in-four (27 per cent) in private rented accommodation.

Table 1: Housing tenure among households by income group: UK 2013-14

	Benefit-reliant	LMIs	Higher income	All households
Owners	20%	55%	76%	58%
Owned with mortgage	10%	36%	57%	41%
Owned outright	10%	18%	19%	17%
Social housing tenants	48%	19%	4%	17%
Rented from housing association	22%	9%	2%	8%
Rented from council	26%	9%	2%	9%
Private renters	32%	27%	20%	24%
Unfurnished	28%	20%	15%	19%
Furnished	4%	7%	5%	5%
All households	100%	100%	100%	100%

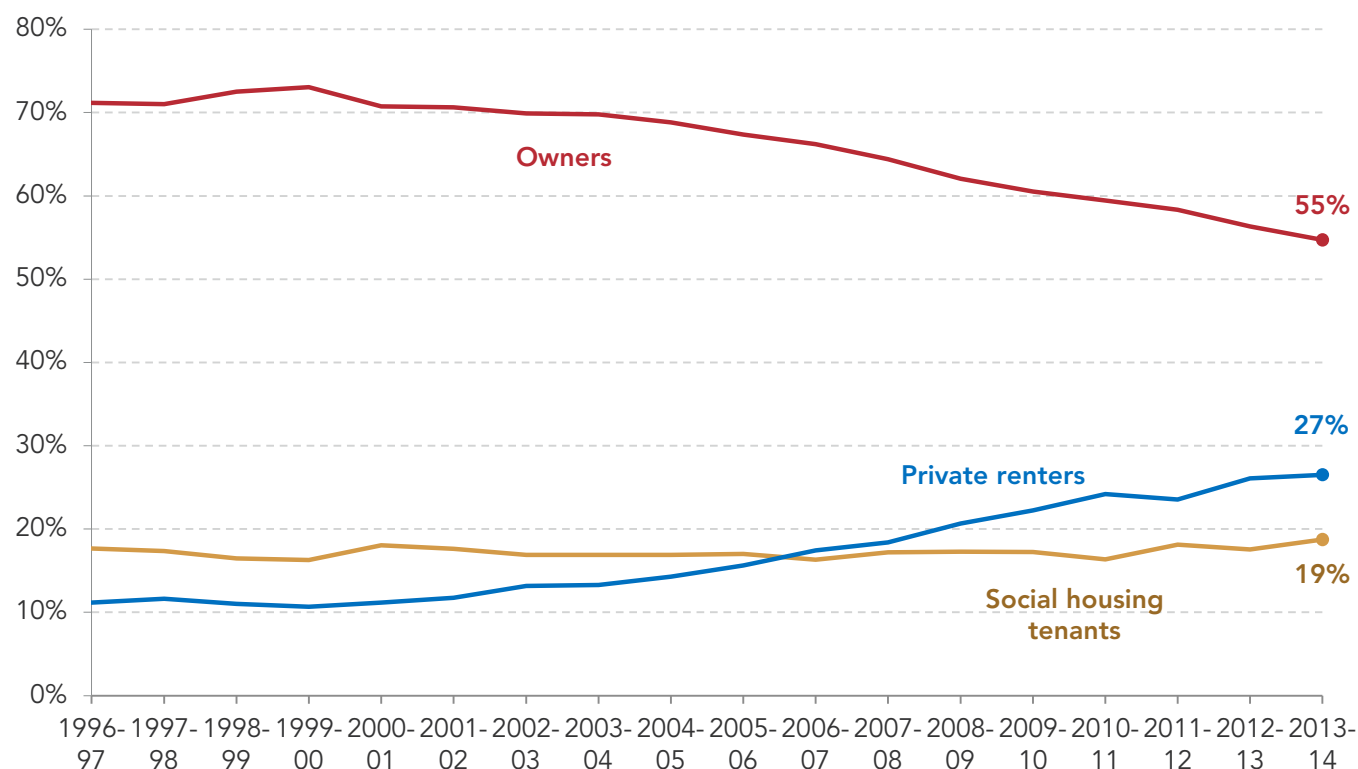
Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Figure 24 charts the shift in the tenure mix among low to middle income households over time. Alongside the sharp fall in ownership, it highlights the surge in private renting within the group. It has gone from being the least used tenure by LMIs as recently as the mid-2000s, to now accounting for more than a quarter.

Figure 24: Change in tenure among low to middle income households: UK 1996-97 - 2013-14

Proportion of households



Notes: Income groups based on FRS definition: see Annex 2. Change in categorisation of benefits and tax credits in 2000-01 means that the composition of the LMI group changed somewhat in that year, meaning comparisons should be made with caution.

Source: RF analysis of DWP, Family Resources Survey 2013-14

And by younger LMIs in particular

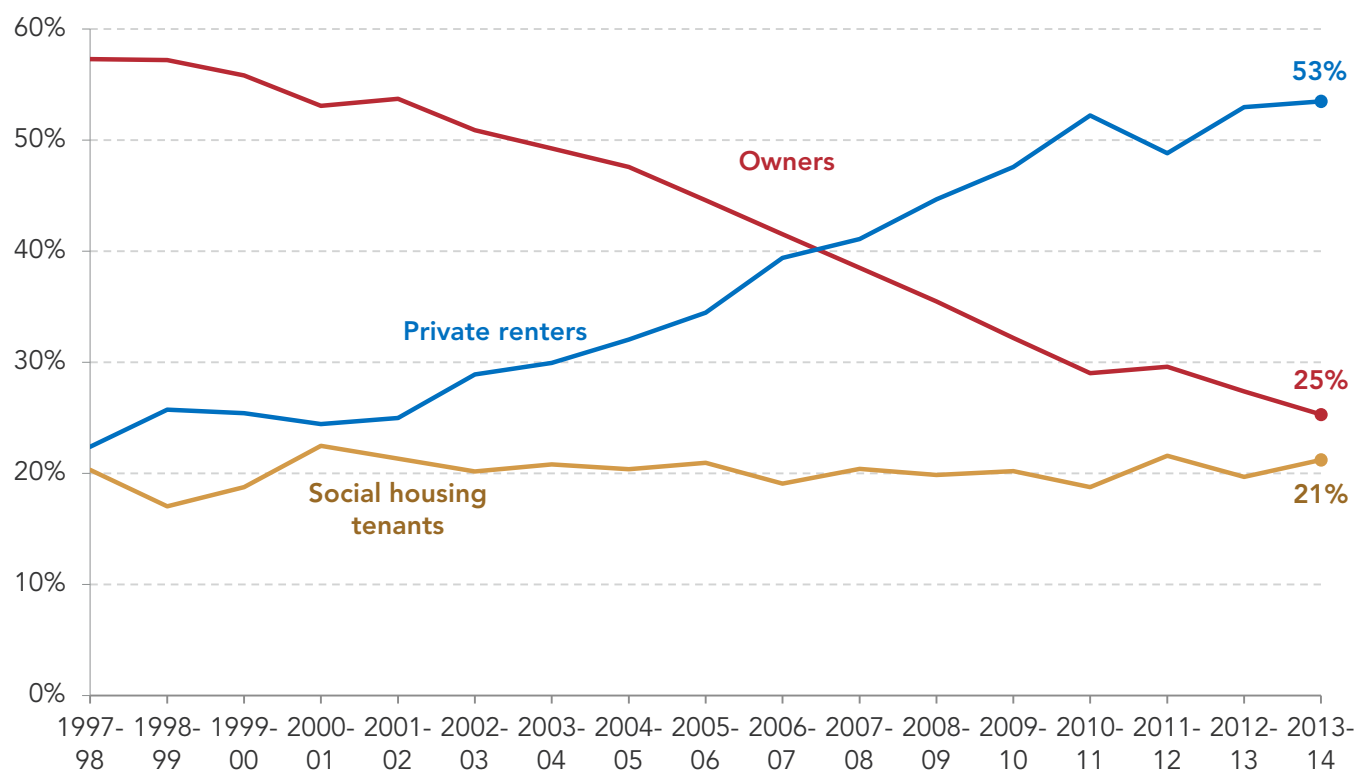
The picture is even starker when focusing on those low to middle income households headed by someone aged under-35. Figure 25 shows that homeownership within this group has dropped by 56 per cent since 1998, from 57 per cent to just 25 per cent. Maintaining the current pace of reduction, ownership among younger low to middle income households would drop to 13 per cent by 2025 and fall below 10 per cent by 2030.

In contrast, private renting has jumped by 139 per cent, from 22 per cent in 1998 to 53 per cent in 2014. It overtook homeownership as the most common form of tenure for younger LMIs in 2008 and members of the group are now twice as likely to live in private rented accommodation as in their own home.

Social renting among this younger group is broadly in line with the overall group trend shown in Figure 24.

Figure 25: Change in tenure among low to middle income households aged under-35: UK 1997-98 - 2013-14

Proportion of households

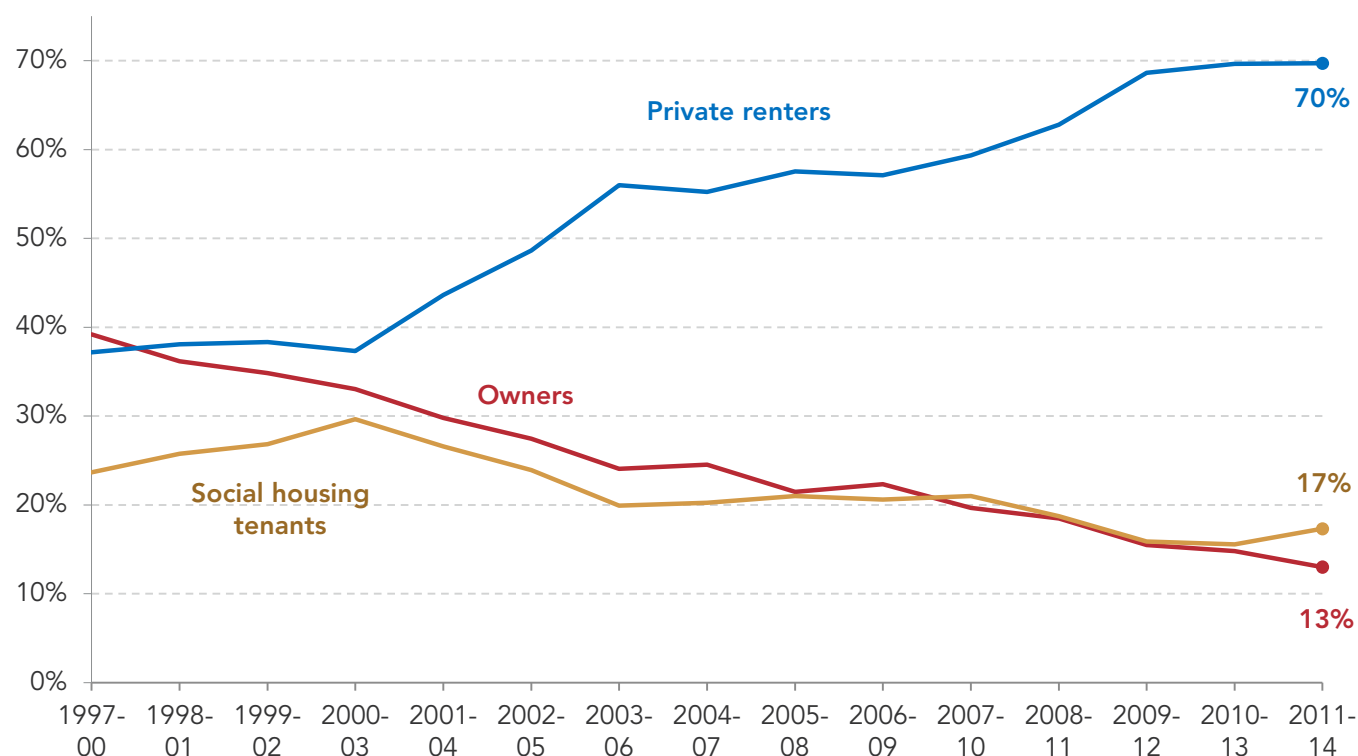


Notes: Income groups based on FRS definition: see Annex 2. Change in categorisation of benefits and tax credits in 2000-01 means that the composition of the LMI group changed somewhat in that year, meaning comparisons should be made with caution.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Looking at the same under-35 group of LMIs in London, Figure 26 shows that homeownership has plummeted by two-thirds (67 per cent), from 39 per cent in 2000 to just 13 per cent in 2014. Again we can consider what might happen if home ownership were to continue to decline at the same rate – finding that it would drop below 5 per cent by 2025.

The chart also shows that younger LMIs in London are now more likely to live in social housing (17 per cent) than in their own home. Conversely, private renting among the group has increased 87 per cent, from 37 per cent in 2000 to 70 per cent in 2014.

Figure 26: Change in tenure among low to middle income households aged under-35: London 1997-2000 - 2011-14*Three-year averages*

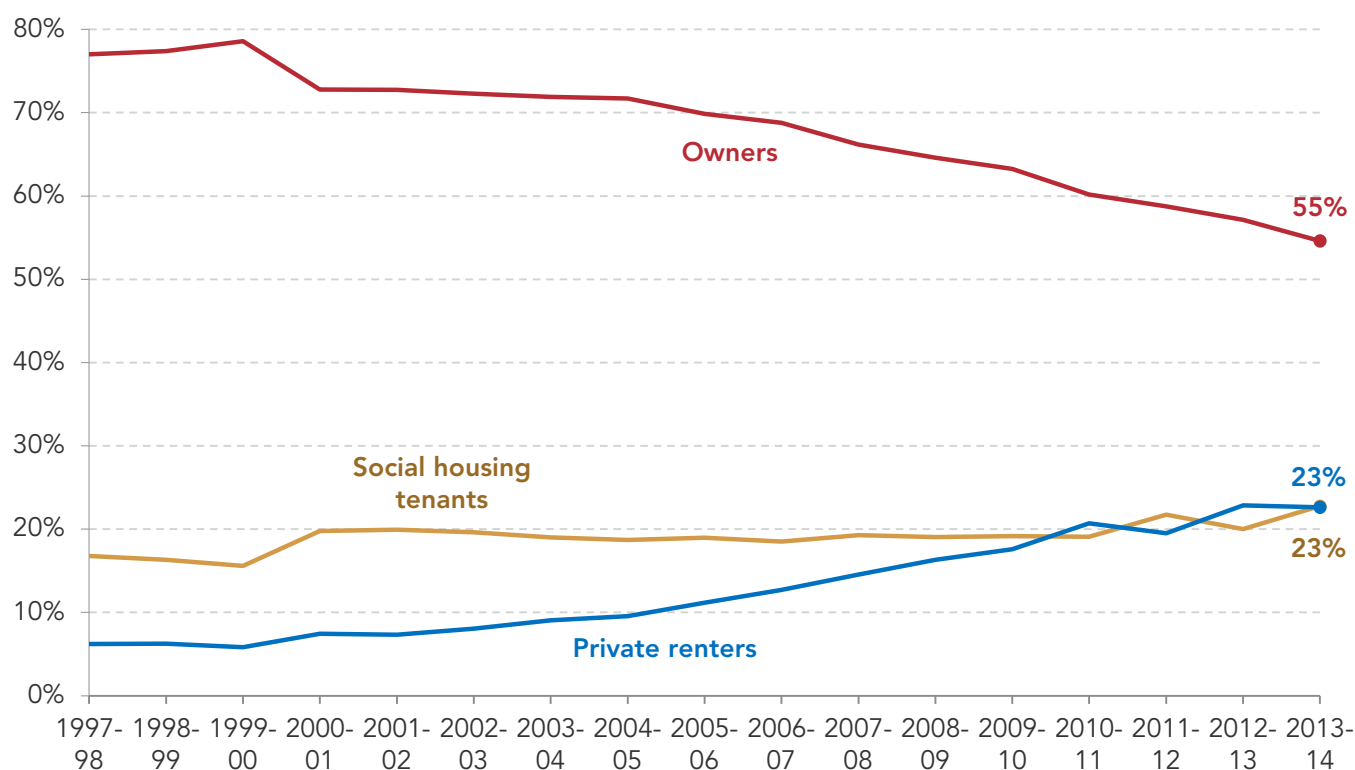
Notes: Income groups based on FRS definition: see Annex 2. Change in categorisation of benefits and tax credits in 2000-01 means that the composition of the LMI group changed somewhat in that year, meaning comparisons should be made with caution. We use three-year averages to account for the smaller sample sizes associated with focusing on London.

Source: RF analysis of DWP, Family Resources Survey 2013-14

LMI families are also increasingly shifting towards renting

The shift in tenure is not just restricted to younger low to middle income households – there has also been a big switch from ownership to renting among those with children. As Figure 27 details, ownership among families has fallen by almost one-third (31 per cent) since 2000, dropping from 79 per cent to 55 per cent. In contrast, private renting has nearly quadrupled, from 6 per cent in 2000 to 23 per cent in 2013-14.

While not as sharp as the drop among younger LMIs, the shift is potentially more challenging due to the relative lack of appropriate, good quality, family size accommodation available for rent.

Figure 27: Change in tenure among low to middle income households with children: UK 1997-98 - 2013-14*Proportion of households*

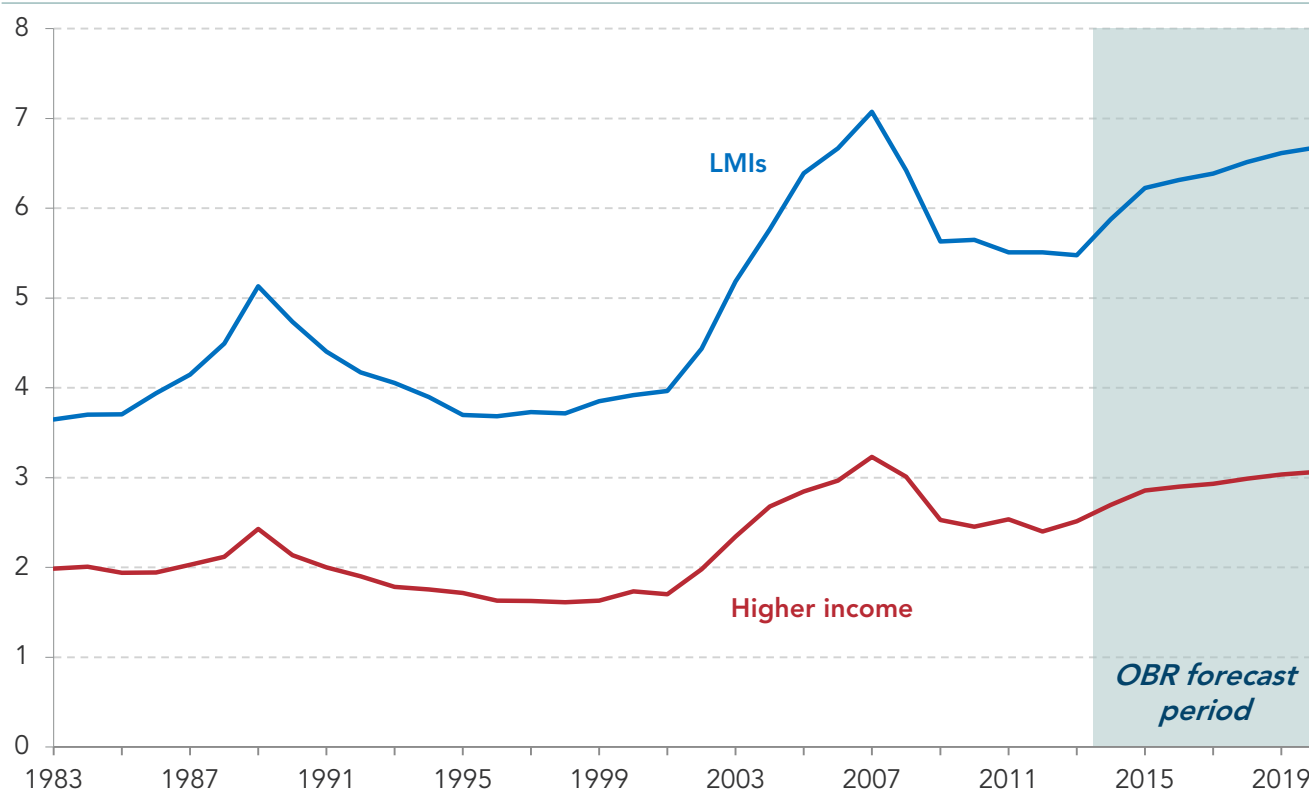
Notes: Income groups based on FRS definition: see Annex 2. Change in categorisation of benefits and tax credits in 2000-01 means that the composition of the LMI group changed somewhat in that year, meaning comparisons should be made with caution.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Homeownership has become increasingly unaffordable for LMIs

Falling levels of ownership at the national level reflect the fact that house prices – including first time buyer homes – have risen much more quickly than incomes over the last decade. But this reduced affordability has been more apparent for LMIs than for higher income households, as set out in Figure 28.

Figure 28: Ratios of average first time buyer house prices to average disposable household incomes by income group: UK 1983 - 2020



Notes: Income groups based on ONS definition: see Annex 2. Income projections are based on OBR projection for RHDH divided by population projections; first time buyer house price projections are simple OBR projections of all house prices.

Source: Analysis of ONS, *The effects of taxes and benefits on household income*; Lloyds Banking Group, *Halifax House Price Index*; OBR, *Economic and fiscal outlook*, November 2015

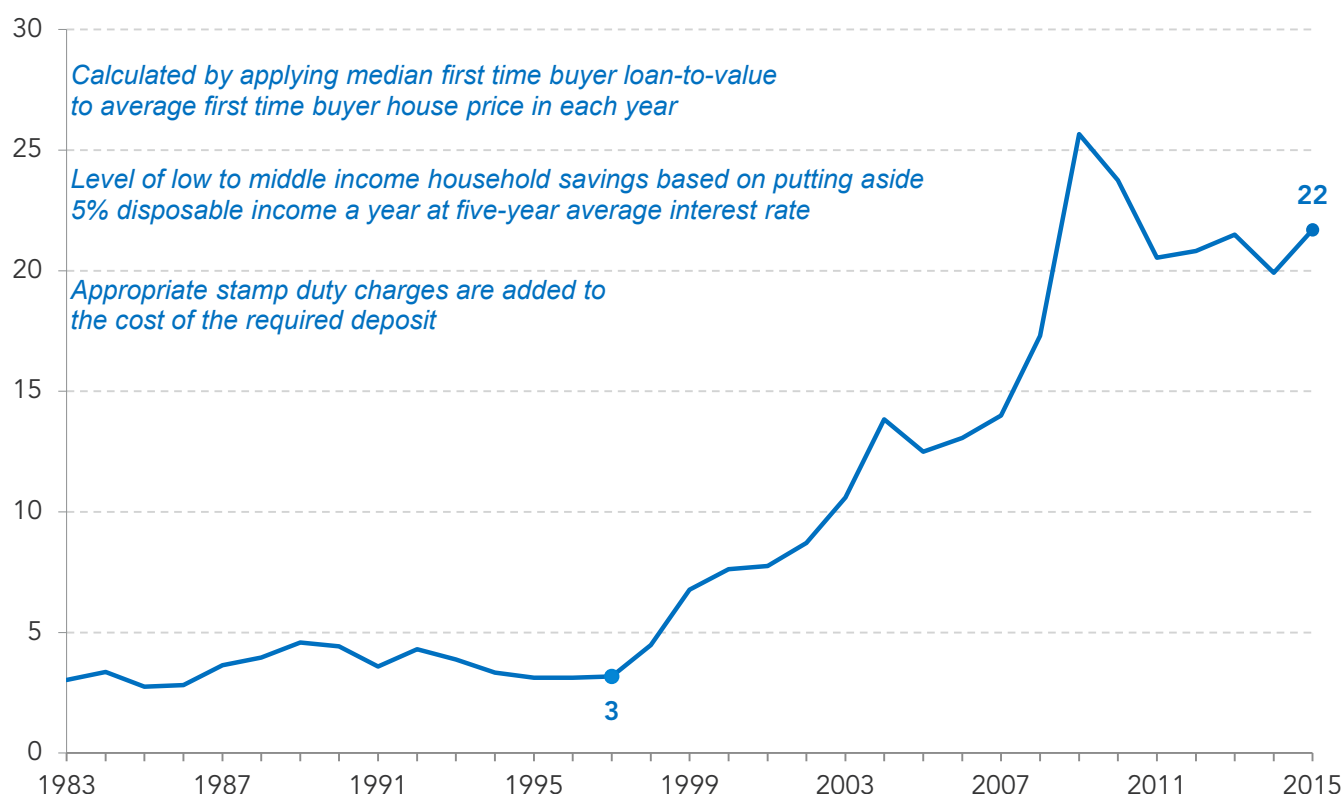
The average first time buyer home cost 3.9 times the average low to middle household income in 1999. It rose to 7.1 times just before the financial crisis in 2007. Despite some house price correction thereafter, it is projected (based on a simple application of OBR projections for disposable income per head and house prices) to head back towards a multiple of 6.7 by 2020 – 83 per cent higher than in 1983.

While first time buyer to household income ratios have also grown for higher income households (from 1.6 in 1999 to 3.2 in 2007 and potentially 3.1 by 2020), the increase of 54 per cent since 1983 is less marked than for LMIs.

The reduced affordability facing LMIs is particularly apparent when considering how long it takes to save towards the purchase costs associated with a typical first time buyer home. Figure 29 accounts for shifts in LMI income, first time buyer house prices, stamp duty costs, typical loans-to-value and savings rates.

Taking this approach, we estimate that the average low to middle income household would take 22 years to save the typical deposit paid on a first time buyer home today. That's down slightly from a peak of 26 years in 2009 – when lenders demanded higher average deposits in response to the credit crunch – but up from just 3 years in the mid-1990s. Clearly this doesn't reflect what families are actually doing, but instead highlights the difficulty facing would-be LMI homeowners.

Figure 29: Number of years required for low to middle income households to meet typical first time buyer purchase costs: UK 1983 -2015



Notes: Average LMI income based on FRS definition: see Annex 2. Deposit costs are calculated by applying median first-time buyer LTVs recorded in each year to mix-adjusted average (mean) first-time buyer house prices. An appropriate stamp duty charge is then added to the deposit requirement. Savings are assumed to be equivalent to 5 per cent of average annual LMI disposable incomes. These savings receive a rate of return equivalent to 90 per cent of the base rate (taken as a five-year average), in line with the relationship between average time deposits and the base rate between 2004 and 2008.

Source: Analysis of ONS, *The effects of taxes and benefits on household income*; Lloyds Banking Group, *Halifax House Price Index*; OBR, *Economic and fiscal outlook*, November 2015; CML, *Table ML2*

Requiring a new focus on housing supply rather than just demand

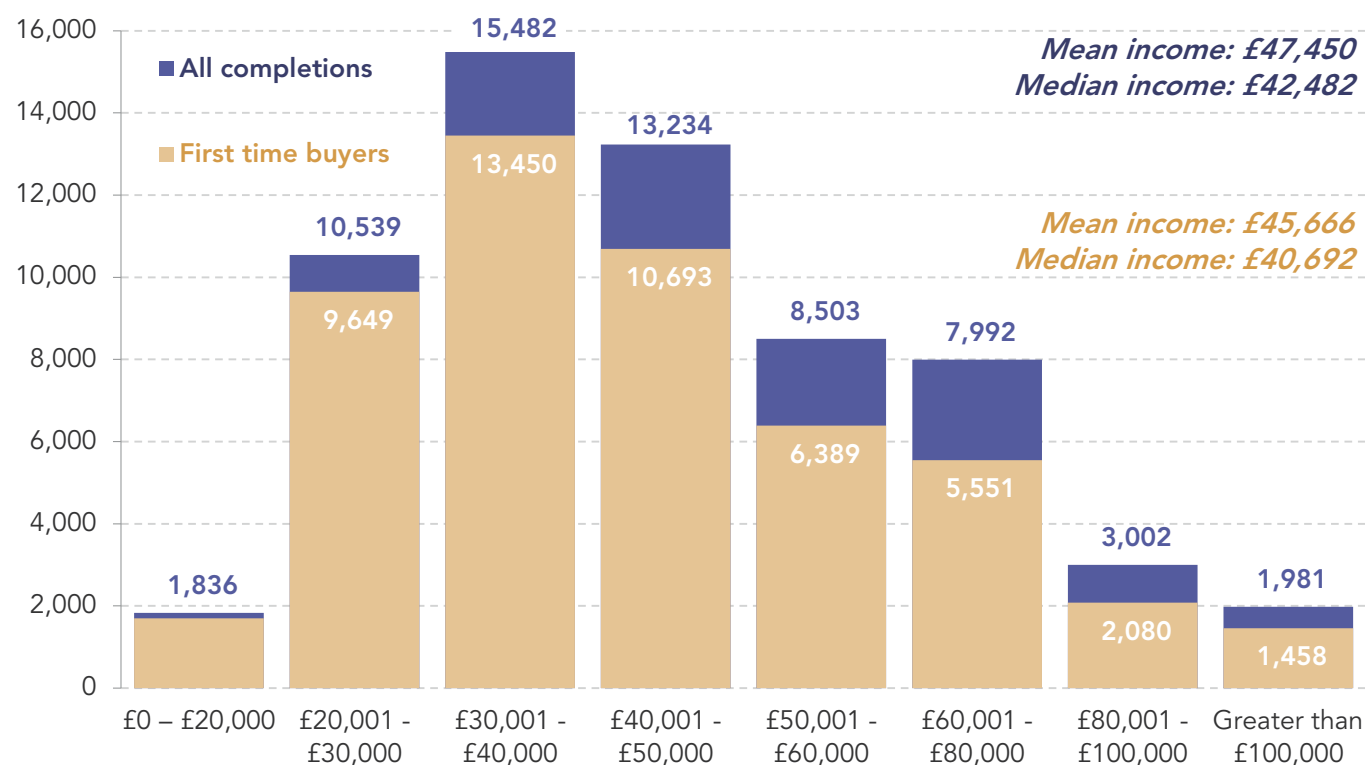
Government has responded to declining homeownership rates by introducing a number of schemes designed to increase access to the housing ladder. However, these schemes – including Help to Buy (Equity Loan and Mortgage Guarantee) and Shared Ownership – appear to be having relatively little bearing on LMI opportunities.

Figure 30 sets out all of the Help to Buy Equity Loan^[6] completions taking place during the first 30 months of the scheme (up to September 2015), split by the income band of the beneficiaries. The scheme has been accessed by around 28,000 households with incomes below £40,000, with around nine-in-ten of these cases being first time buyers. However, a majority (55 per cent) of users of the scheme report incomes in excess of £40,000, with around one-in-five having incomes above £60,000.

^[6] The scheme allows for property purchases up to £600,000 with a maximum equity loan from government of 20 per cent. After accounting for the purchaser deposit and equity loan, the remaining balance must be financed through a mortgage which is not in excess of 4½ times the applicant's household income. For example, a £600,000 property, with a 5 per cent purchaser deposit (£30,000) and a 20 per cent equity loan (£120,000) must fund the remainder of the purchase through a mortgage (£450,000). In this instance, the total applicant household income must be at least £100,000 per annum.

Figure 30: Total number of Help to Buy Equity Loan completions to 30 September 2015, by income band of household: England

Number of completions



Notes: Total applicant household income as registered on the Help to Buy Property Information Form completed at the point of reservation. Income brackets presented here reflect total applicant household income, which does not discriminate between single person applications and joint applications under the scheme.

Source: CLG, Help to Buy (Equity Loan scheme) and Help to Buy: NewBuy statistics: Data to 30 September 2015, England, December 2015

Overall, the mean income of those taking advantage of the loans is £47,450, dropping only slightly to £45,666 among first time buyers. The average purchase price to date is just under £220,000. Similar statistics for the first 23 months of the Help to Buy Mortgage Guarantee^[7] show that the mean income of recipients is around £45,300.^[8]

These income bands aren't equivalised, meaning we can't directly map the results onto our LMI definition, but it appears likely that the scheme is in many instances providing a welcome leg-up for those who would eventually get onto the housing ladder anyway. Ultimately, the fact that just 63,000 homes have been purchased using the Help to Buy Equity Loan and 65,920 using the Mortgage Guarantee – relative to a non-homeowning LMI population of 2.6 million households for instance – highlights that such schemes can only ever make a marginal contribution to the nation's housing deficit.

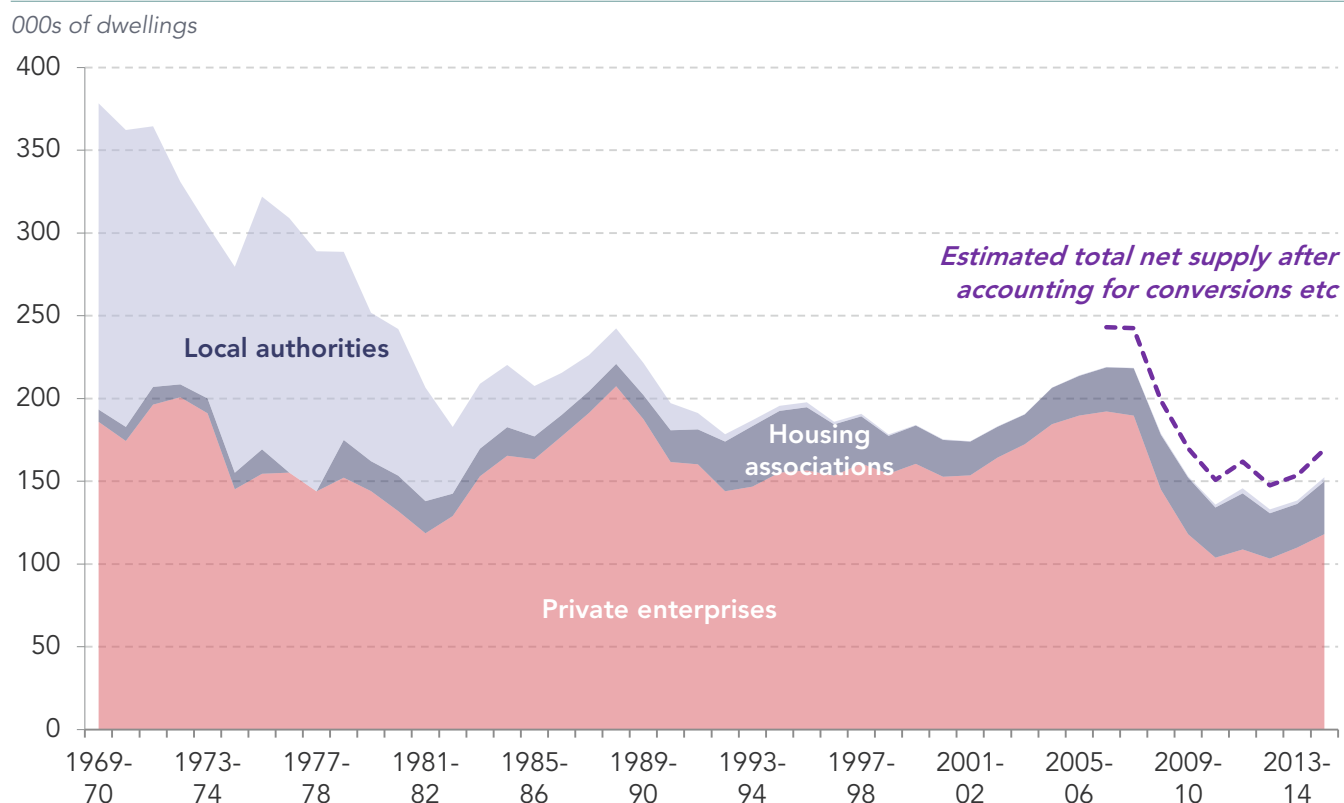
^[7] This is a temporary scheme that will run for three years from January 2014 with the aim of increasing the supply of high loan-to-value mortgages. It offers a government guarantee to lenders who offer mortgages to people with a deposit of between 5 per cent and 20 per cent; is open not only to first-time buyers but also to existing homeowners; has no income cap constraint; and is available on homes with a value of up to £600,000.

^[8] HM Treasury, Help to Buy mortgage guarantee scheme quarterly statistics: October 2013 to September 2015, December 2015.

Shared Ownership^[9] has the potential to open up ownership more widely across the income distribution because it deals not just with the barriers associated with deposit costs but also with ongoing mortgage costs – something that can be particularly problematic in high cost areas of the country. However, it remains very limited in scope. LMI households account for around one-quarter (26 per cent) of all shared owners, with higher income households comprising 54 per cent. But overall the numbers are low, with shared ownership accounting for just 0.7 per cent of all low to middle income homes.^[10]

These various demand management schemes fail to deal with the underlying problem of house prices that are inflated relative to wages and incomes. This in turn has been underpinned by a generalised slowdown in housebuilding over recent decades, exacerbated by the fallout from the financial crisis. As Figure 31 shows, total completions of 152,000 in 2015 compare with 378,000 in 1970 – a drop of 59 per cent.

Figure 31: Permanent dwellings completed each year: UK 1969-70 - 2014-15



Source: CLG, Live Table 209

Reversing this decline is likely to be a necessary part of any approach designed to widen access to homeownership and bring it back within reach of working household on modest incomes, but this is clearly not a straightforward task. It is an issue we'll return to in future work.

[9] Available to first time buying households with earnings of £60,000 a year or under (£71,000 in London for a one or two bedroom property and £85,000 a year in London for a three or more bedroom property).

[10] DWP, Family Resources Survey 2013-14

Section 5

The living standards outlook: back to the future?

Heading towards the conclusion of the last parliament, the key living standards debate centred around whether household incomes had yet regained their pre-crisis levels: seven years after the financial crisis hit, there was still a question mark over the durability of the recovery. Questions remain, not least given signs of slowdown in some emerging markets, but the UK is currently enjoying high employment, low inflation and a return to wage growth. The central view is that living standards will continue their long climb back over the course of this parliament.

Yet experiences of the downturn and the early recovery have varied significantly across society. As we have set out above, working-age households have fared less well than pensioners on average, while outcomes in Scotland look very different from those in the West Midlands. We might therefore expect the living standards focus to increasingly switch towards the distribution of gains from growth – identifying those who are missing out and considering how their circumstances might be improved.

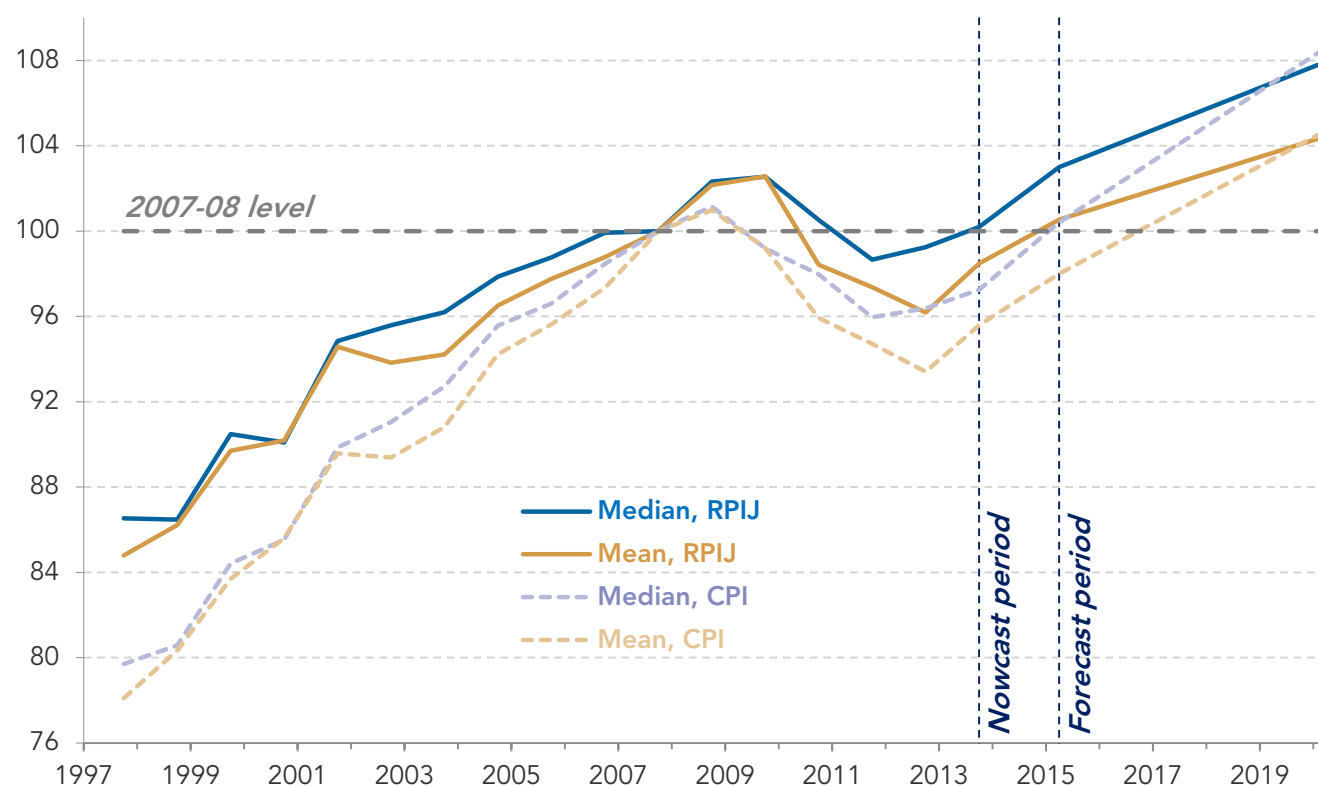
In this section, we build on our 2015 nowcast by forecasting incomes in 2020 (see Box 3), allowing us to draw some – necessarily tentative – conclusions about how incomes will grow for different groups in the coming years.

Income growth is set to grow steadily

Looking first at the headline findings, Figure 32 shows that mean and median incomes are expected to grow steadily, albeit slowly, over the coming years. Growth is set to be a little stronger when measured using CPI, due to the impact of rising mortgage costs on RPIJ, but all measures are estimated to have surpassed their post-crisis peaks by 2017.

Figure 32: Indices of weekly net household income: UK 1997-2020

2007-08 = 100 (before housing costs)



Source: RF analysis of DWP, Family Resources Survey and nowcasting/forecasting

i Box 3: Forecasting to 2020

Our forecast rolls forward the 2015 nowcast data set out in Sections 2 and 3 to 2020. It follows a similar methodology, but uses projections of inflation, employment, population, earnings and housing costs (taken from either the OBR or from announced government policy) rather than outturn data.

Where we have no way of sensibly predicting how change might be distributed – in relation to the characteristics of tomorrow's workers for instance – we apply average historic changes. However, where we are able to be more definitive, we apply focused changes in order to bring out the distributional outcomes.

This is most apparent in relation to pay. The introduction of the National Living Wage (NLW) will provide a significant pay boost for around six million lower paid employees (both those being directly affected and those benefiting

from 'spillover' effects). We therefore apply the NLW in a detailed way – following earlier modelling we have undertaken* – and subsequently boost the earnings of those not affected by the measure in a way that ensures overall earnings growth matches the OBR's projection.

By casting further forward and relying on projections which are by definition unknown, the findings are even more subject to uncertainty than those associated with our nowcast. Our results should therefore be considered indicative only.

See Annex 1 for more details.

* See for example, C D'Arcy, A Corlett & D Finch, *Higher ground: Who gains from the National Living Wage?* September 2015

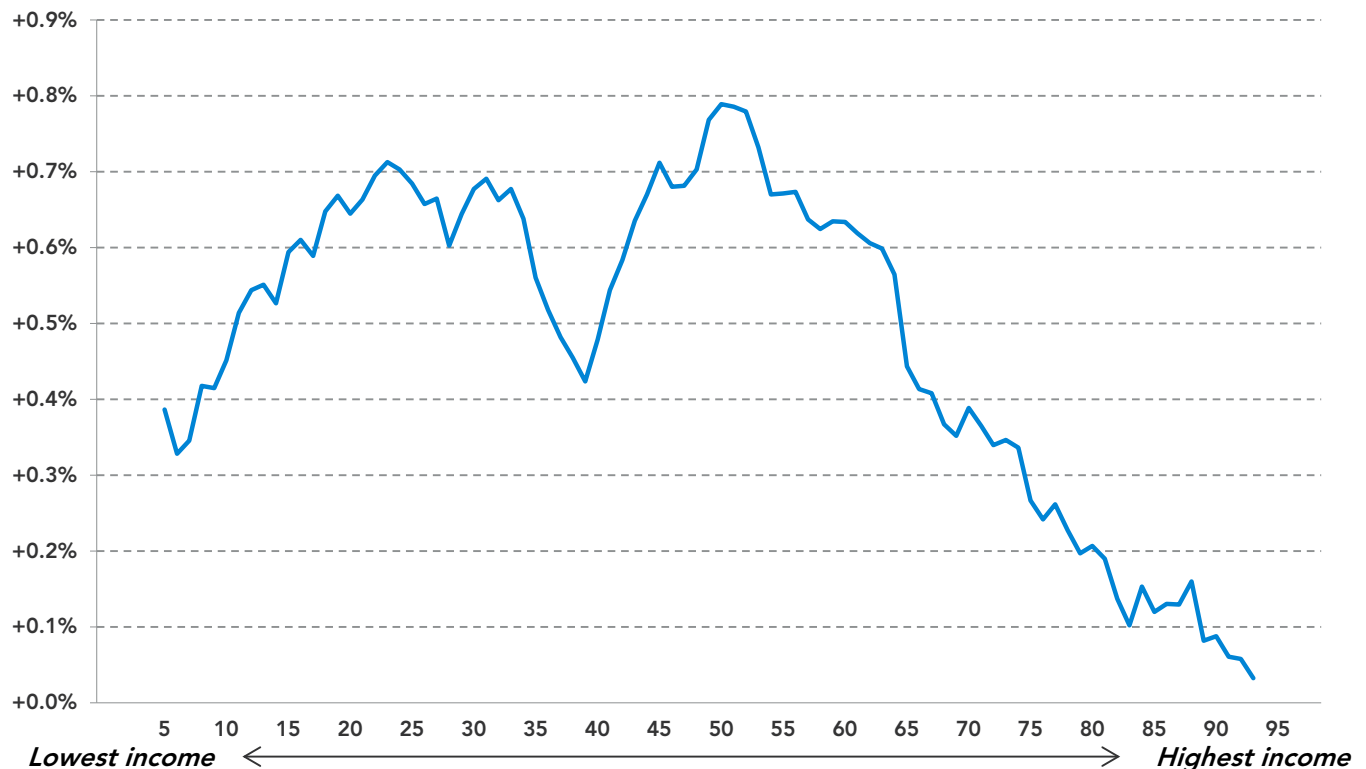
With the biggest gains coming in the top half of the income distribution

Digging beneath the headlines, we can again consider how this income growth is split across the distribution. As discussed in Section 2, benefit cuts are expected to drag on working-age incomes over the rest of the parliament, especially for those on lower incomes. However, the introduction of a new minimum wage supplement (the National Living Wage, or NLW) is designed to simultaneously boost pay at the bottom of the earnings distribution.

This is a significant and very welcome move. However, our analysis has shown that it does not provide a straight compensation for those losing out in terms of cuts in support. Figure 33 sets out our estimate of the gains accruing from the NLW across the income distribution by 2020. Two things stand out. First, the average income gains are modest, amounting to no more than 0.8 per cent of income in any given percentile. Secondly, the gains are evenly felt across the bottom three-quarters of the income distribution, reflecting the fact that low earners do not necessarily live in low income households. Indeed, small gains are recorded all the way up the income distribution.

Figure 33: Income boost associated with the National Living Wage in 2020

Change in net household income due to NLW, by position in equivalised distribution



Source: RF analysis

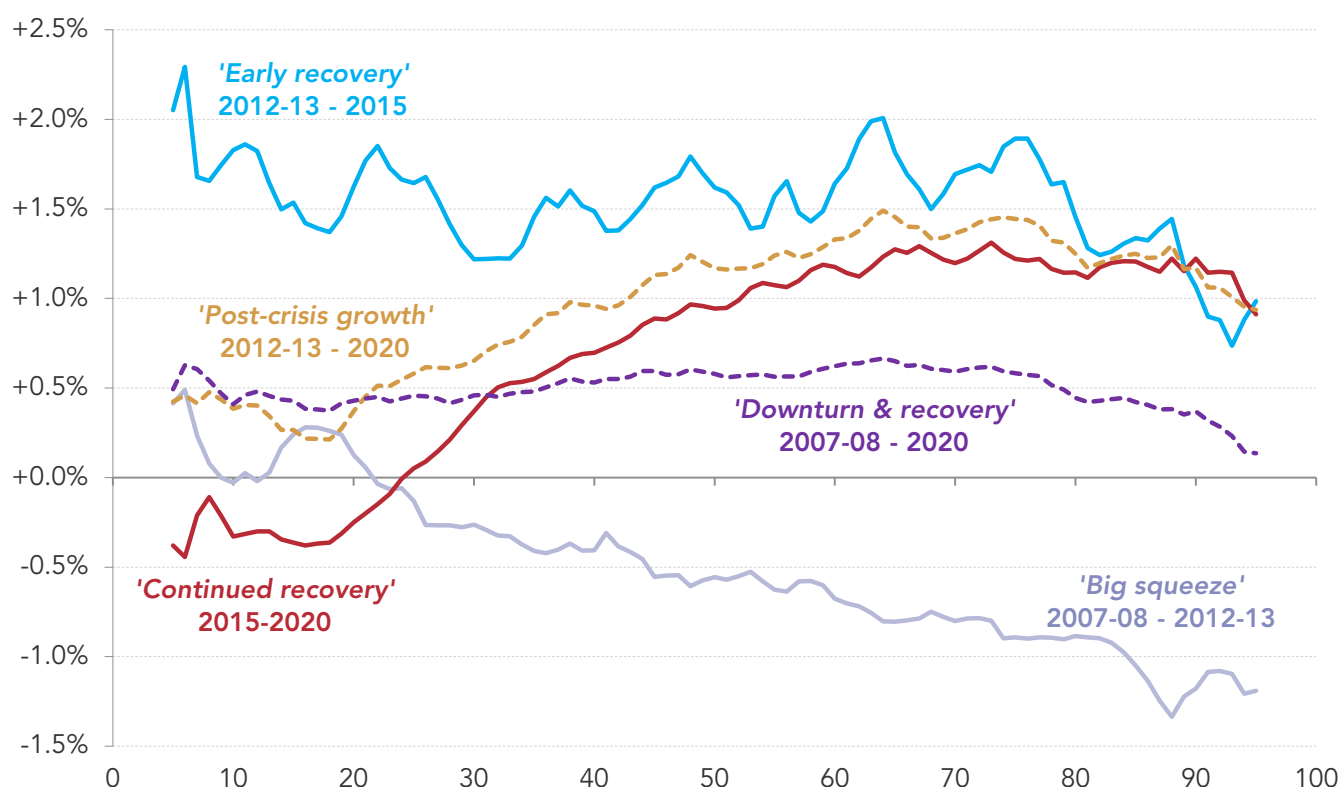
Accounting for these wage and benefit trends, along with a range of other projections, Figure 34 shows that our 'continued recovery' period of 2015-2020 raises income most in the top half of the income distribution. Indeed, the bottom quarter of households record small average annual losses. The shape of this growth is somewhat reminiscent of the 'pre-crisis slowdown' presented in Figure 12.

The gold dotted 'post-crisis growth' line stitches together our nowcast and forecast to provide an estimate of average annual growth in the entirety of the post-2012 period. Its upward slope implies that the recovery is set to reverse the reductions in income inequality recorded over the course of the downturn.

This outcome is reflected in the 'downturn & recovery' line which covers 2007-2020 and show that the post-crisis period as a whole looks set to produce average annual growth that is even and low by historic standards.

Figure 34: Average annual income growth in selected periods: UK 2007-2020

Average annual growth in real disposable household income, by income percentile (RPIJ-adjusted)



Notes: Percentiles at the extreme top and bottom of the distribution are excluded for reasons of robustness.

Source: RF analysis of DWP, Family Resources Survey and nowcasting/forecasting

Housing cost trends are uncertain, but likely to pull back on income growth slightly

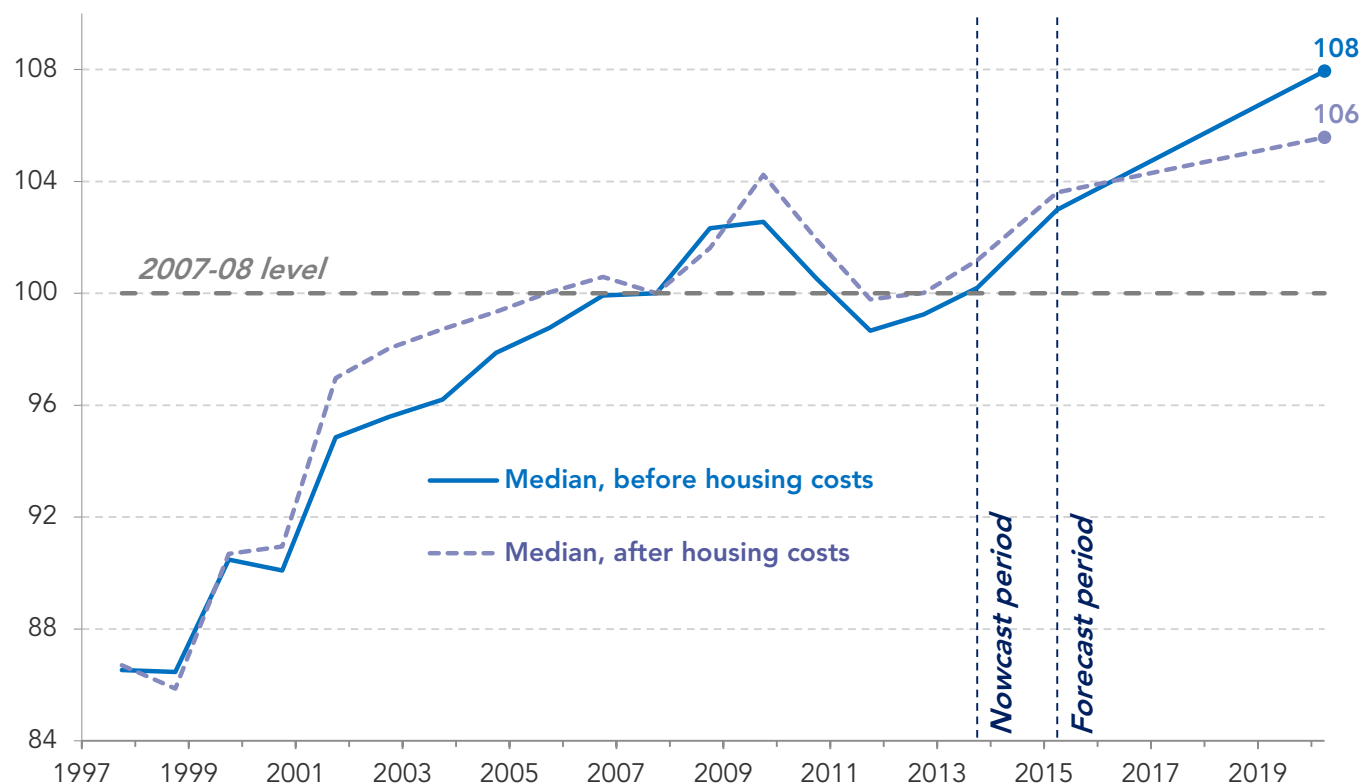
While our forecast includes projections for changes in housing costs across different tenure types, the outcome is particularly uncertain – not least because we can expect households to switch tenures in the coming years in reaction to price changes. It is also very sensitive to movements at the extremes of the distribution. For that reason, we choose not to show average AHC data in this section. Nor do we set out AHC measures across different types of households.

Instead, Figure 35 presents BHC and AHC versions of *median* income for the purposes of illustration. The implication is that income will grow more slowly on an AHC basis than on a BHC one, reflecting

expectations of rising mortgage costs once interest rates (eventually) start to rise. However, even on this measure median income is expected to surpass its 2009 peak within the next year.

Figure 35: Indices of weekly household income before and after housing costs: UK 1997-2020

2007-08 = 100 (RPIJ-adjusted)



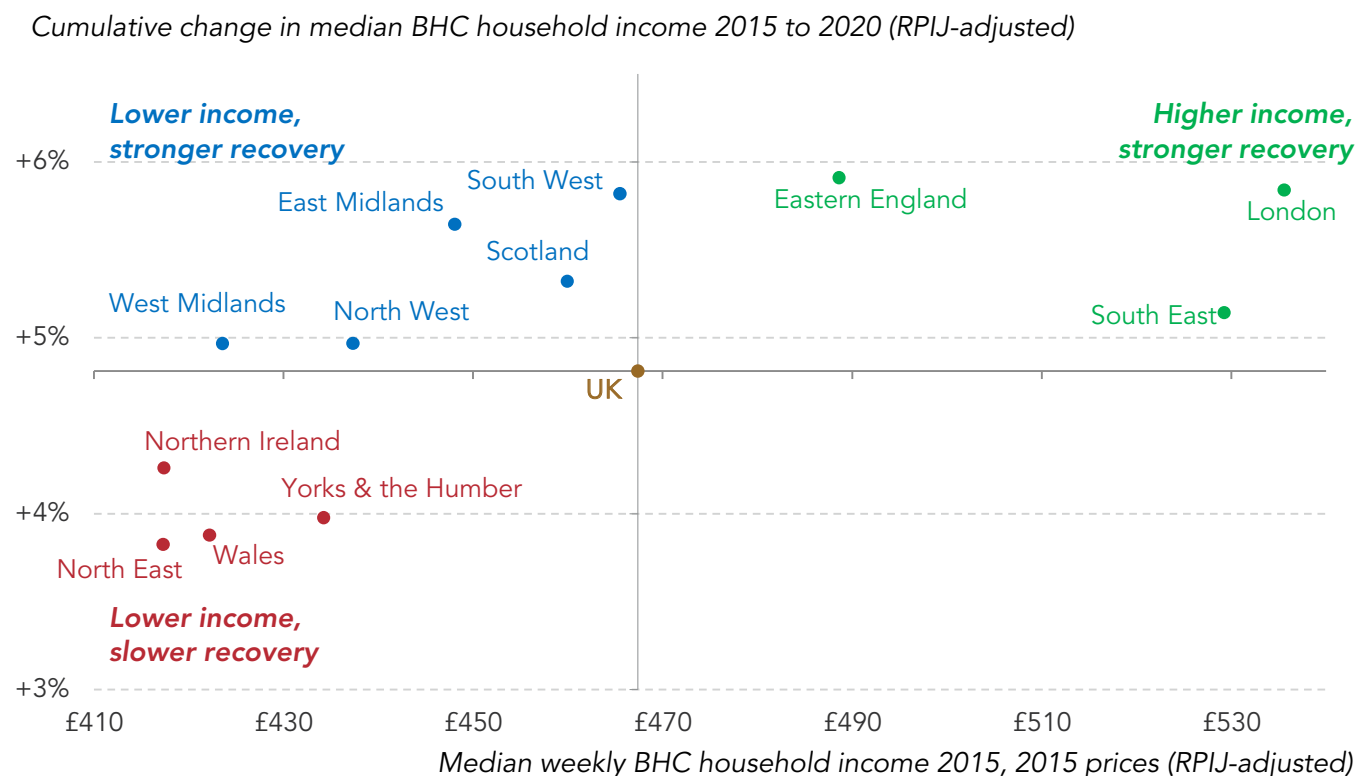
Source: RF analysis of DWP, Family Resources Survey and nowcasting/forecasting

Uneven income growth could reinforce the North-South split

Continuing with the BHC measure of income, Figure 36 presents a potential picture of regional income growth distribution in the 'forecast recovery' phase. To be clear, these regional projections are not based on any assessment of how the local economies might develop. Instead they are the product of applying national projections and therefore rest on the specific compositional make-up of each area.

With that in mind, the results should be treated as little more than indicative. What they imply however, is that the return of income inequality set out in Figure 34 would – all else equal – also lead to a return to geographical inequality. The higher income regions of Eastern England, the South East and London are therefore shown to experience above-average levels of income growth. In contrast, lower income areas such as the North East, Northern Ireland, Wales and Yorkshire and the Humber are found to record below-average levels of income growth.

Figure 36: Median household income and income growth, before housing costs: UK



Source: RF analysis of DWP, Family Resources Survey and nowcasting/forecasting

However, this is not true across the board, with the relatively low income areas of the West Midlands, the North West, the East Midlands, Scotland and the South West also experiencing above-average growth in our forecast.

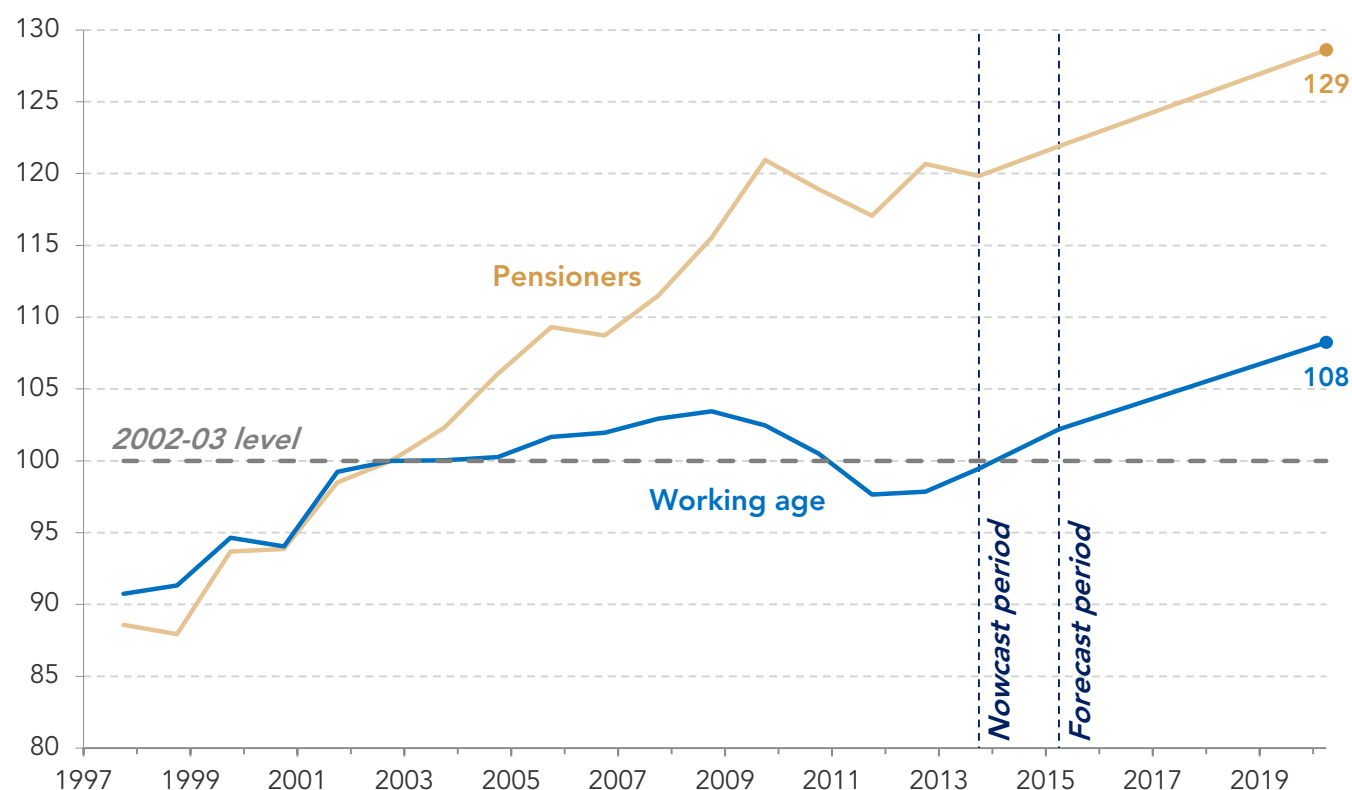
Growth is likely to be more evenly shared across the generations

Finally in this section, we consider how income growth might differ by age. As discussed in Section 3, the divergence of experience recorded by pensioners and working-age households in the post-crisis period is a product of a prolonged wage squeeze on the one hand, and new pensioner protections on the other.

The 'triple lock' on the state pension, introduced in 2010, guarantees that the state pension will rise by the higher of wages, inflation or 2.5 per cent each year. During a period of falling real-terms pay, this meant that pensioner incomes regularly increased more quickly than the incomes of those in work.

With wages set to grow broadly in line with their pre-crisis trend in the coming years, the expectation is that this advantage will come to an end. However, the state pension will continue to rise in line with these growing wages (or by 2.5 per cent if wage growth doesn't pick up), meaning that none of the gap opened up over the course of the downturn is likely to be narrowed.

Figure 37 appears to confirm this, showing median incomes in working-age and pensioner households growing broadly in step with each other after 2015. As a result, by 2020, pensioner incomes are projected to be 29 per cent above the 2002 level, while working-age incomes will be just 8 per cent higher.

Figure 37: Household income growth by age: UK 1997-2020*Indices of median net weekly household income, 2002-03 = 100 (RPIJ-adjusted)*

Source: RF analysis of DWP, Family Resources Survey and nowcasting/forecasting

As stated, the findings in this section are inherently uncertain and should be treated with caution. But they highlight the potential for continued divergence in the income trends of households across the country. Indeed, it is likely that we will see some return of income inequality in the coming years, reversing the gains made since 2007. And it is likely too that different parts of the country will enjoy faster levels of income growth than others. Generationally, there is little prospect of younger cohorts reclaiming any of the 'lost income growth' of recent years.

Despite the very welcome good economic news of 2015 – and as we cover in Annex 3 – for millions of low to middle income households, the economic outlook remains uncertain.

Annex 1: Methodology

As discussed in the body of the report, our living standards analysis is underpinned by two pieces of modelling which aim to, first, ‘nowcast’ household incomes as reported in the *Family Resources Survey 2013-14* into 2015 and, secondly, to forecast outcomes through to 2020. In this annex we provide some more detail on the processes behind these approaches.

Nowcasting

Nowcasting involves the use of outturn data from timely data sources in order to roll forward more detailed data from less timely sources. Our approach is to bring forward the 2013-14 version of the DWP’s *Family Resources Survey* (FRS) by 18 months, covering the period from Q4 2014 to Q3 2015 (‘2015’ for shorthand). We use outturn data from the quarterly *Labour Force Survey* (LFS - pooled over four quarters) in order to determine the trends in pay, employment, and family status over those 18 months.

On pay, we establish 60 groupings of employees. These clusters take into account region, hours worked, the public/private sector split and presence in the bottom of the earnings distribution. For example, one cluster covers full-time private sector employees in the South West (excluding the lowest paid). We choose these variables on the basis of their importance for wage growth (established using simple regressions). We calculate average change in pay in each of these LFS clusters and apply it to the same set of clusters for individuals in the FRS. For the self-employed, for whom reliable earnings data is unavailable, we apply the average growth in wages.

We also account for changes in demographics, employment and family status over time. Again we create groupings based on region, employment, family status, age and occupation and then reweight the FRS data to account for recorded changes between 2013-14 and 2015. Finally, we apply housing cost uprating factors which vary depending on the tenure held by each households. We use ONS data on private rents (and uprate London separately to reflect the very different trend in rents here), CLG data on social rents and Bank of England figures on mortgage lending and interest rates to establish reasonable growth rates.

We then run our 2012-13 and 2015 household datasets through the IPPR tax-benefit model, which we update to account for changes in tax and benefit policy. This provides us with figures for changes in net household income for each record, which we apply to the original 2013-14 FRS dataset. This produces an uprated and re-weighted ‘2015’ FRS sample, which we can cut in order to report income trends by percentile, age and region.

Forecasting

Our forecast builds on the nowcast for 2015 but takes it forward to 2020 using projections of inflation, employment, population, earnings and housing costs based on either OBR economic assumptions from the November 2015 *Economic and Fiscal Outlook* or announced government policy.

On population and employment levels, we follow a similar method to that of the nowcast but account only for changes by age, sex, economic activity status split by public or private sector employment and region. We utilise the IFS-built Stata command ‘`reweight2`’^[11] to estimate how population clusters will change by 2020.

[11] J Browne, “[REWEIGHT2: Stata module to reweight survey data to user-defined control totals](#)”, IFS, July 2012

Earnings growth overall rises in line with OBR projections, but we split this by public and private sector employment and account for the implementation of the National Living Wage^[12] and compositional effects from our reweighting procedure. Income from self-employment rises in line with the overall average earnings projection.

Changes in mortgage costs account for the OBR's expected path of both interest rates and secured debt. Private rents are assumed to rise in line with CPI inflation and social housing rents move in line with government policy.

We apply the tax and benefit regime for 2020 to account for policies announced up to and including Autumn Statement 2015. We exclude measures that have not been costed within OBR projections of government spend. We do not, for instance, model the unfunded ambition to reach a personal tax allowance of £12,500 and higher rate threshold of £50,000 by 2020.

Key measures include: increases to the personal tax allowance and higher rate threshold in April 2016 and 2017; reducing Universal Credit work allowances; freezing working-age benefits for four years from April 2016; reducing social rents by 1 per cent a year from 2016-17; removing the family element from new claims to tax credits or Universal Credit from April 2017; and limiting support to two children for new births or claims from April 2017.

To take account of the transition from the tax credit system to Universal Credit, and the impact of 'flow' measures (those that affect new claims to the benefit system but not existing claimants), we estimate a weighted change in income in 2020. Our weights are based on the fact that around half of the total savings accruing from flow measures are expected to be delivered by 2020 and the fact that over 80 per cent of tax credit cases are expected to have been moved onto Universal Credit by the same point in time.^[13] We do not account for transitional protection.

As with the nowcast, we run both our 2015 baseline and 2020 constructed dataset through the IPPR tax-benefit model.

[12] For more detail of this methodology, see C D'Arcy, A Corlett & D Finch, [Higher ground: Who gains from the National Living Wage?](#) September 2015

[13] Summer Budget policy costings, HMT (2015)

Annex 2: Defining 'low to middle'

The Resolution Foundation is concerned with improving outcomes for low to middle income households (LMIs). From a conceptual perspective, we define this group as including those who are squeezed by the workings of the modern UK economy: too poor to be able to benefit from the full range of opportunities provided by private markets, but too rich to qualify for substantial state support.

From an analytical perspective, we consider the group to include those on below-average incomes who remain largely independent of state support. While median income is relatively straightforward to establish as an upper threshold, defining when people become independent of state support is more difficult, particularly as all income groups are entitled to some welfare payments.

The statistical definition used has therefore evolved over time and has been dependent in part on limitations imposed by the data sources we have analysed. It remains unavoidably imperfect, but it is designed to ensure that as many as possible of those households that could be considered to sit within our conceptual definition are captured statistically.

Our analysis focuses on LMI *households*, in an effort to remove the distortions associated with capturing a large number of students and non-working members of high income families when adopting an *individual* approach. The cost of this approach is that, in relation to households in which income and expenditure is not equally shared, we are likely to miss some individuals who fit the LMI profile. However, in making the assumption that income is usually shared, we are consistent with the approach used by the DWP in its *Households Below Average Income* study.

The precise definition of the group varies from source to source. We therefore detail three different approaches below, corresponding to the data sources underpinning most of our statistical analysis. We use:

- » DWP's *Family Resources Survey* (supplemented with the associated *Households Below Average Income* dataset), which provides UK data at the household, family and individual level – latest data is 2013-14 (see 'FRS definition');
- » The Bank of England's *NMG Survey*, which is produced annually and provides GB data for households – latest data is September 2015 (see 'NMG definition'); and
- » ONS's *The effect of taxes and benefits on household incomes*, which is not a raw dataset but is instead derived from the *Living Costs and Food Survey*. It allows us to track incomes and compositions over a longer timeframe than is permitted by reference to the above sources (see 'ONS definition').

FRS definition

A majority of the figures presented in this report are derived from an analysis of the DWP's *Family Resources Survey* (FRS) and the associated *Households Below Average Income* (HBAI) survey, using a three-stage process, whereby we filter on the basis of age, gross income and benefit receipt.

We first remove retired households from the overall population. The reduced earnings faced by most people at retirement means that many of those considered LMIs during their working lives will fall into the benefit-reliant group in retirement, while some higher income households will drop into the LMI group. However, because such households are also likely to face reduced spending commitments, the pressures they face should be less intense than those experienced by working-age households in corresponding income bands.

Among the remaining population of working-age households, we equivalise gross incomes to weight for differing household sizes and compositions, using the modified OECD scale. This matters because, for any given level of income, a household of five adults is likely to achieve a lower standard of living than a single-person household. The equivalisation process takes account of such differences by inflating the incomes of smaller households and deflating the incomes of larger ones. Incomes before housing costs (BHC) are used.

We next rank the working-age households on the basis of their equivalised incomes and separate them into ten equally-sized deciles (where decile 1 has the lowest income). Given that we are concerned with those on low to middle incomes, we use median income – the boundary between deciles 5 and 6 – as the upper threshold of the LMI group. At the lower end we create a threshold at the boundary between deciles 1 and 2. We do this in part because it represents the approximate level of earnings associated with working full-time at the minimum wage, and in part because decile 1 often produces unusual results due to the large number of households within it that have temporarily low incomes or incomes that come neither from employment nor the state.

Therefore, at this stage, the LMI group comprises all of those working-age households with equivalised gross incomes in deciles 2-5 of the income distribution. 2013-14 boundaries for a selection of household compositions are detailed in Table 2.

Table 2: Upper and lower gross household income thresholds for low to middle income households, by selected composition: UK 2013-14

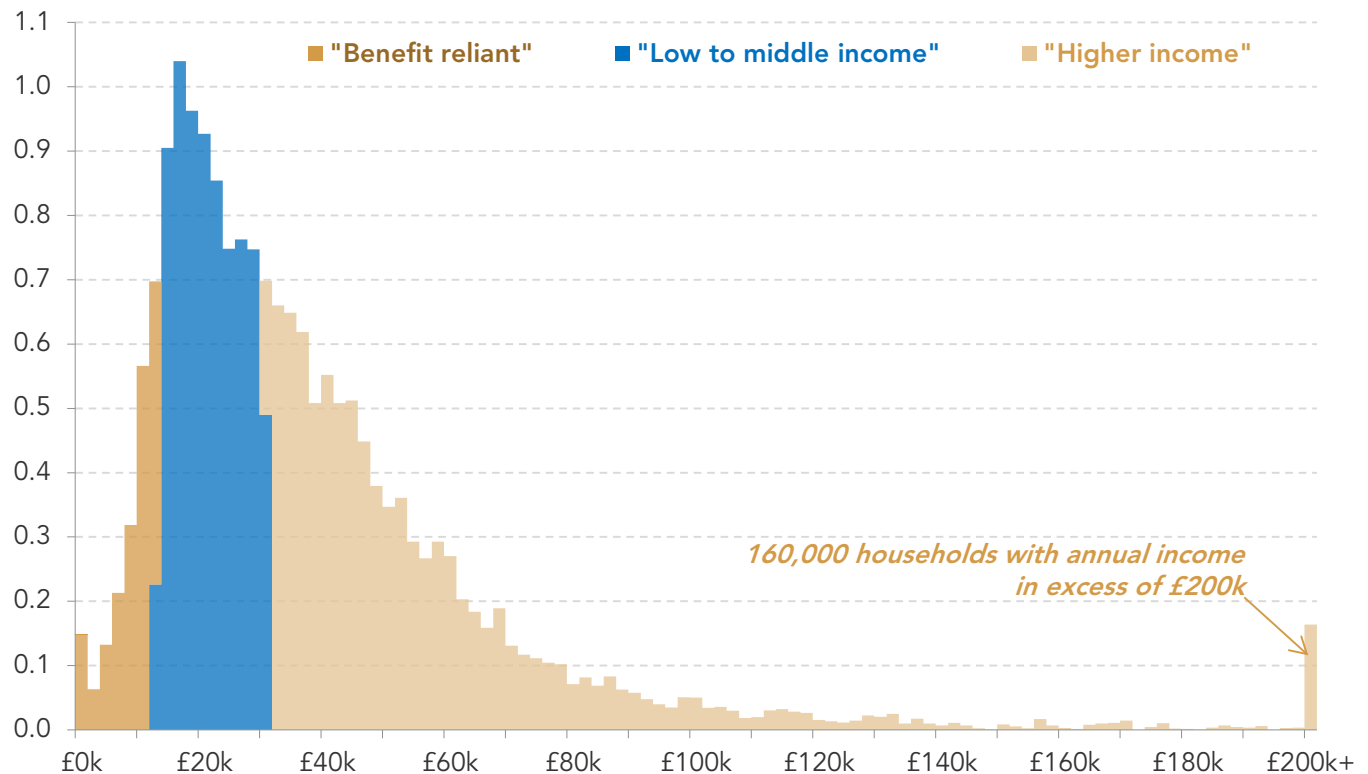
	Weekly income (£)		Annual income (£)	
	Lower	Higher	Lower	Higher
Single no children	170	400	9,000	21,000
Single with one child	230	520	11,700	27,300
Single with two children	280	650	14,400	33,550
Single with three children	330	770	17,100	39,800
Couple with no children	260	600	13,450	31,350
Couple with one child	310	720	16,150	37,650
Couple with two children	360	840	18,850	43,900
Couple with three children	410	960	21,550	50,150
Couple with four children	470	1,090	24,250	56,450
Three adults, no children	340	800	17,900	41,700
Four adults, no children	430	1,010	22,500	52,350
Equivalised income ¹	260	600	13,450	31,350

Notes: Equivalised incomes calculated using modified-OECD scale.

Source: RF analysis of DWP, Family Resources Survey 2013-14

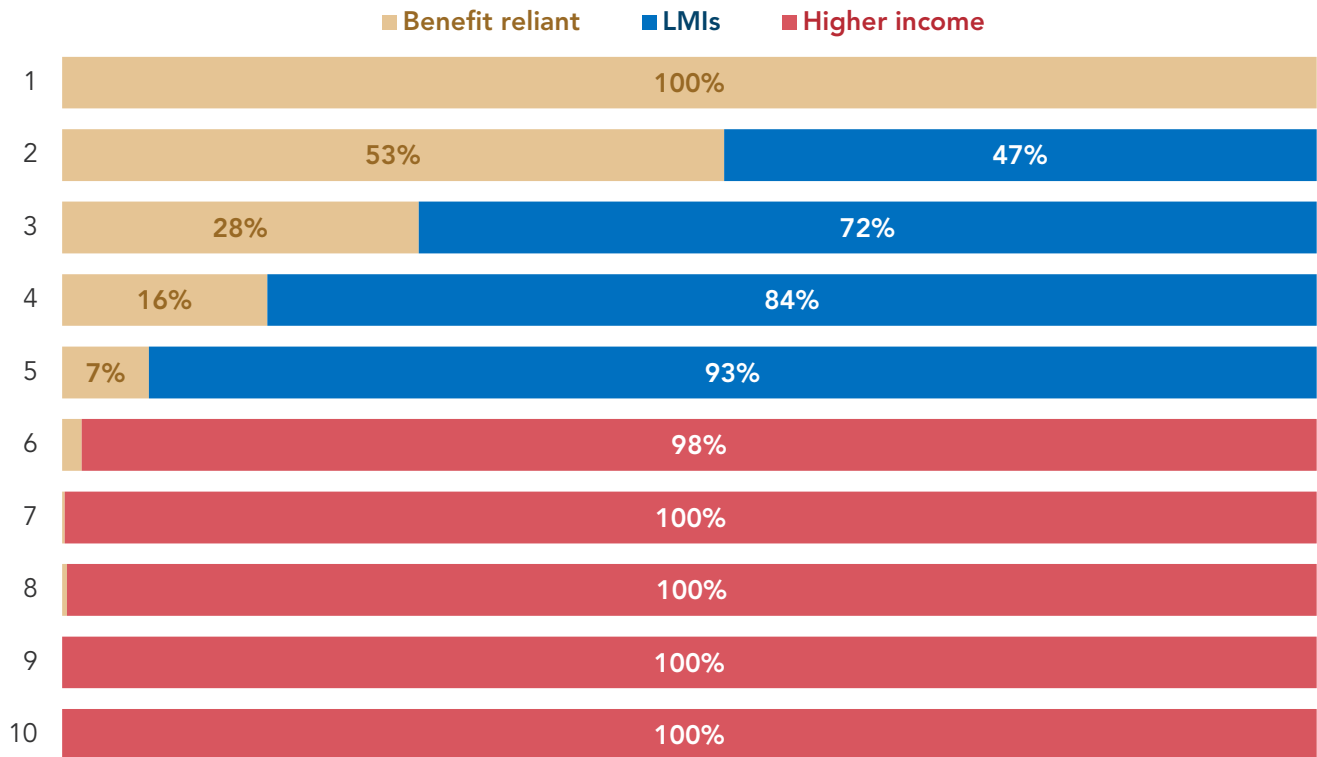
For simplicity, we refer to those households with above median incomes as 'higher income', while those households with the lowest incomes are classified as being 'benefit-reliant'.

Our third stage reduces the size of both the higher income and, more particularly, the LMI groups by filtering all those households that receive more than one-fifth of their household income from income-related benefits into the benefit-reliant group. The specification of income-related benefits means those in receipt of universal benefits are not excluded from the group. We omit tax credit receipts from our calculation of income-related benefits because these payments were designed specifically for LMI households, meaning that it would be counter-intuitive to exclude households from the group on the basis of their receipt. The position of the LMI group in the working-age income distribution is shown in Figure 38.

Figure 38: Position of low to middle income households in working-age income distribution: UK 2013-14*Millions of households per £2,000 equivalised annual income band*

Source: RF analysis of DWP, Family Resources Survey 2013-14

Figure 39 shows how these three income groups are spread across working-age household income deciles at the end of this three-stage process. It shows, for example, that 53 per cent of households in income decile 2 are in the benefit-reliant group, while 47 per cent are considered LMI. Within the LMI group, 16 per cent are drawn from decile 2, 24 per cent from decile 3, 28 per cent from decile 4 and 31 per cent from decile 5.

Figure 39: Household income groups by equivalised income decile: UK 2013-14*Household income group distribution in each working-age income decile*Source: RF analysis of DWP, *Family Resources Survey* 2013-14

As discussed above, our analysis uses the household as the basis of measurement of LMIs. However, in accordance with the level of analysis provided in the DWP's *Family Resources Survey*, we also present data at benefit unit (or family) and individual adult levels.

- » Households are defined as 'a single person or group of people living at the same address who either share one meal a day or share the living accommodation'.
- » Benefit unit is a term that relates to the tighter family definition of 'a single adult or couple living as married and any dependent children'. So, for example, a man and woman living with their young children and an elderly parent would be one household but two benefit units.

Those benefit units living in 'conventional' households (i.e. those containing relations) are assumed to share income and expenditure and are therefore allocated to the same income group as their overall household (although we exclude all families headed by someone above retirement age even if a member of the household is of working age). In relation to non-conventional households comprising unrelated sharers however, we allocate benefit units to one of the three income groups on the basis of their place within the benefit unit (rather than household) income distribution. Throughout the report we use the term benefit unit interchangeably with families and family units.

As with benefit units, adults are primarily allocated to income groups based on the status of their household. Once again though, we exclude all individuals above retirement age, irrespective of the age of the household head, and those living in non-conventional households are categorised in relation to their place within the individual working-age income distribution. An additional filter is introduced, namely that all who describe themselves as being in full-time education are removed from the analysis entirely.

Table 3 provides summary data for households, individuals and benefit units for the three income groups. It shows that, for example, LMIs make up 5.7 million of the total 19 million working age households in the UK.

Table 3: Summary data for households, individuals and benefit units by income group: UK 2013-14

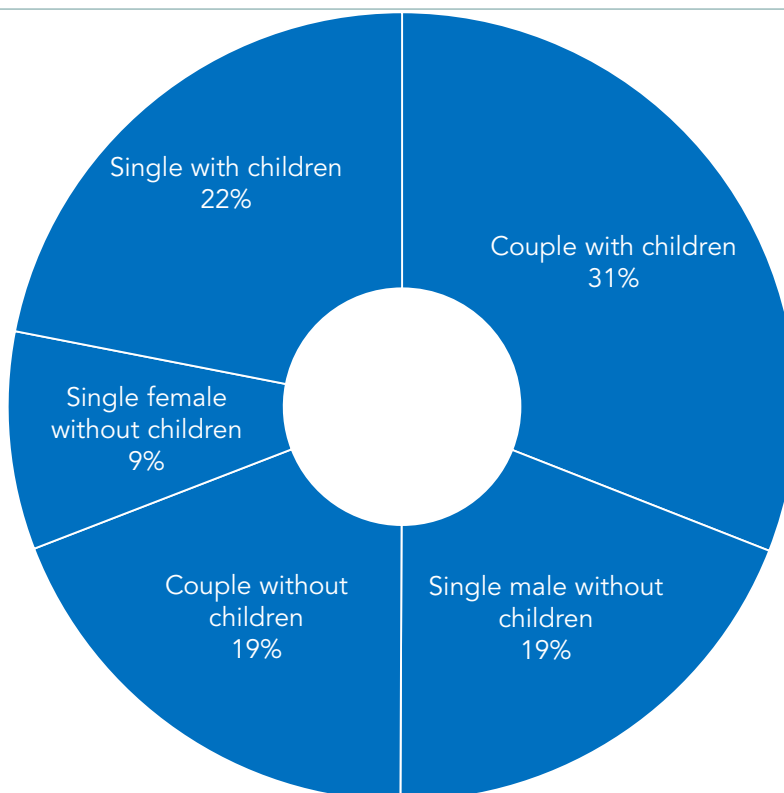
000s	Benefit-reliant	LMIs	Higher income	All households
Working-age households				
Total	3,800	5,700	9,500	19,000
<i>With children</i>	1,700	3,000	3,100	7,800
<i>Without children</i>	2,100	2,700	6,500	11,300
Individuals within working-age households				
Total adults	5,700	10,300	18,400	34,400
<i>Men</i>	2,700	5,100	9,700	17,500
<i>Women</i>	3,000	5,200	8,600	16,800
Total children	3,100	5,300	4,700	13,200
Benefit (family) units in working-age households				
Total	4,700	7,500	12,200	24,400
<i>Couple with children</i>	800	2,300	2,800	5,900
<i>Single male</i>	1,500	1,700	2,900	6,100
<i>Couple without childre</i>	500	1,400	4,300	6,300
<i>Single female</i>	1,000	1,400	1,900	4,300
<i>Single parent</i>	1,000	700	200	1,900

Notes: Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14

The composition of the families in the LMI group is shown in Figure 40. This shows that just over half of LMI families are families with children: 22 per cent are single parents and 31 per cent are couple parents. Couples without children comprise 19 per cent of the LMI group, as do single men without children. The smallest group, 9 per cent of the total, comprises single females.

Figure 40: Low to middle income family composition: UK 2013-14



Source: RF analysis of DWP, Family Resources Survey 2013-14

NMG definition

Several outputs in the statistical annex are based on the Bank of England's annual *NMG Survey*. Due to the nature of the data source, the income bands are defined on the basis of a two- rather than three-stage process.

First, records in which the respondent is above retirement age are removed from the analysis. Secondly, the population of households is split on the basis of equivalised gross income (this time using a simplified version of the OECD scale to reflect the fact that there is insufficient detail provided about the ages of children in each household).

Because it is not possible to apply our usual third-stage filter on the basis of level of state support, we do not include the whole of decile 2 in the LMI group, but instead create a lower boundary at the 15th percentile. The equivalised *gross* income thresholds used in relation to the 2015 survey are therefore £12,500 and £28,000.

ONS definition

We use one other definition in the report, in relation to the ONS statistical release *The effect of taxes and benefits on household income*. The data is presented by the ONS by equivalised disposable (rather than gross which we use in relation to other sources) working-age household income decile. No information on the level of state support is provided and it is not possible to look within the decile data. As such, our definition of LMIs is simply based on the data provided for income deciles 2-5. We simply multiply the average figures in each decile by the numbers in the sample and then average across the decile groups that we specify.

Annex 3: Low to middle income Britain – a statistical annex

In previous versions of our living standards publication we have presented a wealth of information on LMI households, representing a snapshot of their experiences of work, housing and household finances. We have not updated that material for a couple of years, so here we present at length a statistical annex revisiting many familiar metrics. We have set out a number of key housing findings in Section 4, so here focus on LMI characteristics, experiences of work and financial situations.

Work and earnings

As Table 4 shows, 8.7 million LMI adults are economically active, representing 89 per cent of the group. That's significantly higher than within the benefit-reliant group (50 per cent) and only slightly below the level recorded among higher-income households (96 per cent).

Over half of LMIs are full-time employees (52 per cent) and one-in-five (20 per cent) are part-time employees. This is somewhat different to the split in the higher income group, where three-quarters (74 per cent) are full-time employees and just 12 per cent are part-time employees.

LMIs are over-represented among the self-employed: 13 per cent work for themselves either full-time or part-time, meaning LMIs account for roughly 40 per cent of the self-employed workforce.

Table 5 provides a further split, by showing how economic activity varies according to income group and sex. Within the LMI group, males are more likely to be economically active and in full-time employment than females. Over one-in-five female LMIs are economically inactive, with around half of these saying they are looking after family/the home.

Table 7 details the number and proportion of jobs carried out by adults in each income group across different sectors of the economy. It shows, for example, that of the 9.6 million jobs carried out by those in LMIs households, 1.7 million are in the 'retail, wholesale & repair of motor vehicles' sector and 1.4 million are in the 'health & social work' sector. Almost a third of all LMI jobs are in these two sectors.

Relative to the share of the adult population they account for, LMIs appear to be over-represented in hospitality, retail and other services. In contrast, they are relatively under-represented in ICT, finance and professional, scientific and technical industries..

Table 4: Economic activity among adults by income group: UK 2013-14

	Number (000s)			Proportion in each income group			Proportion by activity category		
	Benefit-reliant	LMI	Higher income households	Benefit-reliant	LMI	Higher income households	Benefit-reliant	LMI	Higher income households
Economically active	2,700	8,700	17,200	50%	89%	96%	9%	31%	60%
Full time work	1,000	6,100	14,600	18%	62%	81%	5%	28%	67%
Part time work	800	2,200	2,400	14%	23%	14%	14%	41%	100%
Full-time employee	600	5,100	13,300	12%	52%	74%	3%	27%	100%
Full-time self-employed	300	1,000	1,300	6%	10%	7%	13%	38%	100%
Part-time employee	600	2,000	2,100	12%	20%	12%	14%	42%	100%
Part-time self-employed	100	300	300	2%	3%	2%	18%	38%	100%
Unemployed	900	400	200	17%	4%	1%	60%	27%	100%
Economically inactive	3,000	1,600	1,200	56%	16%	7%	52%	28%	100%
Looking after family/hom	700	600	400	13%	6%	2%	41%	38%	100%
Permanently sick/disabled	1,600	400	200	30%	4%	1%	73%	19%	100%
Retired	100	200	400	2%	2%	2%	16%	33%	100%
Temporarily sick/injured	100	0	0	2%	0%	0%	65%	23%	100%
Student	100	0	0	1%	0%	0%	52%	23%	100%
Other inactive	400	300	200	8%	3%	1%	47%	28%	100%
All adults	5,300	9,800	17,900	100%	100%	100%	16%	30%	54%
			33,000						100%

Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.
Source: RF analysis of DWP, Family Resources Survey 2013-14

Table 5: Economic activity among working-age adults by income group and sex: UK 2013-14

	Benefit-reliant		LMIs		Higher income		All adults	
	Male	Female	Male	Female	Male	Female	Male	Female
Economically active	53%	41%	90%	79%	96%	91%	88%	78%
Full time work	24%	11%	78%	40%	91%	67%	76%	49%
Part time work	9%	18%	8%	35%	4%	23%	6%	26%
Full-time employee	14%	9%	61%	37%	81%	63%	65%	45%
Full-time self-employed	9%	3%	16%	3%	10%	4%	12%	3%
Part-time employee	7%	16%	6%	31%	3%	21%	5%	23%
Part-time self-employed	2%	2%	2%	3%	1%	2%	1%	3%
Unemployed	21%	12%	4%	4%	1%	1%	5%	4%
Economically inactive	47%	59%	10%	21%	4%	9%	12%	22%
Looking after family/home	2%	21%	1%	11%	0%	4%	0%	9%
Permanently sick/disabled	31%	26%	4%	5%	1%	1%	6%	7%
Retired	3%	1%	3%	2%	2%	2%	3%	2%
Temporarily sick/injured	2%	1%	0%	0%	0%	0%	0%	0%
Student	1%	1%	0%	0%	0%	0%	0%	1%
Other Inactive	8%	8%	2%	3%	1%	2%	2%	3%
All adults	100%	100%	100%	100%	100%	100%	100%	100%

Notes: Income groups based on FRS definition; see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Table 6: Workforce jobs by income group of adult: UK 2013-14

	Number (000s)			Proportion in each income group			Proportion in each sector					
	Benefit-reliant	LMIs	Higher income	All adults	Benefit-reliant	LMIs	Higher income	All adults	Benefit-reliant	LMIs	Higher income	All adults
Retail, wholesale & repair of motor vehicles	850	1,680	1,900	4,430	18%	17%	11%	14%	19%	38%	43%	100%
Health & social work	570	1,360	2,450	4,380	12%	14%	14%	14%	13%	31%	56%	100%
Manufacturing	560	980	1,890	3,440	12%	10%	11%	11%	16%	28%	55%	100%
Construction	410	780	1,230	2,420	9%	8%	7%	8%	17%	32%	51%	100%
Education	250	760	2,100	3,100	5%	8%	12%	10%	8%	24%	68%	100%
Hotels & restaurants	540	740	500	1,780	12%	8%	3%	6%	31%	41%	28%	100%
Admin. & support services (e.g. cleaners, maintenance)	360	600	710	1,670	8%	6%	4%	5%	22%	36%	42%	100%
Transportation & storage	270	560	750	1,590	6%	6%	4%	5%	17%	35%	47%	100%
Public admin, defence & compulsory social security	100	430	1,450	1,980	2%	4%	8%	6%	5%	22%	73%	100%
Professional, scientific & technical (e.g. lawyers, marketing)	140	360	1,460	1,960	3%	4%	8%	6%	7%	19%	74%	100%
Other service activities (e.g. hairdressers)	130	280	320	730	3%	3%	2%	2%	18%	38%	44%	100%
Arts, entertainment and recreation	130	220	350	690	3%	2%	2%	2%	18%	32%	50%	100%
Financial & insurance activities	80	270	930	1,280	2%	3%	5%	4%	6%	21%	73%	100%
Information and communication	80	250	920	1,250	2%	3%	5%	4%	7%	20%	74%	100%
Agriculture, forestry and fishing	40	120	210	360	1%	1%	1%	1%	10%	33%	57%	100%
Real estate activities	10	80	180	280	0%	1%	1%	1%	5%	30%	65%	100%
All other industries	80	160	410	650	2%	2%	2%	2%	12%	25%	63%	100%
All jobs	4,610	9,630	17,750	31,990	100%	100%	100%	100%	14%	30%	55%	100%

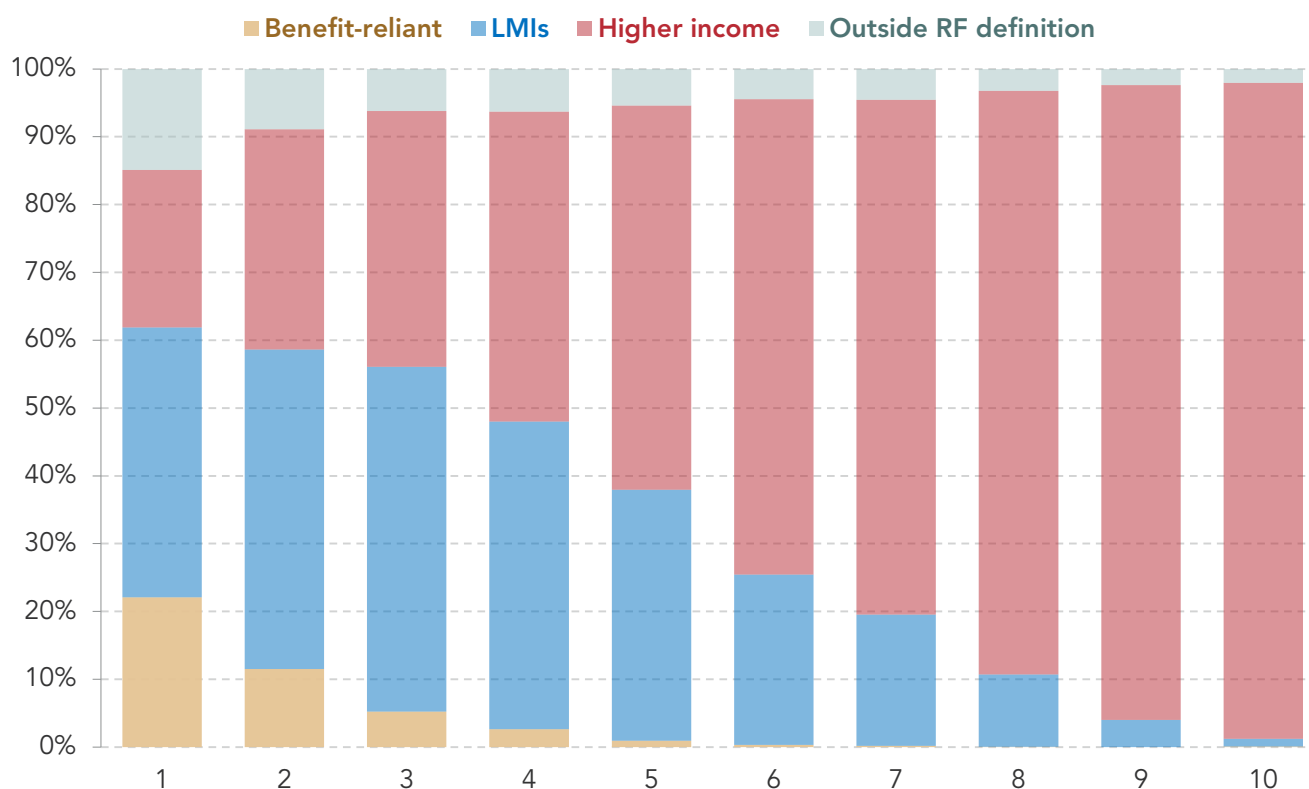
Notes: Industries correspond to the SIC 207 categories established by the ONS. Respondents to FRS surveys prior to 2009-10 were allocated to industries within the SIC 92 classification system, making comparisons of the figures in this table with earlier years unreliable. Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Individuals in LMI households are spread throughout the individual earnings distribution, as Figure 41 illustrates. The chart shows that individuals in LMIs can be found in every earnings decile, but that four-fifths (83 per cent) are in the bottom half of the earnings distribution. Among the lowest paid 10 per cent of employees, one-third (35 per cent) are LMIs. Members of the benefit-reliant and higher income groups each comprise a further fifth, with pensioners and others accounting for the remaining 13 per cent.

Figure 41: Mapping of income group members to the earnings distribution: UK 2013-14

Composition of each employee earnings decile



Notes: Income groups based on FRS definition: see Annex 2. Those deemed 'outside RF definition' include members of pensioner households and full-time students who are working.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Alongside formal work roles, LMIs often have informal caring responsibilities. As Table 7 shows, of LMI adults are informal carers, with women slightly more likely than men to be in this position.

Table 7: Proportion of adults who are informal carers by income group: UK 2013-14

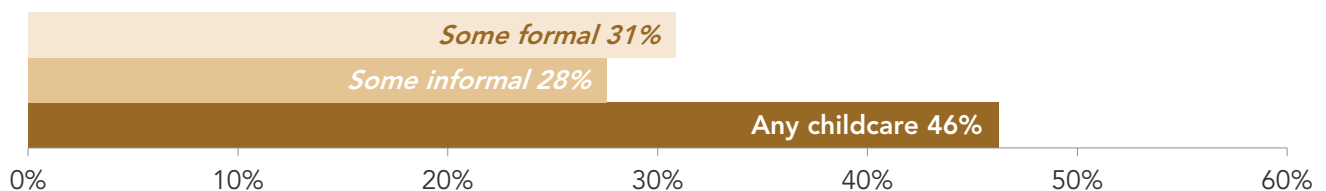
	Benefit-reliant	LMIs	Higher income	All adults
All adults	14%	10%	8%	10%
Under 20 hours a week	6%	7%	6%	6%
20-34 hours a week	2%	1%	1%	1%
35 hours or more a week	7%	3%	1%	2%
All women	16%	13%	11%	12%
Under 20 hours a week	6%	8%	8%	8%
20-34 hours a week	2%	1%	1%	1%
35 hours or more a week	8%	3%	1%	3%
All men	12%	8%	6%	7%
Under 20 hours a week	5%	5%	5%	5%
20-34 hours a week	2%	0%	0%	1%
35 hours or more a week	5%	2%	1%	2%

Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, *Family Resources Survey 2013-14*

Figure 42 shows how the use of childcare, both formal and informal, varies by income group. Higher income groups (56 per cent) use more childcare than LMIs (51 per cent) and members of the benefit-reliant group (46 per cent), but the differences are relatively small.

Figure 42: Household use of formal and informal childcare by income group: UK 2013-14

Higher income**Low to middle income****Benefit reliant**

Notes: Income groups based on FRS definition: see Annex 2.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Household finances

Table 8 sets out average incomes within each group, detailing income sources too. Before accounting for taxes and benefits, LMIs average £22,400 in 'original' income, roughly one-third as much as higher income households. Their benefit receipt of £2,200 is roughly double the level among higher income households and well below that recorded by the benefit-reliant group. But LMIs have very similar levels of tax credit receipt (at £1,900 a year) as benefit-reliant households.

Once taxes are paid, LMI net household income averages £23,000, just under half as much as higher income households. A reported real-terms increase of 0.3 per cent in 2013-14 relative to the previous year compares with a reduction of 0.6 per cent among benefit-reliant households and an increase of 2.7 per cent among higher income ones.

Table 8: Average annual gross household income by income group: UK 2013-14

	£	Benefit-reliant	LMIs	Higher income	All households
Original (non-benefit) income		3,000	22,400	69,300	41,700
Gross earnings		2,700	21,100	64,600	39,000
Gross income from employment		2,200	18,500	57,500	34,500
Gross self-employment earnings		500	2,600	7,100	4,400
Investment income		100	400	3,000	1,600
Non-state pension income		200	900	1,700	1,200
+ Benefit income		9,500	2,200	1,000	3,000
State pension, income support + pension credit		100	300	300	200
Disability benefits		1,000	400	200	400
Other benefits		8,300	1,600	600	2,400
Non-income-related benefit income		2,600	1,800	900	1,500
Income-related benefit income		6,900	400	100	1,500
+ Tax credits		2,200	1,900	100	1,100
+ Remaining income ¹		600	1,700	1,500	1,400
= Gross household income		15,300	27,900	71,400	46,900
- Direct taxes and other deductions ²		1,300	4,900	21,600	12,500
= Net household income		14,000	23,000	49,800	34,400
Real-terms change from 2012-13		-0.6%	+0.3%	+2.7%	+2.3%

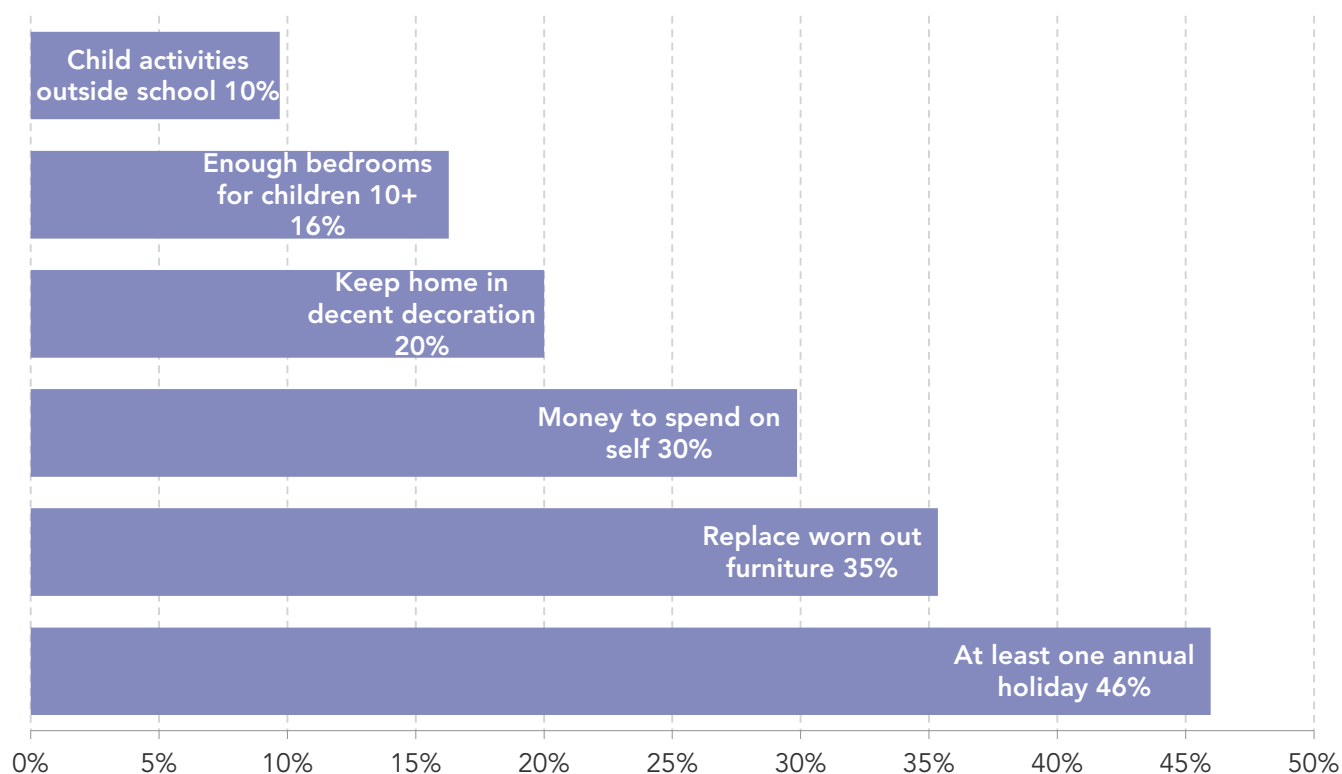
Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

¹ Includes income derived from sub-tenants, odd-jobs, free school milk and/or meals, private benefits (such as personal health insurance, trade union strike pay and government training allowances), student/school grants, royalties, allowances from friends, relatives or an organisation and allowances from local authorities for foster and adopted children.

² Income is net of: income tax payments; NICs; domestic rates/council tax; contributions to occupational pension schemes; maintenance and child support payments; parental contributions to students living away from home; and student loan repayments.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Figure 43 illustrates the incidence of selected material deprivation measures among LMIs. These are goods or activities that LMI respondents say they would like, but cannot afford. It shows that close to half (46 per cent) cannot afford to go on holiday and more than one-third (35 per cent) are unable to replace worn out furniture. LMIs are much more likely to report levels of adult deprivation than child deprivation, possibly suggesting that limited resources are directed towards younger members of families. Nevertheless, 16 per cent say they don't have enough bedrooms for children aged ten and over, and one-in-ten say they can't afford to fund activities for their child outside of school.

Figure 43: Selected material deprivation measures among low to middle income families: UK 2013-14*Proportion of LMI families who would like, but cannot afford...*

Notes: Income groups based on FRS definition: see Annex 2.

Source: RF analysis of DWP, Family Resources Survey 2013-14

LMI's lack savings. Table 9 shows that the majority (57 per cent) have no savings at all, with 13 per cent reporting having £1,500 or less. Even among higher income households 29 per cent say they have no savings or assets, with close to half of working-age families in this position overall.

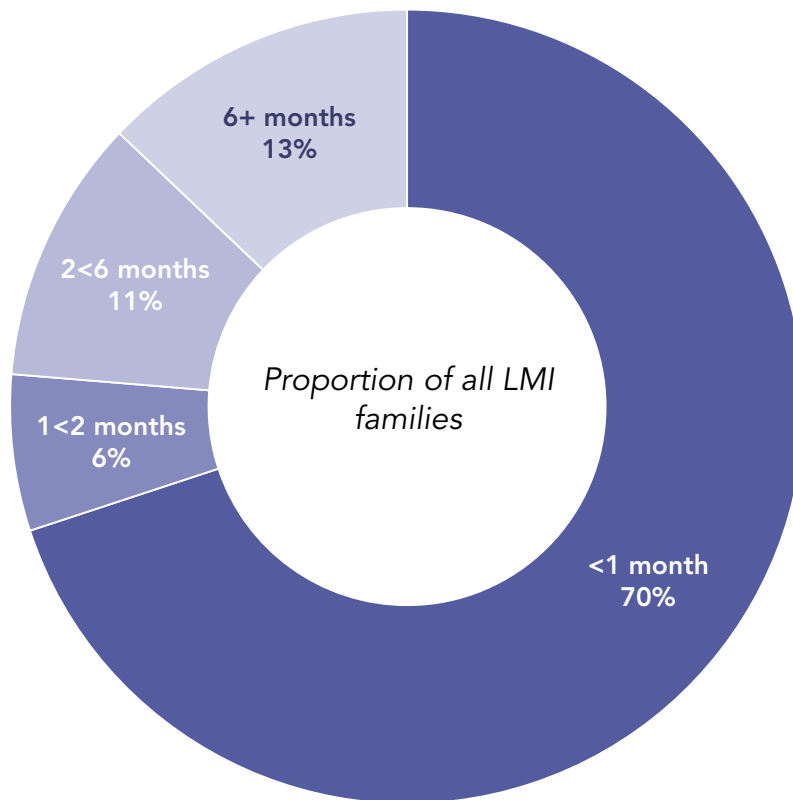
Table 9: Value of savings/financial assets in family by income group: UK 2013-14

	Benefit- reliant	LMIs	Higher income	All family units
No savings	80%	57%	29%	48%
< £1,500	9%	13%	12%	11%
£1,500 < £3,000	4%	8%	11%	9%
£3,000 < £8,000	3%	8%	14%	10%
£8,000 < £20,000	2%	5%	11%	7%
£20,000 < £25,000	1%	1%	4%	2%
£25,000 < £30,000	0%	2%	3%	2%
£30,000 < £35,000	0%	1%	2%	1%
£35,000 < £40,000	0%	1%	1%	1%
£40,000+	2%	4%	14%	9%
Total	100%	100%	100%	100%

Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding. "Savings" cover all assets other than housing. Those with values between £1,500 and £20,000 are asked detailed questions and totals are taken at the end of the month (i.e. just before payday). Those reporting savings below £1,500 or above £20,000 have their total capital estimated from information about interest income.

Source: RF analysis of DWP, *Family Resources Survey 2013-14*

Figure 44 illustrates the number of months' net income held in savings/financial assets by LMIs. It shows that 70 per cent of LMIs have savings levels equivalent to less than one month's net income whereas just 13 per cent have savings levels equivalent to more than six months' net income.

Figure 44: Number of months' net income held in savings/financial assets by low to middle income families: UK 2013-14

Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14

The high proportion of LMI families with low levels of savings is, in part, a consequence of insufficient incomes. As Figure 45 shows, 43 per cent of LMI families would like to save at least £10 a month, but are unable to afford to do so. Once again, the figure remains relatively high even within the higher income group.

Figure 45: Families' attitudes to saving at least £10 a month: UK 2013-14

Proportion of families who would like to save at least £10 a month, but can't afford it

Higher income**Low to middle income****Benefit reliant**

0% 10% 20% 30% 40% 50% 60% 70% 80%

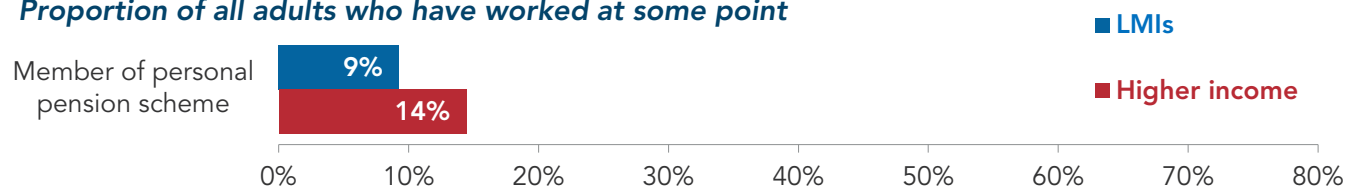
Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding. Personal pension/no pension questions only cover adults who have worked at some point, even if currently unemployed/inactive. Occupational pension question only covers those currently in work.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Two-thirds of working-age adults in the LMI income group who have worked at some point in their lives are not currently saving into a pension, either because they do not have a pension or have a frozen pension only, as shown in Figure 46.

Among those currently in work, 52 per cent of LMIs are eligible for an occupational pension scheme, with 40 per cent take-up up such a scheme employees. These proportions are likely to increase as auto-enrolment continues to be rolled out, but Figure 47 shows that the longer-term trend in pension ownership among LMIs has been downwards.

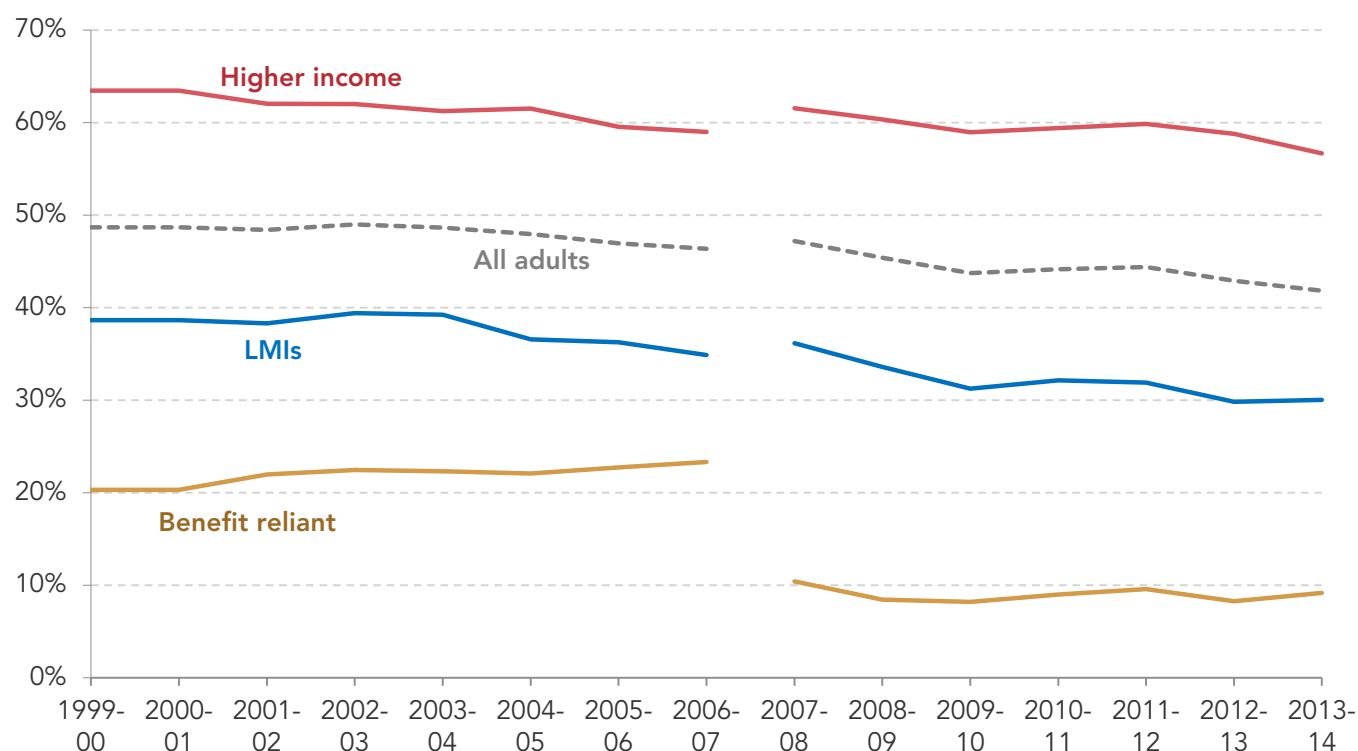
Figure 46: Proportion of working-age adults actively contributing to an occupational or personal pension: UK 1999-00 to 2013-14

Proportion of all adults who have worked at some point**Proportion of all adults currently in work****Proportion of all adults who have worked at some point**

Notes: Income groups based on FRS definition: see Annex 2. Break in series in 2006-07 due to change in questions asked. After this date, interviewer specifically checks if respondent has a pension. Prior to this, figures are based on responses to series of questions about ownership of different types of pensions. Personal pension/no pension questions only cover adults who have worked at some point, even if currently unemployed/inactive. Occupational pension question only covers those currently in work.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Figure 47: Proportion of working-age adults actively contributing to an occupational or personal pension: UK 1999-00 to 2013-14



Notes: Income groups based on FRS definition: see Annex 2. Break in series in 2006-07 due to change in questions asked. After this date, interviewer specifically checks if respondent has a pension. Prior to this, figures are based on responses to series of questions about ownership of different types of pensions. Personal pension/no pension questions only cover adults who have worked at some point, even if currently unemployed/inactive. Occupational pension question only covers those currently in work.

Source: RF analysis of DWP, Family Resources Survey 2013-14

Table 10 uses NMG Survey data to present the debt profiles of the three income groups. It shows that 62 per cent of LMI households report having some outstanding unsecured debt, while 24 per cent have secured debts. Of those holding secured debt, the average amount still outstanding is £67,000, roughly three times the average LMI net income reported in Table 8.

Table 10: Debt position of households by income group: GB Sep 2015

	Benefit-reliant	LMIs	Higher income	All households
Secured debt				
Proportion with outstanding debts	13%	24%	48%	34%
Mean outstanding debt among all answering question	£5,700	£16,000	£47,600	£30,200
Mean outstanding debt among all with secured debt	£45,200	£67,000	£99,400	£88,400
Unsecured debt				
Proportion with outstanding debts	57%	62%	63%	62%
Mean outstanding debt among all answering question	£3,300	£4,600	£6,400	£5,300
Mean outstanding debt among all with unsecured debt	£5,700	£7,400	£10,100	£8,600

Notes: Income groups based on NMG definition: see Annex 2. Numbers may not sum due to rounding.

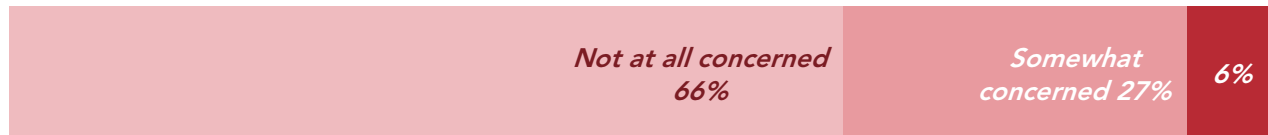
Source: RF analysis of Bank of England, 2015 NMG survey, Sep 2015

Taking all debts together, approaching half (44 per cent) of LMI households say they are concerned about their level of debt, with 11 per cent saying they are “very concerned”, as set out in Figure 48.

Figure 48: Reported concern with current level of debt: GB Sep 2015

How concerned are you about your current level of debt?

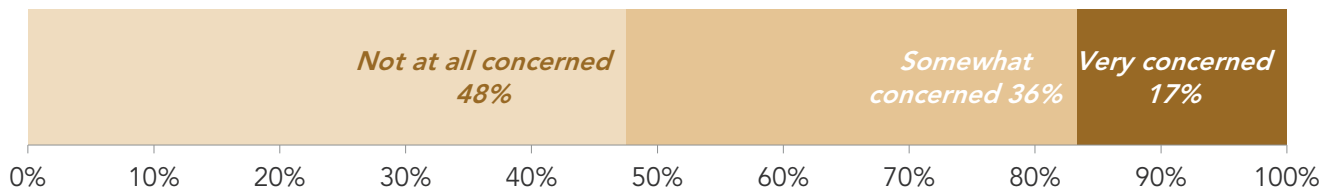
Higher income



Low to middle income



Benefit reliant



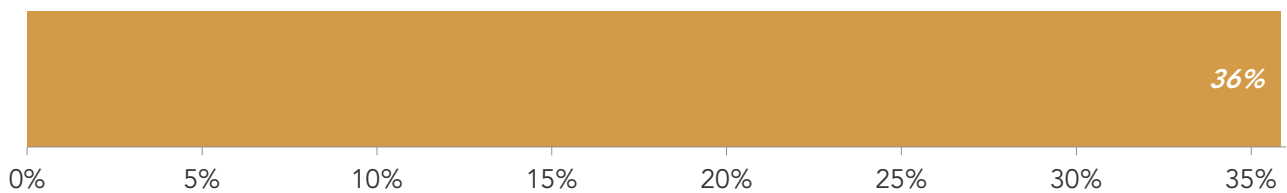
Notes: Income groups based on NMG definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of Bank of England, 2015 NMG survey, Sep 2015

Despite being regular users of credit, Figure 49 shows that a significant proportion of LMIs (30 per cent) report some level of ‘credit constraint’ – as defined as being put off spending because of concerns about their lack of access to credit.

Figure 49: Reported 'credit constraint': GB Sep 2015

Proportion reporting being put off spending because they were concerned that they would not be able to get credit when they needed it

Higher income**Low to middle income****Benefit reliant**

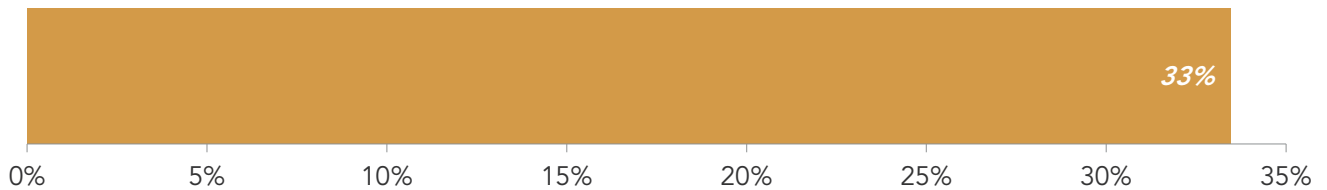
Notes: Income groups based on NMG definition: see Annex 2.

Source: RF analysis of Bank of England, 2015 NMG survey, Sep

Around one-quarter (23 per cent) of LMIs report having difficulty paying for their accommodation over the course of the year, as shown in Figure 50. This is 10 percentage points lower than the proportion reported by households in the benefit-reliant group (33 per cent) and 11 percentage points higher than the proportion reported by high income households (12 per cent).

Figure 50: Proportion of households reporting having difficulty paying for their accommodation in the past 12 months: GB Sep 2015

In the past twelve months, would you say you have had any difficulties paying for your accommodation?

Higher income**Low to middle income****Benefit reliant**

Notes: Income groups based on NMG definition: see Annex 2.

Source: RF analysis of Bank of England, 2015 NMG survey, Sep 2015

Despite the financial pressures set out above, relatively few LMIs are in arrears on household bills, though they are much more likely to be in this position than higher income households. Table 11 shows that around 5 per cent report being behind on Council Tax payments, while roughly 3 per cent are in arrears on water, gas or electricity.

Table 11: Families behind with household bills by income group: UK 2013-14

	Benefit-reliant	LMI's	Higher income	All family units
Council tax	9.9%	4.9%	0.7%	3.8%
Water rates/Rates (NI)	12.2%	3.5%	0.5%	3.7%
Gas bill	8.3%	3.2%	0.5%	2.8%
Electricity bill	8.4%	3.0%	0.6%	2.8%
Telephone bill	3.4%	1.3%	0.2%	1.2%
Other HP payments	1.6%	0.6%	0.2%	0.6%
Television/video rental or HP	1.3%	0.4%	0.0%	0.4%
Insurance policies	0.2%	0.1%	0.0%	0.1%
Other fuel bills	0.3%	0.1%	0.0%	0.1%

Notes: Income groups based on FRS definition: see Annex 2. Numbers may not sum due to rounding.

Source: RF analysis of DWP, Family Resources Survey 2013-14



Resolution Foundation

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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