

Housing Intelligence

Where is the first rung of the housing ladder?
Challenges and risks of a longstanding
imbalance in housing supply



Key points

- The so-called first rung of the housing ladder comprises less than 800,000 dwellings or 3.1% of supply. In contrast, family housing accounts for 70% of housing stock.
- This profile of supply is distorting house prices with the value of one and two bed homes compressed right up towards the value of three bed homes. This presents problems for both first time buyers and 'down traders' and risks for lenders and developers.
- Improving affordability is a question of increased supply, especially if that supply is focused on the key market 'pinch points'. Despite a high proportion of new flats being built, one bed homes account for just 10% of all output.
- Delivering the right tenure of housing is as important as the right size of homes. Encouraging greater owner occupation of smaller sized homes, where prices are more volatile, may not be the most desirable solution.



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Low supply adds to affordability problems

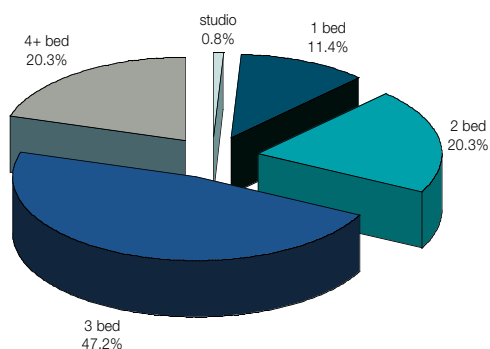
The plight of first time buyers trying to access the housing market is well documented yet the whole debate is based on the assumption that there is a ready supply of homes making up the so-called 'first rung' of the housing ladder. New analysis by Hometrack reveals that the reality is quite different. This article examines the structure of housing supply by property size and looks at how increasing supply in a focused manner could start to alleviate the affordability crisis.

Family housing dominates current supply

The Hometrack stock model uses a range of data to calculate the supply of housing by both size and tenure - from the macro to micro level. It shows that three bed properties account for just under half (48%) of supply in England and Wales with 4+ bed homes accounting for a further 20%. Thus two thirds of supply comprises 'family' homes of three or more bedrooms. One and two bed homes account for less than a third of housing supply.

Figure 1

Current profile of housing supply by size - all tenures

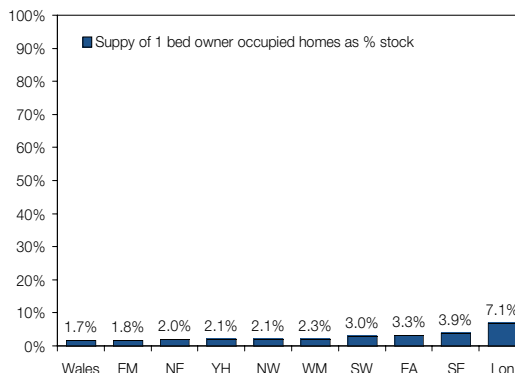


Source: Hometrack

The first rung of the housing ladder i.e. one bed homes in the 'owner occupied' sector, accounts for just 3.1% of housing supply, or less than 800,000 dwellings. Within this headline figure there are significant regional variations - from a low of 1.7% in Wales to a relative high of 7.1% in London - see Figure 2. The differentials largely reflect the historic development of the housing market over time.

Figure 2

Current profile of housing supply by size - all tenures



Source: Hometrack

Distortion in pricing levels

This lack of supply is compounding the affordability problems facing first time buyers. Robust economic growth over the last decade has driven demand and a lack of supply has resulted in the value of one and two bed homes being 'compressed' up towards the pricing level of three bed homes. The current 25% discount from a three bed (£194,000) to a one bed property (£141,000) is small compared to the early 1990's when first time buyers were able to skip the first rungs of the ladder.

"The low supply of smaller sized homes is compounding the affordability pressures faced by first time buyers"

As well as causing problems for those looking to get on the ladder the relatively high price of smaller sized homes acts as a disincentive for those looking to trade down. This is because the equity that can be released is limited and fails to offset the loss of space. The net result is a lower turnover rate for family housing, which in turn limits supply and increases price pressures back down the ladder into the first time buyer sector.

This structure of supply also makes the value of one bed homes more volatile. Any sudden decline in demand would have a potentially disproportionate impact on the value of one bed homes. This is an important area of risk for both developers and lenders.

Policy conundrum

This structure of supply presents some major challenges for policy makers. Unfortunately most supply side analysis tends to be high level, focusing on the big picture numbers. There is very little emphasis on the types of housing that are needed beyond headline assumptions of how much new supply should be 'affordable' versus 'open market'.

It is vital that housing and planning policies are developed in relation to the type and size of homes as well as tenure. The dilemma facing policy makers today is whether to 1) focus delivery on the supply "pinch points", or 2) under balanced housing market principles, focus on delivering homes that match existing supply in an area.

More one bed homes the solution?

One option would be to encourage the development of smaller sized homes to boost the first rung of the ladder. This runs slightly contrary to current thinking which questions the number of new flats being developed. Just under half of all new homes built last year were flats, but 90% of new housing completions today are properties of two or more beds. One bed homes account for just 10% of new housing output each year.

Furthermore, the deficit in supply has enabled developers to achieve high values for new build apartments relative to second hand homes. Rising affordable housing quotas and the move to higher density schemes have increased the costs (and risks) of development. Developers have reacted in a number of ways, not least by pushing the value of owner occupied homes to the outer limits as they try and offset higher development costs while still out-bidding the competition for land.

The net result has been new housing supply sold at a premium which has done little to improve the affordability of housing, especially for those looking to access the market. However, developers may start to come under closer scrutiny in this area as new, recently published planning guidance enables local planning bodies to hold developers more accountable over what they build.

Focus on other end of supply spectrum?

Given the pressure on prices coming down the housing ladder another option would be to encourage the development of homes for those looking to trade down the market. The profile of supply means that the economics of trading down is not hugely attractive, with limited incentives for households to downsize unless they really have to. For example, the current average price of a two bed property in the South East of England is just £68,000 less than that for a three bed property before any allowance for moving costs are taken into consideration.

Increased provision of bespoke housing for those looking to trade down the market could potentially free up the availability of family housing which, in turn, should unwind prices back down the ladder. It would certainly provide more balance to existing supply.

A slow process

Nothing other than a sharp re-correction in house prices is going to provide instant relief from the affordability problems facing first time buyers. With the prospect of a prolonged period of relatively high house prices and single digit growth, policy makers need to look to the supply side if they are to begin to lay the foundations for a better balance in housing supply.

It is important to note that getting the right balance of tenure is just as important as developing the right size of homes. Improved supply of smaller sized homes in the rented sector may be a more attractive option than simply increasing the supply of owner occupied homes.

"Delivering new housing supply into the key market pinch points is the way to get the most immediate results"

However, with just 1% being added to supply each year there will be no instant results. Only by ensuring an appropriate balance of new supply into the principal 'pinch points' do we stand a chance of improving the affordability pressures facing those looking to access the housing market.

Hometrack Data Systems

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We have a proven track record of working with clients to deliver innovative, on-line products which provide unique information to inform enhanced decision making and improved risk analysis across a range of markets. Our success is based on strong business insight, market leading technology and unique data.

We have two principal business areas:

Lending Solutions

Hometrack is the market leading provider of automated valuations of residential property and risk based analytics to the financial services industry.

Hometrack's Automated Valuation Model is used by lenders to inform individual lending decisions as well as having major applications in the securitisation and capital market arenas.

Hometrack also deliver leading edge risk modelling and stress testing of mortgage portfolios for Basel and capital adequacy purposes.

Housing Intelligence

The residential sector is the UK's largest asset class yet in terms of analysis and information to help inform decisions it is far from transparent. The Housing Intelligence team are at the forefront of developing on-line systems and reporting products that deliver vital market intelligence for use in a range of markets.

Hometrack's market leading Housing Intelligence System is being used by local and regional government to inform policy and strategy in the housing and planning areas. Developers and investors are using the information and analysis in the system for demand modelling, scheme appraisals, planning negotiations and strategy development.

For further information on Hometrack and our products and services please e-mail business@hometrack.co.uk

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