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## Affordability and first-time buyers

- Gordon Brown has already identified as one of his top priorities “young couples finding it difficult to buy their first home.” Our research shows that this is a high priority for parents, too, with increasing numbers helping their children to become first-time buyers by providing them with a deposit.
- Northern Ireland and London are where first-time buyers are most likely to receive assistance. In each of these areas, more than 40% of first-time buyers aged under 30 receive help from relatives.
- Our research shows that an overwhelming majority of people support measures to ease affordability for first-time buyers. They favour moves to reduce rates at the start of a mortgage, extend its term and relax lending criteria. But lenders need to assess the associated risks carefully.
- People also want the government to help. But the most popular suggestions – cutting stamp duty or restoring tax relief on mortgage interest – would require a major reversal of policy that has increasingly taxed home-ownership.
- Through Homebuy and other schemes, the government has supported modest measures to ease affordability for first-time buyers who qualify. But the dilemma for the government is that this simply drives up prices further for other first-time buyers.
- For the foreseeable future, the first-time buyer market looks to be sustained by financial help from parents and other relatives. It is not clear whether there is any natural limit to the recycling of housing wealth in this way. Over time, however, the market could become polarised – with children of existing home-owners more likely to become first-time buyers.

### Distribution strategy workshops

11, 18 and 25 September 2007—CML Offices, Aldwych, London  
Hosted by Mungo Dunnett Associates

Is your organisation facing key distribution decisions? Do you have a strategy in place?

These three workshops will provide delegates with an understanding of the key pressures affecting mortgage lenders' distribution choices, the variety of strategies being adopted, and the best practices emerging from both individual channel usage and the effective combination of multiple channels.

to find out more about this event visit our website at [www.cml.org.uk](http://www.cml.org.uk) or contact Minal Chowdhri on 020 7438 8918 or by email: [minal.chowdhri@cml.org.uk](mailto:minal.chowdhri@cml.org.uk)



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# Affordability and first-time buyers

## “A problem to deal with”

As he prepares finally to succeed Tony Blair as prime minister, Gordon Brown has spoken about the issues he sees as priorities when he takes over later this month. In a BBC interview, he acknowledged that Britain faced a “housing problem that we have got to deal with.” He spoke of the need to focus on the sometimes conflicting objectives of increasing housing supply, building in a more environmentally sustainable fashion and addressing the affordability problems of “young couples finding it difficult to buy their first home.”

Data which we unveiled last month at the first in a series of journalist briefings shed fresh light on how first-time buyers cope with affordability problems. The data suggested that, while the number of first-time buyers had been surprisingly resilient, almost half (46%) of those aged under 30 were likely to be getting substantial financial help from relatives to raise a deposit. As many as 70,000 young first-time buyers may have received this sort of help in 2005. And the proportion has risen steadily from around 10% in 1995.

Our new research followed a poll we commissioned last year that looked at the challenges facing young people trying to buy their first home, and what might be done to help them. This earlier poll – carried out by YouGov – found that more than 80% of people believed that market conditions were either very difficult or the hardest they had ever been for first-time buyers. Only eight out of 2,400 people taking part in the poll believed that market conditions did not present difficulty for first-time buyers.

## Affordability – and aspirations

Since then, affordability has got no easier. The latest *Housing Market Report* showed that a typical couple, with two incomes, buying their first property in the last quarter of 2006 would have found that initial mortgage payments consumed 34% of their take-home pay. Despite the challenges, however, aspirations to home-ownership remain high – although perhaps, in some cases, unrealistic. Seventy-eight per cent of adults want to be home-owners within two years, and 84% aspire to owner-occupation within a decade. Both figures are significantly higher than the current level of home-ownership, which extends to 70% of the population.

First-time buyers are now borrowing, on average, 3.3 times their income. That figure has been trending upwards since December 2005, when it stood at 3.13 times income. And the proportion of first-time buyers taking out larger loans relative to their income has also been growing. In April 2005, 11% of first-time buyers borrowed four times their income but, by March 2007, the proportion had risen to 21%. Despite worsening affordability, however, there has been no decline in first-time buyer activity since 2004.

Lenders base the decision to offer a mortgage on more than just the income multiple. Buyers with larger deposits may, for example, be able to borrow higher multiples of income. Since the late 1990s, the average deposit paid by a first-time buyer has been largely unchanged, at around 10% of the value of the property. But there has been an increase in the number of buyers providing substantial deposits. In 2006, more than 20% of first-time buyers paid a deposit that was larger than their reported annual income. One in 10 provided a deposit of more than twice their income.

Some of these may be former owner-occupiers returning to the market, perhaps after a period working abroad or renting. These “returners” are captured in our first-time buyer data if they did not own a property at the time of their current purchase. It has been estimated that up to 20% of those classified as first-time buyers are, in



**“In London,  
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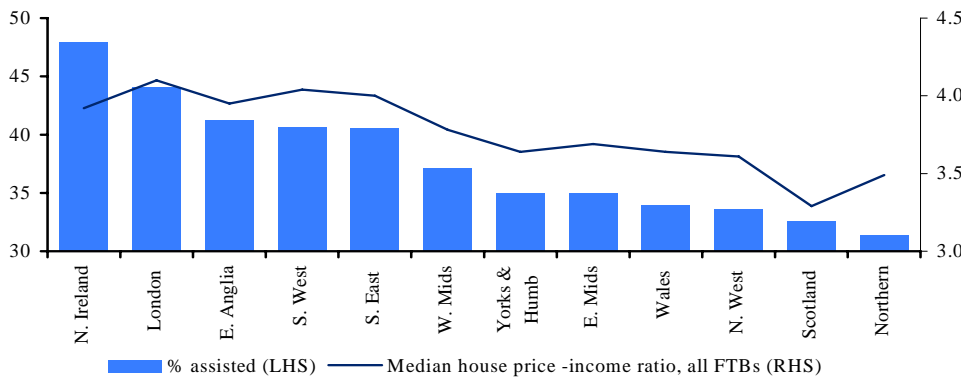


fact, returners. Many in this group may be able to put down substantial deposits from the proceeds of the sale of a property they formerly owned.

## Regional differences

There are, of course, unlikely to be many returners among first-time buyers aged under 30. A high proportion of buyers with larger-than-expected deposits in this group are therefore likely to be receiving financial help, mainly from parents or other family members. Our data suggests there is considerable regional variation in the proportion of first-time buyers receiving this sort of help. Northern Ireland has the highest proportion (48%), with London – where affordability is most stretched – in second place (44%).

**Chart 1: Assistance for first-time buyers under 30 versus house-price earnings ratio, UK regions, 2006**



Source: Regulated Mortgage Survey, CML/BankSearch

Areas with the highest levels of help generally have low levels of first-time buyer activity – hardly surprising as they are also the areas where affordability is most stretched. The exception is London, where, despite affordability constraints, there are both large numbers of first-time buyers and a high degree of financial assistance for them. In the capital, first-time buyers getting help with their deposit represent fully one-fifth of all house purchases where a mortgage is required.

It is in London that the differences between assisted and unassisted buyers are most pronounced. Last year, the typical buyer receiving help put down a deposit of £57,000 – more than twice the amount in any other region, apart from the south east (£34,950). By comparison, the average London first-time buyer receiving no help paid a deposit of just £12,500. The big difference in ability to put down a deposit clearly puts the assisted first-time buyer at a considerable advantage in the London market.

## Different risks

Looking at all the data, we concluded that first-time buyers not receiving help tended to have higher incomes and take out larger mortgages at higher loan-to-value ratios than those that are helped. Assisted buyers were purchasing more expensive properties and had significantly higher income multiples. That meant that buyers receiving help were potentially more exposed to higher interest rates, while those buying with no assistance were more at risk if house prices fall.

Although first-time buyer numbers have been holding up recently, mounting affordability problems have brought about significant changes over a longer period. In 2001, 40% of people aged under 30 were buying with a mortgage, while 33% were renting privately. By 2006, those percentages had been reversed.

**“Many forms of help imply greater risk for the borrower or the lender or both, and may therefore be possible only in some cases, perhaps where greater risk is mitigated by other factors”**



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Because renting provides greater mobility and more opportunity to live near work, it is perhaps preferred by increasing numbers of young people. However, demographic changes are set to produce an increase in numbers of young people. That should help sustain the first-time buyer market in the longer term, although recent rate rises – and the possibility of another one to come – might bear down on the market in the near future.

When we asked people in the YouGov poll about action to help first-time buyers address affordability problems, an overwhelming majority (78%) believed that something should be done. Asked who should be providing help, the government was the most popular choice, cited by 79% of respondents. People believed that the next most appropriate sources of help were local authorities (66%), lenders (61%) and builders (48%).

## What sort of help?

Asked what lenders should do to help, respondents favoured a variety of measures, including restructuring mortgage payments so they were lower at the start of the loan (68%), lowering mortgage rates (62%), lengthening repayment periods (62%), relaxing lending criteria (25%) and lending more money (14%). To some extent, each of these might be viewed as alternative means of easing affordability for first-time buyers who cannot rely on financial help from their families. But each of the options implies greater risk for the borrower or the lender or both, and may therefore be possible only in some cases, perhaps where greater risk is mitigated by other factors.

Our poll showed that the most popular courses of action that the government could pursue to help first-time buyers were abolishing stamp duty (supported by 66%), providing subsidies for first-time buyers (65%) and reintroducing tax relief on mortgages (63%). Clearly, the re-introduction of tax relief or abolition of stamp duty would require significant reversal of a policy approach that has relentlessly raised taxation on home-ownership. The government has shown little appetite even for modest reform of stamp duty. So far, the threshold for the basic rate of duty has been increased only twice in the last 15 years, and has risen considerably slower than the rate of house price inflation.

The government has supported modest measures to ease affordability for some first-time buyers, mainly in the public sector, through Homebuy and other schemes. But while these measures provide some help for those who qualify, the dilemma for the government is that they are likely to drive up prices further for all other first-time buyers – unless complemented by measures to increase housing supply. But although Gordon Brown has said recently that he would like to see a significant increase in house-building rates, it has proved difficult for governments to deliver this.

## The future

Affordability will therefore remain constrained, and the growing tendency for parents and other relatives to help young people become home-owners looks likely to sustain the number of first-time buyers for the foreseeable future. This will result, however, in housing equity held by older owner-occupiers being recycled to their children. That will help sustain house prices, creating wealth for existing owner-occupiers and giving them more potential to help their children.

It is not clear whether there are natural limits to the extent to which financial assistance can support housing market prices and activity. It also perpetuates a vicious circle. The more parents help their children to become home-owners, the higher house prices will be driven upwards and the more help the next generation of would-be home-buyers will need. Over time, the housing market could therefore become more polarised, with children of existing home-owners accounting for a progressively larger proportion of first-time buyers.



**“The more parents help their children to become home-owners, the higher house prices will be driven upwards and the more help the next generation of would-be home-buyers will need”**



## Mortgage endowment complaints fall by a third

The number of new mortgage endowment complaints received by the Financial Ombudsman Service (FOS) fell by a third in the last year, the ombudsman has announced.

The FOS received 46,134 new mortgage endowment complaints last year, down from 69,149 the year before, according to its annual review for 2006/07. Complaints about mortgage endowments accounted for almost half those received (49%) during the year.

But the review said that the ombudsman had seen a “marked improvement” in the way firms – particularly larger ones – had handled endowment complaints. That had led to an increase in the number of cases in which the FOS had ruled that complaints had been properly investigated by firms, and the right outcome reached.

In its review last year, the ombudsman had said it was not sure whether “re-projection” letters to consumers – informing them of a date on which any complaint would be “time-barred” for good – would spark an increase in complaints. In the event, there was no corresponding peak in complaints, but a steady decline in the number of cases throughout the year.

Areas in which the ombudsman saw an increase in complaints last year included banking (up 47%), loan protection (39% higher) and motor insurance (up 25%).

## CML signs declaration on climate change

The CML has become the first trade body in the financial services sector to sign up to the Trade Association Forum’s declaration on climate change.

We are committed to a range of measures to cut carbon emissions, including reducing staff travel, using public transport where possible, reducing electricity consumption by installing energy-efficient lighting in our offices, and recycling paper, plastics, glass and cans.

We are also aiming to take climate change into account in our wider work. Clearly, consumers also have an important role. But providing an energy performance certificate (EPC) with a home information pack (HIP) does not mean that householders will take steps to save energy. EPCs are a good first step but unless householders act on the information they contain they will not improve energy efficiency and reduce carbon emissions as the government suggests.

Delivering EPCs through HIPs means it will take more than 13 year before all home-owners receive one. Yet delivering EPCs is the government’s main rationale for pressing on with HIPs. The government should reflect on whether EPCs could be delivered more quickly and more universally by different methods.

- Strong rental demand means buy-to-let landlords are achieving desired rental yields, despite growth in the number of properties to rent, according to the National Association of Estate Agents. Migration and buoyant employment are driving demand for rented property.
- House prices in England and Wales were rising at an annual rate of 9.1% in April, according to the Land Registry. The average property sold for £179,935 in April.
- Proposals by the Northern Ireland Executive to create an affordable housing task force have been welcomed by Margaret Ritchie, the social development minister. House prices in Northern Ireland are currently rising by around 50% a year.





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# Automated valuation set to grow sharply

The use of automated valuations methods (AVMs) is forecast to grow sharply in the next four years, with lenders adopting the technique to value property in a quarter of house purchases and more than half of remortgaging.

A survey of lenders we conducted earlier this year showed that the use of AVMs is expected to grow in a modest way this year. In 2007, lenders predict they will use them for 3% of house purchases and more than a quarter (28%) of remortgaging.

Expected growth in the use of AVMs over the next four years will take place largely as an alternative to physically inspecting property. Interestingly, however, lenders in the survey predicted lower use of AVMs for house purchase than was suggested by our earlier research into the impact of home information packs (HIPs). But this may reflect the fact that home condition reports have been removed from HIPs in the interim.

Increasing use of AVMs in the coming years partly reflects a growing willingness to use the technique at higher loan-to-value ratios, both for house purchase and remortgaging.

While there was hardly any use of AVMs for loan for house purchase in 2006, lenders representing one-fifth of such lending expect to consider automated valuation this year in cases where the loan-to-value ratio is less than 75%. By 2011, this proportion is expected almost to treble, with lenders representing one-third of business also expecting to use AVMs for loan-to-value ratios up to 80%.

Forty per cent of lenders are already comfortable with using AVMs for remortgaging, but a similar pattern of expansion is expected in the coming years. This year, lenders accounting for almost 70% of such business expect to use AVMs on loan-to-value ratios up to 75%, and this looks set to become almost universal by 2011. Nearly one-third of lenders already use AVMs on loan-to-value ratios up to 80%, and by 2011 this is expected to climb to more than 70%.

There is much more reticence, however, about using AVMs where the loan-to-value ratio exceeds 80%. As might be expected, there is a little more appetite for this with remortgaging, but lenders in our survey showed no great enthusiasm for pushing beyond this level at this stage.

**Table 1: Percentage of loans using different valuation techniques**

	House purchase			Remortgage		
	2006	2007	2011	2006	2007	2011
Physical inspection	99	95	71	54	44	35
External inspection/drive-by	1	1	2	34	25	10
Desktop assessment	0	0	1	1	1	2
AVM	0	3	25	8	28	55
Other valuation	0	0	0	0	0	0
No valuation	-	-	-	3	3	-

Source: CML survey, March-April 2007

