

PENSIONS POLICY INSTITUTE

PPI

To buy or not to buy: the changing landscape of housing in retirement



The Pensions Policy Institute (PPI)

The PPI is an educational, independent research organisation with a charitable objective to inform the policy debate on pensions and retirement income provision. The PPI's aim is to improve information and understanding about pensions and retirement provision through research and analysis, discussion and publication. It does not lobby for any particular issue or reform solution but works to make the pensions and retirement policy debate better informed.

The PPI is funded by donations, grants and benefits-in-kind from a range of organisations, as well as being commissioned for research projects.

Pensions affect everyone. But too few people understand them and what is needed for the provision of an adequate retirement income. The PPI wants to change that. We believe that better information and understanding will lead to a better policy framework and a better provision of retirement income for all. The PPI aims to be an authoritative voice on policy on pensions and the provision of retirement income in the UK.

The PPI has specific objectives to:

- Provide relevant and accessible information on the extent and nature of retirement provision
- Contribute fact-based analysis and commentary to the policy-making process
- Extend and encourage research and debate on policy on pensions and retirement provision
- Be a helpful sounding board for providers, policy makers and opinion formers
- Inform the public debate on policy on pensions and retirement provision.

We believe that the PPI is unique in the study of pensions and retirement provision, as it is:

- Independent, with no political bias or vested interest
- Led by experts focused on pensions and retirement provision
- Considering the whole pension framework: state, private, and the interaction between them
- Pursuing both academically rigorous analysis and practical policy commentary
- Taking a long-term perspective on policy outcomes on pensions and retirement income
- Encouraging dialogue and debate with multiple constituencies

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Mark Baker joined the PPI in November 2018, as the Senior Policy Researcher. Prior to joining the PPI, Mark earned a PhD in Sociology from the University of Exeter before working for RNIB and RNID in senior research and policy roles, authoring a number of influential research reports as well as chairing the Disability Benefits Consortium and ACEVO's welfare to work special interest group.

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Prior to joining Hewitt John worked for the Government Actuary's Department for 8 years in the Occupational Pensions directorate, during which time he calculated public sector pension scheme valuations, bulk transfer values, and designed models for the use of other Government departments.

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Executive Summary

Rates of home ownership are declining in the UK

UK home ownership grew steadily after World War II, peaking in the early 2000s before the 2007-08 financial crisis saw a slight dip, from which a slow recovery is being made.¹ At the peak of home ownership in 2003, 71% of people owned their own home, either outright or with a mortgage. Recently, however, ownership rates have fallen, particularly among younger age groups.

The continuing rise in property prices has increased the number of (mainly younger) people who will be less likely to own their own home. Rental costs can prevent people from building up meaningful savings, making it harder for them to save for a deposit for a mortgage. This has implications for the future likelihood of people owning their own homes in retirement, which in turn could have a negative impact on their disposable income in later life.

Over the last two decades the average cost of a home across the UK has doubled,² even when taking the financial crisis into consideration. The rise in house prices has outperformed rises in average earnings, which stand at an increase of 70%³ over the same period. These factors have combined to make home ownership more difficult for many to afford, and for those who can afford to buy, the initial purchase occurs later in life on average.

More people are renting later in life

The increase in house prices has led to a rise in the numbers of working-age people renting, particularly in the 34-54 age group when historically people have been getting on to the property ladder (Chart Ex.1). While some of these people may inherit property or wealth later in life which may help them to buy, many could reach retirement still renting their homes.

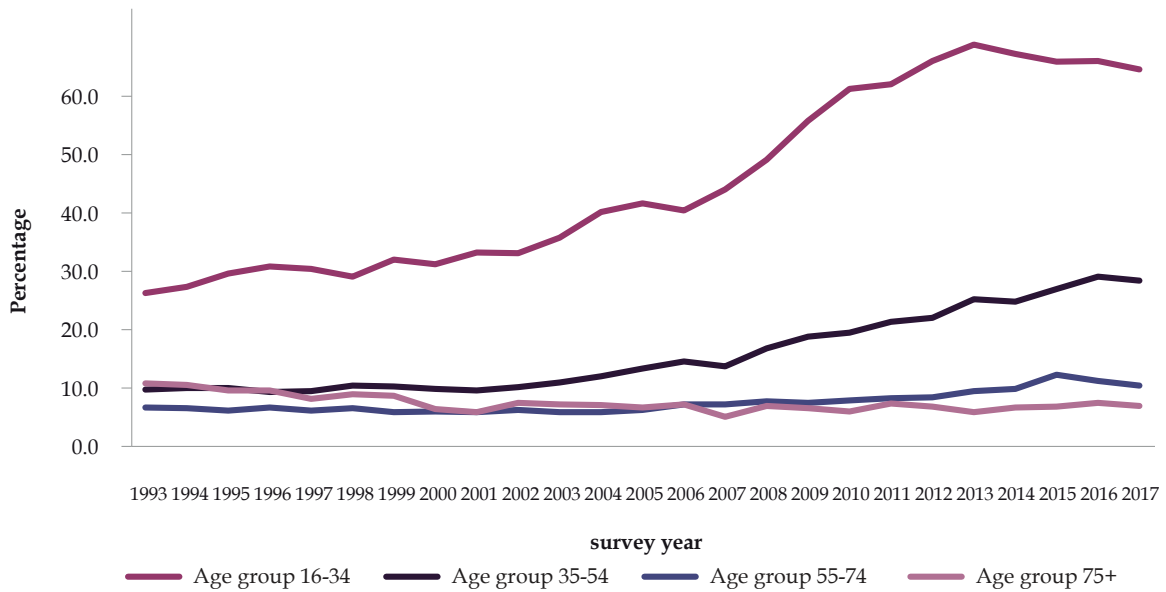
1 English Housing Survey 2018-19

2 Halifax 12 month rolling House Price index to November 2019

3 Annual Survey for Hours and Earnings, 2019

Chart Ex.1⁴
The percentage of younger people in the private rented sector has risen

Percentage of population renting privately by age band



Renting a home will reduce disposable income

For people who cannot yet afford to buy, renting a home is usually the only option. Renting a home throughout working life and retirement is generally more expensive than buying a property of a similar type and location within the UK. Renting can also result in less security and poorer standards of living, as a greater proportion of income over a lifetime is often spent on housing costs. Not only do renters have lower disposable incomes than homeowners, but homeowners also have the option to generate an extra source of income in retirement by using equity release schemes.

However, renting can enable more flexible use of income. Tenants are not responsible for meeting costs of repairs or home insurance for example, which may free up some disposable income for saving, including making extra contributions to a workplace pension. Renters also have greater geographical mobility, in that they do not have to rely on the sale of their property should they want to move elsewhere, perhaps in order to move to better-paid work.

Younger people are also more likely to live in shared rental accommodation, paying a fraction of the market price of the property and thereby increasing their disposable or saveable income.

When renting, younger people will also be making important long-term decisions about their futures. They will be balancing their everyday expenditure with saving for a deposit for a mortgage, or further in the future, making additional contributions to their workplace pension for their retirement (Figure Ex1).

4 ONS analysis of the Survey of English Housing / English Housing Survey

Figure Ex1



Owning a home can be both a means of saving money (in that once a mortgage has been paid off, housing expenditure will be minimised) and of generating income (releasing equity in the future). It also represents long-term security in retirement.

Automatic enrolment into workplace pensions has allowed millions of people to save for their retirement, but people may need to make additional contributions

Saving into to a private pension through working life can increase retirement income but reduces disposable income for working age people. Automatic enrolment into workplace pensions has seen 10 million more people paying into schemes that will allow them to accrue private pension savings to supplement their state pension in retirement. However, current levels of minimum contribution are relatively low, and people may find themselves without a level of retirement income that meets their needs or expectations, and they need support to make additional contributions to ensure better retirement outcomes if they can afford to.

People are likely to need to find a balance between pension savings, daily expenditure and saving towards a deposit on a property.

This report considers the type of support that people may require in order to ensure that they achieve an adequate retirement income and standard of living. As well as looking at those people who can afford to buy their home, it also looks at the implications for the growing number of people for who home ownership is unrealistic.

In order to understand the impact of access to the housing market, PPI modelled three hypothetical individuals with different life courses, who pursue different saving scenarios. The intention is to understand the effect of their decisions on their income after housing costs in retirement. PPI modelling is intended to be illustrative and are not intended to serve as projections of real-life outcomes. The modelling does not seek to account for all possible potential factors that can affect people's retirement outcomes.

People who can combine saving into their pension with home ownership are more likely to achieve an adequate retirement income than those who rent in retirement

'Comfortable Colin' is a hypothetical higher than average earner at the 70th percentile (£23,500 per year at age 22) and saves 8% over 20 years for a deposit. He has paid off his mortgage by the time he retires. He also saves with his employer 8% of total salary into a Defined Contribution workplace pension from age 22 to State Pension age (68).

Below shows the weekly retirement income (After Housing Costs) Colin receives from both State and private pensions under the following scenarios:

- After saving for his deposit, Colin does not contribute additionally to his workplace pension: a total contribution of 8% from age 22 to 68.
- After saving for this deposit, Colin contributes an additional 8% of total salary to his workplace pension: a contribution of 8% from age 22 to 42 and of 16% from age 42 to 68.

People, like 'Comfortable Colin' who can afford their own home may need support to make additional contributions to their pension pot as well as paying their mortgage if they are to continue to maintain their working-life standard of living in retirement.

Not only will these people have lower housing costs in retirement, but they could also release equity in their property to supplement their pension income or can downsize their home and generate income from the profit.

While owning a house in retirement reduces living costs and allows for a potential extra source of income through equity release, home ownership alone is unlikely to enable people to replicate their working life living standards in retirement.

In order to maintain his working age standard of living, Colin may need to contribute additionally into a private pension, above the minimum level under automatic enrolment. The more Colin earns while working, the more he will need to save into a pension, as the State Pension will replace proportionally less of his income. For example, someone who earns at the 70th percentile of median earnings who saves an additional 8% of income would still only meet their working age standard of living for six years after reaching State Pension age.

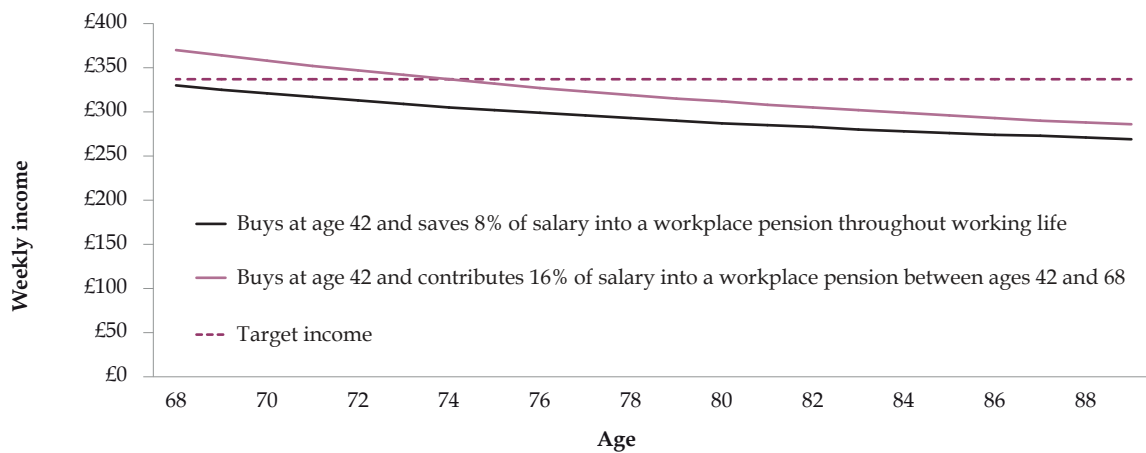
Assuming Colin lives to his average life expectancy of 89,⁵ when he dies his disposable, After Housing Costs (AHC), income under each scenario would be £269 per week without additional pension contributions and £286 per week with additional contributions, representing shortfalls against target income of 20% and 15% respectively (Chart Ex2).

5 Average life expectancy from age 68 for male, current age 22

Chart Ex2⁶

For homeowners on a higher income, additional pension contributions are still important in meeting target retirement income

Weekly retirement income After Housing Costs in 2020 earnings terms. Male, earning at 70th percentile, under different pension contribution scenarios compared to target income



'Capable Carol' is a hypothetical individual who earns at the 70th percentile for women (£22,290 per year at age 22. Below shows the weekly disposable After Housing Costs (AHC) retirement income Carol receives from both State and private pensions under the following scenarios:

- After saving for her deposit, Carol does not contribute additionally to her workplace pension: a total contribution of 8% from age 22 to 68.
- After saving for her deposit, Carol contributes an additional 8% of total salary to her workplace pension: a contribution of 8% from age 22 to 42 and of 16% from age 42 to 68.

Women like 'Capable Carol' on a higher income will typically have a lower retirement income than men

Women generally save less into a pension due to, among other factors, lower earnings, on average and the tendency to take a portion of time away from full-time work in order to meet caring responsibilities.

Earning at the 70th percentile of female earnings, Carol will have a weekly income after housing costs 13% lower than Colin upon retirement. As a result, Carol would have a lower target income, that she would manage to meet well into retirement even without making additional workplace pension contributions above the 8% minimum. However, because her earnings are lower, she will experience a lower standard of living both in working life and retirement, and as a result is more likely to face financial difficulties, even if she does meet her target income.

Assuming Carol lives to her average life expectancy of 91⁷, she will have a disposable AHC income of £249 per week in 2020 earnings terms, without making additional contributions above the 8% minimum, and £268 with additional contributions from age 42. Even without additional pension contributions of 8% of salary after having saved for a mortgage deposit, she will exceed her target income into her 80s. With these extra contributions, she will continue to exceed them until she dies (Chart Ex3).

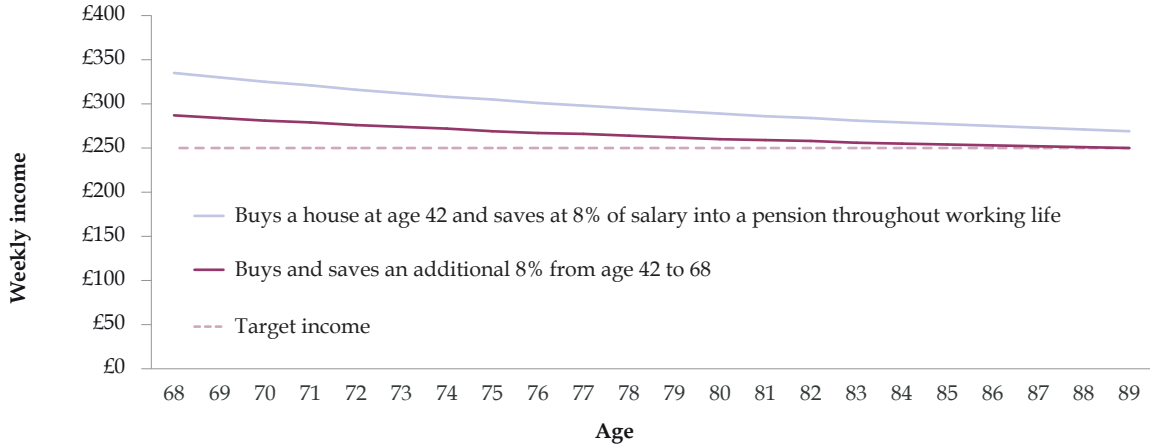
6 PPI modelling

7 Average life expectancy from age 68 for female, current age 22

Chart Ex3⁸

Higher earning women will typically have a lower retirement income than men

Weekly retirement income After Housing Costs in 2020 earnings terms. Female, earning at 70th percentile under different pension contribution scenarios compared to target income



‘Average Alan’ is a hypothetical median earner at the 50th percentile (£20,400 per year at age 22) and rents throughout his life. He saves into a workplace pension at 8% of total salary from age 22 to 68 and rents in the private sector at median rent throughout his retirement.

Below show the weekly disposable AHC retirement income Alan receives from both State and private pensions under the following scenarios:

- Alan maintains an 8% workplace pension contribution throughout his working life with no additional savings.
- Alan saves into a lifetime ISA (which allows him an additional 25% contribution from the government via tax relief) from age 22 and uses this to buy a house at age 36. Alan does not make additional pension contributions after buying his house but continues contributing at 8%.

Additional support for those who might find it more difficult to buy could make a significant difference as these people would gain financially from home ownership

People on median incomes such as ‘Average Alan’ could benefit from schemes that support them to buy a first home. Schemes that reward saving for a home or that provide greater flexibility in the use of savings, such as Lifetime ISAs and sidecar pensions, as well as schemes that combine renting with mortgages, can assist people to buy. As a result of buying, people generally face lower housing costs in retirement and may also be able to use some of the value of their property to supplement their income.

Some people might only be able to afford mortgages which extend into retirement. And some may never fully pay off their mortgages. People with longer mortgages generally also have lower working-life incomes and are likely to have lower target retirement incomes than higher earners. This means that while they may still need to save the 8% automatic enrolment minimum contribution level into their workplace pension, they might not need to make significant additional contributions in order to achieve their target income.

Assuming Alan lives to his average life expectancy of 89, at the time of his death, his disposable AHC income in 2020 earnings terms would be £205 per week renting and £258 having bought a home. Comparing these to his target income of £237 per week shows that home ownership in retirement gives him an income surplus of 9% when owning and a shortfall of 14% from his target income when renting.⁹

'Zero Hours Zoe' is a hypothetical lower earner at the 30th percentile (£15,000 per year at age 22) and rents throughout her life. She saves into a workplace pension at 8% of total salary, making no additional payments. She continues to rent in the private sector throughout her retirement with some contribution from Housing Benefit to meet her rent.

People who cannot afford to buy may need more structural support, such as social housing at reduced rent if they are to achieve a decent quality of life in retirement

People entering retirement who have not been able to get on to the property ladder, perhaps because of caring responsibilities or short-term and part-time working patterns, such as 'Zero Hours Zoe' may need more structural support in later life, such as more affordable social housing and help to meet housing costs from Housing Benefit.

The decline in the availability of social housing, as housing purchased by tenants under the buy-to-let schemes has not been replaced by new stock, has meant that more people are having to rely on the more expensive and less secure private rental market in retirement. Rising homelessness has further contributed to lengthy waiting lists for the social housing that does exist.

People renting in the private sector are also more likely to be reliant on Housing Benefit to help them meet their rent, because of the higher costs. However, Housing Benefit is set at a maximum of the 30th percentile of local rental costs and may not cover the costs of all suitable accommodation, meaning that some people may have to spend

an unaffordable proportion of income on rent, which reduces disposable income levels below that needed to meet basic needs.

In retirement, people who claim Housing Benefit and who have made contributions to their workplace pension may see their retirement income or savings eroded, as Housing Benefit is means-tested. If changes were made to the benefit system, for example, disregarding private pensions from the housing benefit means test, renters would find it easier to meet a target income after housing costs.

If it is assumed that private pension savings and income is disregarded in the means test for Housing Benefit, this would increase Zoe's disposable AHC weekly income in retirement by 20% (+£44) at age 68 and by 9% (+£16) by age 91.¹⁰ As it is anticipated that up to 50% more people will be renting in retirement in future, it is worth reflecting on whether the current means tested benefit system is best suited to support future pensioners.

Had Zoe been able to rent social housing in retirement, where rents are typically only 50% of those in the private sector, she could be around £33 per week better off throughout retirement after housing costs.¹¹

Financial advice and guidance could help people in making decisions that can improve retirement outcomes

Many of the choices people have to make about balancing saving for a deposit, renting, help-to-buy schemes, mortgages, contributions and equity release could have better long-term outcomes if people made use of financial advice or guidance services.

However, financial advice and guidance is under-utilised by younger people and those on lower wages. Advice is often perceived to be unaffordable and many people are unaware of the range of free guidance services on offer. With the length of time needed to save for a deposit for a mortgage increasing along with the size of required deposits, people may be taking decisions with far-reaching consequences at an earlier age. Greater use of available advice and guidance services would potentially assist more people to make effective decisions that will impact future retirement income.

9 PPI modelling

10 Average life expectancy from age 68 for current UK female aged 22.

11 PPI modelling

Introduction

This report seeks to understand the implications of a changing housing market on current and future retirement income and needs, particularly considering the growing private rental sector.

House prices have been rising steadily since 2013, in part because of the recovery from the 2008 financial crisis which affected property values at the time of the last PPI report that focused on housing.

People are finding it harder to get on to the property ladder, meaning that a growing number of people may enter retirement with no property equity at all. People are tending to buy their first home later in life than previous generations which is resulting in more people entering retirement with some level of mortgage on their home. This means that future people will enter retirement with more security in terms of their pension, but less in terms of their housing.

Building on previous PPI reports that looked at housing in 2004¹² and 2009,¹³ this report examines the impact of owning your own home at retirement, the possibilities associated with using property as a means of support in retirement, and the challenges facing a growing number of retirees in the rental market.

This report is informed by desk research, PPI modelling and interviews with experts in housing and retirement policy.

Chapter One examines the growth in the proportion of people approaching retirement in private sector rented accommodation and the reasons behind the predicted rise in retired renters.

Chapter Two examines the potential impact of renting versus home ownership on the growing numbers of people entering retirement without owning their own homes.

Chapter Three examines the decisions that people face as they reach retirement. It uses individual modelling to consider how they might mitigate the precarity of renting. It also looks at what homeowners might choose to do to use their property as a vehicle for retirement income.

12 Curry, C. PPI (2004)

13 Adams, J. & James, S. PPI (2009)

Chapter One: How will the increase in renting affect disposable retirement incomes?

This chapter examines the growth in the proportion of people approaching retirement in private sector rented accommodation, the reasons behind the predicted rise in retired renters and the financial consequences of renting in later life.

The Housing Market has changed considerably

A century ago, the majority of homes were rented privately, and only in the 1970s did home ownership become the most common form of tenure. Recent years have seen a growth in the private rental sector.¹⁴

After the first world war, the Government promised ‘Homes fit for heroes’ and embarked on a plan to build social housing, as 76% of households were rented privately with little or no control over rents or housing conditions.

Between the wars, despite economic pressures, the proportion of households in social housing reached 10% by 1939. Private building had also provided the basis for a rise in the proportion of owner-occupiers to 32%.

After World War 2, the proportion of socially rented homes increased steadily, reaching a peak of 32% in 1981, while the proportion of privately rented homes fell, reaching a low of 9% in 1991. The largest change however was in the proportion of owner-occupiers, which trebled from 32% in 1953 to 70% by the end of the century.

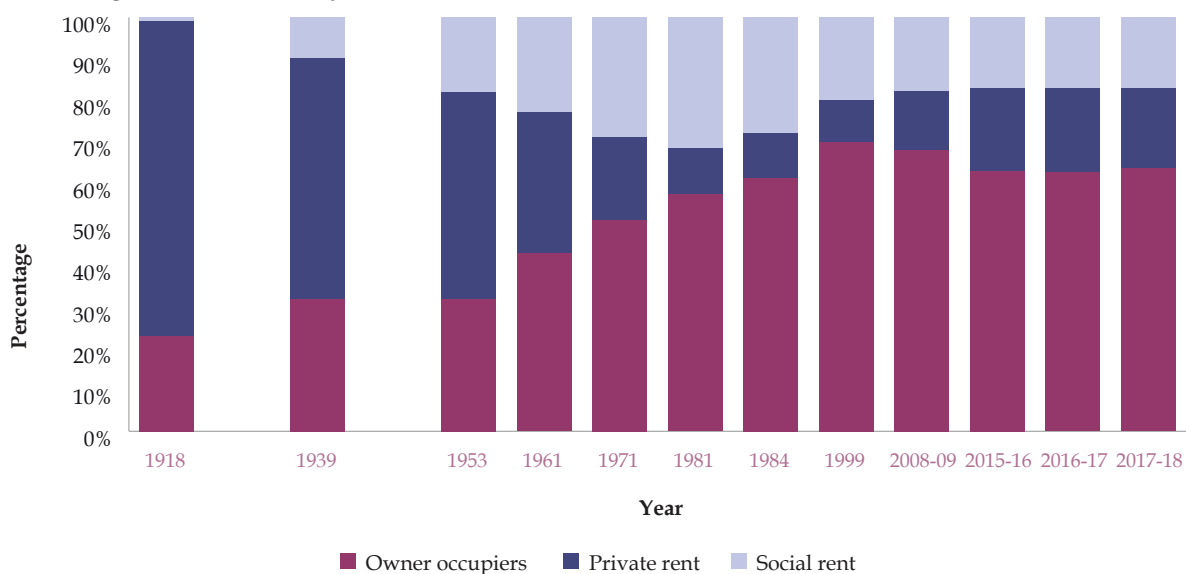
Since 2000, the financial crash of 2007-8 saw the proportion of owner-occupier households fall to around 63% on average, while private rental (20%) has again overtaken social housing (17%).

It was only in 1971 that home ownership became the most common form of tenure, with a significant increase seen during the 1980s, a period during which the right of social housing occupants to buy their home was introduced (Chart 1.1).

14 English Housing Survey 2018-19

Chart 1.1
Home ownership became the most common form of tenure within the last 50 years

Percentage of households by tenure, 1918-2018



Demand for appropriate housing across both the rental and purchase sectors has continued to outstrip supply since the 1980s, due largely to the lack of large scale housing projects undertaken by both the private and public sectors and the selling of almost 1.9 million council homes¹⁵ plus an increased demand from people using buy-to-let as an investment. This excess of demand contributes to the continued rise in house prices across the UK, meaning that more young people are reliant on the private rental sector, where they might have previously been able to buy or rent in the social housing sector.

As house prices have risen faster than wages, so has the amount of money and the proportion of income needed for people to pay a deposit for a mortgage, with an average of 19 years of saving now needed to reach the required level.¹⁶

At the same time as demand for rented properties has risen, there has been a long-term decline in the availability of social housing. As private rented accommodation is almost always more expensive than social housing, the greater proportion of income spent on rent will make it harder for renters to save for a deposit.

Recent changes to Housing Benefit, such as a reduction in the amount that people can claim

and a four-year freeze on working age benefits, could see people using a greater proportion of income to meet their rent, therefore having less of disposable income available for saving.

Buying a property is increasingly unaffordable for first-time buyers

One in three young people in the UK today might never own their own home and will continue to rent throughout retirement.¹⁷ Most of these people will be renting privately, facing greater financial demands as well as less security in their accommodation.

The cost of buying a home continues to rise, making it less affordable for people on lower incomes

House prices across the UK reached a peak in 2007 before the 2008 recession but recovered strongly after 2013. Nationally, house prices rose 23% between the 2007 peak and 2018, with significant regional variations. Prices in London (62%), the East of England (41%) and South East England (38%) rose sharply, compared to Scotland (7%) and the North East of England (where prices have yet to recover and stand at -6%) (Chart 1.2).

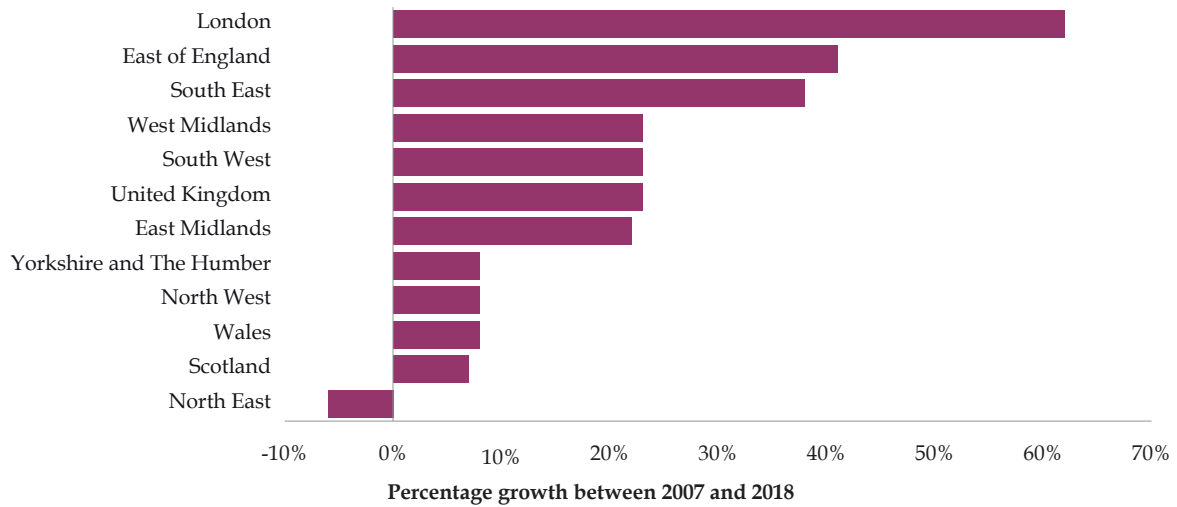
¹⁵ National Audit Office (2016)

¹⁶ <https://www.resolutionfoundation.org/comment/the-real-barrier-to-millennials-owning-a-home-is-not-the-mortgage-its-the-deposit/> Accessed 15/01/20

¹⁷ Judge, L. & Thompson, D. (2018)

Chart 1.2¹⁸
House prices continue to rise, though there are significant regional variations

Percentage of house price growth across GB between 2007 and 2018 by region

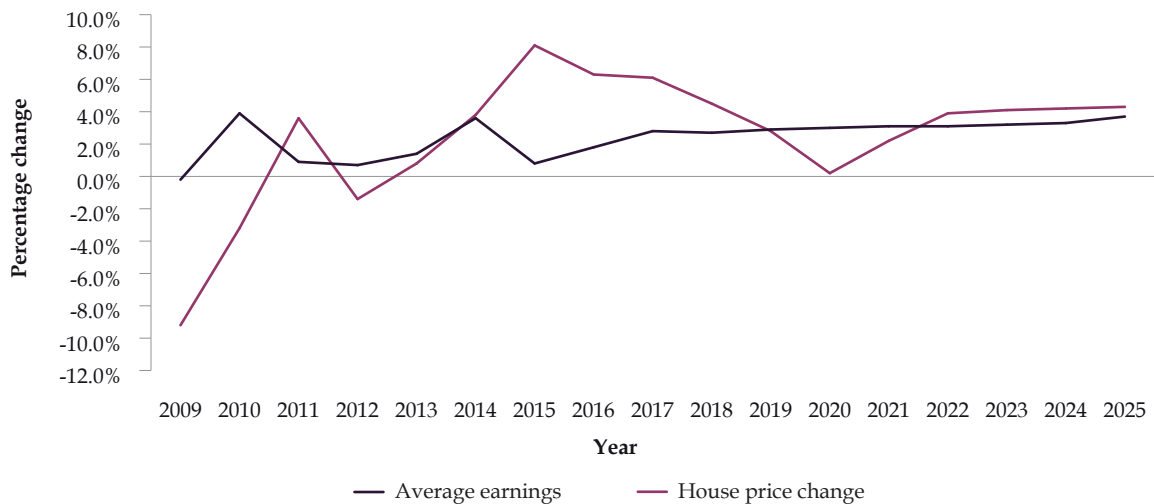


House prices are still rising, making deposits more expensive

House prices are projected to continue to rise faster than earnings over the next five years, making it more difficult for people on an average income to meet the costs of a deposit (Chart 1.3).

Chart 1.3¹⁹
House prices have generally risen faster than earnings since 2009

Variations in house prices and average earnings 2009-2025



Despite fluctuations in the housing market, low wage growth has been a contributing factor to house prices rising faster than earnings, making it harder for people to afford to buy.

18 PPI analysis of ONS House Price Indices (consistent with OBR approach)

19 PPI modelling based on English Housing Survey 2017-18

The difficulty of saving for a deposit is the main barrier to home ownership

The main barrier to people accessing the property market is that of saving for a mortgage deposit. The average home in the UK in December 2019 cost £235,000,²⁰ meaning that a 5% deposit, the current minimum available, would be £11,750.

As people in the private rental sector are spending a greater proportion of their income on rent, saving for a deposit is becoming harder for many families. In the 1990s it took the average young family three years to save for a reasonably-sized deposit; today it would take the same family 19 years to accrue the amount they need.²¹

The time taken to save for a deposit means that those who don't make early decisions about their priorities for later life may not achieve their desired retirement outcomes. The fact that a family may have to save for 19 years

before starting to pay off a mortgage lasting the current average for first-time buyers (of 29 years) means that for a family starting to save for a deposit at age 25, a mortgage may not be completely redeemed until age 73.

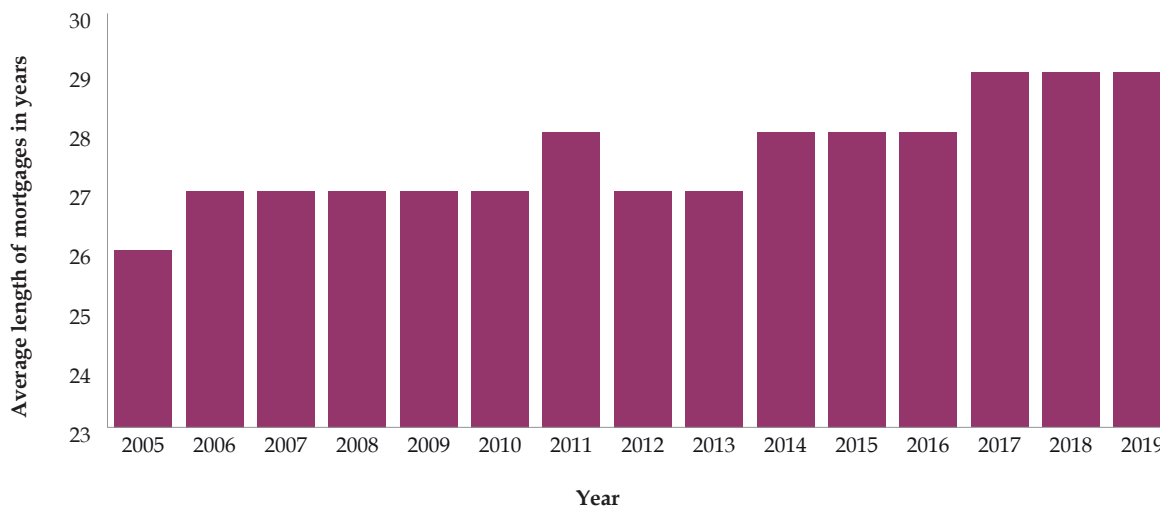
However, among private renters, 63% do not have any savings at all, and only 11% have savings totalling more than £16,000,²² indicating that the majority of renters in the private sector are currently not in a position to save for a mortgage deposit.

The length of time that people spend paying a mortgage has risen, seeing more people in debt for longer

The average length of a first-time mortgage has risen from just under 26 years in 2005 to over 29 years in 2019, and more long-term mortgage products, lasting up to 40 years are being taken up, as a result, more people will find themselves with outstanding mortgage debt by the time they reach State Pension age (Chart 1.4).

Chart 1.4²³
The average length of mortgages for first-time buyers has risen by three years since 2005

Average length of mortgages for first-time buyers across GB, 2005-2019



20 <https://landregistry.data.gov.uk/app/ukhpi>
 21 <https://www.resolutionfoundation.org/comment/the-real-barrier-to-millennials-owning-a-home-is-not-the-mortgage-its-the-deposit/> Accessed 15/01/20
 22 English Housing Survey, Private Rented Sector, 2017-18
 23 English Housing Survey, 2017-18

Housing demand continues to outstrip supply, helping to increase prices further

There has been a general shortfall in housing supply since the 1980s, particularly for first-time buyers. There is a variety of estimates regarding the housing shortfall in the UK, in terms of required new build, ranging from 250,000²⁴ to 340,000²⁵ new homes per year. The shortfall serves to drive prices up, compounding unaffordability. The previous, 2019, Government committed to building 300,000 new homes in England per year to meet the shortfall, however, only 241,000²⁶ new homes were completed in 2018-19.²⁷

Bequests are not typically used to fund house purchases

Most people of working age can expect to inherit some wealth during their lifetime. However, bequests from deceased parents typically occur only when the second parent dies. Increases in longevity mean that inheritance is claimed later in life and is less likely to form the basis for buying property. Housing wealth is also relatively illiquid and is likely to be shared between siblings as a bequest, meaning that housing, while it may form a significant part of an estate, is unlikely to provide a platform for house buying,²⁸ and more likely to form part of general saving or investment. There has also been a growth in the equity release market that may have seen the size of bequests fall.

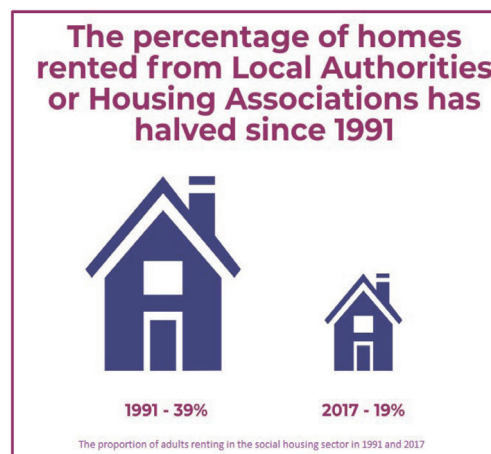
However, the advent of pensions freedoms has meant that people can withdraw Defined Contribution pension savings more flexibly from age 55. Some people are using their 25% tax free pension commencement lumps sum to provide financial assistance for their adult children, in part to help them in the housing market.²⁹ This trend will increase the ability of some younger people to purchase a first home, but could adversely affect the retirement income of their parents.

The availability of social housing has fallen sharply, making people on lower incomes more dependent on the relatively expensive private rental sector

The number of new homes available for social rent in 2018-19 in England stood at 6,287, the second lowest number since the Second World War, and a fall of 83% since 2010-11.³⁰ The depletion of social housing stock and changes to the criteria for social housing eligibility throughout the UK has meant that more people on low incomes have had to seek accommodation in the private rental sector, where rents are more expensive, impacting more on their ability to save either for a deposit or for retirement.

While there has been a steady growth in the number of new homes at 'affordable rent' levels (57,485 in England in 2018-19), these homes are more expensive to rent than social housing, being set at a cost equivalent to 80% of the local private rental market. Social rents tend to average about 50% of the private market. Since 1991, the percentage of homes that were rented from a Local Authority or Housing Association has halved, from 39% in 1991 to 19% in 2017³¹ (Figure 1.1).

Figure 1.1



24 Holmans, A (2019)

25 Bramley, G (2019)

26 Figure is net of loss of existing stock and includes conversions

27 Ministry of Housing, Communities & Local Government (2019d), Housing supply; net additional dwellings, England 2018-19.

28 Crawford, R. (2018), The use of wealth in retirement, Institute for Fiscal Studies

29 Parkin, R. (2019)

30 Ministry of Housing, Communities and Local Government (2019b), Affordable housing supply statistics 2018-19.

31 PPI modelling based on the British Household Panel Survey (1992) and Understanding Society (2018)

The growth of the private rental sector and the buy-to-let market have made it more difficult for people to access the property market

The growth in the buy-to-let market and the influx into the rental market of former social housing properties purchased under the Right-to-Buy scheme which have not been replaced,³² have contributed to expansion of the private rental sector. As this sector has grown faster than new build accommodation, the stock of housing available for purchase has dwindled, increasing the cost of owning a home outright.

The number of buy-to-let mortgages has risen fifteenfold over the past two decades.³³ Buy-to-let became more prevalent with changes to tenant's rights in the Housing Act 1988, bringing about the Assured Shorthold Tenancy, meaning that tenants did not have indefinite right to reside.

Buy-to-let mortgages are often cheaper than owner-occupier, because they are based on a calculation of the rental income for the buyer. While the interest rates on buy-to-let are generally higher, most are purchased as interest-only products, with the loan being met from the eventual sale of the property (which itself will provide a surplus for the owner or their estate). These are therefore cheaper, because the payment due is only on the interest of the loan rather than the full value of the loan itself.

The popularity and affordability of buy-to-let as a basis of generating income led to a spike in house prices,³⁴ though recent legislation has served to curtail the attractiveness of buy-to-let mortgages. Reducing higher rate tax relief, removing Capital Gains Tax advantages on second properties and increasing stamp duty have combined to make buy-to-let mortgages less affordable,³⁵ and there are signs that the buy-to-let market is shrinking.³⁶

In 2018, 11% (5.5 million) of the adult population owned a second home,³⁷ with 1.9 million of these being buy-to-let properties. Among working age people, 11% expect to use rental income to help fund their retirement. This can be a good investment for retirees, providing an extra source of income in retirement but can also place more strain on the property-for-sale market by reducing available stock. The number of second homes that are not used for rental also represents a greater potential loss of stock that could be used for residential purposes.

The cost of prime property rental prices is set to rise. Between the years of 2019 and 2023, the overall growth of prime real estate rental prices is projected to reach 12.6%.³⁸

The Right-to-Buy social housing has helped people onto the property ladder, but has also diminished the stock of social housing

The introduction of Right-to-Buy in 1980 allowed council tenants to purchase their homes at a considerable discount from market rates (between 33% and 70%). Since its introduction, almost 1.9 million council homes have been purchased under this scheme in England.³⁹ Although local authorities received half of the proceeds from sales, they were restricted to use it to clear existing debt rather than build more homes. In this way, the scheme further contributed to the decline in social rented housing.

It has been estimated that 40% of Right-to-Buy properties have ended up in the private rental sector,⁴⁰ further diminishing the retail housing stock by more than 450,000 homes.

32 Jones, C. & Murie, A. (2006)

33 Data from Mortgage Finance Gazette <https://www.mortgagefinancegazette.com/lending-news/buy-to-let/imla-calls-government-stop-intervening-buy-let-09-07-2019/> Accessed 21.02.20

34 <https://www.mortgagefinancegazette.com/features/influence-buy-let-uk-housing-06-02-2017/> Accessed 17.12.19

35 See Appendix 1 for further details

36 <https://www.theguardian.com/money/2020/feb/08/britains-buy-to-let-boom-is-over-we-should-rejoice> Accessed 08.02.20

37 Resolution Foundation (2019)

38 <https://www.statista.com/statistics/323657/uk-wide-prime-property-rental-price-growth/> accessed 17.01.20

39 Ministry of Housing, Communities and Local Government (2019c), Social housing sales, annual sales by scheme in England, 1980-81 to 2018-19

40 <https://www.insidehousing.co.uk/news/news/exclusive-7-rise-in-former-right-to-buy-homes-now-rented-privately-53507> Accessed 17.01.20

Homelessness is rising, with more people excluded from the housing market

It has been estimated that there are currently 320,000 homeless people in the UK,⁴¹ including those people living in statutory temporary accommodation, hostels or sleeping rough. This represents a rise of 8.7% over two years. While these numbers are relatively small in terms of the UK housing market, they do reflect the need for affordable social housing. The growing number of homeless people creates more pressure on the social rented sector, making waiting lists for available homes longer. There are currently 1.15 million households currently on social housing waiting lists.⁴²

Changes to Housing Benefit have increased the costs of renting for some people

Housing Benefit reform has impacted working age people, as the rate at which benefits have been paid has been frozen since 2016, while rental prices have increased, meaning that renters have had to use an increasing proportion of their non-benefit income to meet rent costs. Given the low levels of Housing Benefit, it is unlikely that many people receiving it can save for a deposit. For working age people, Housing Benefit is being rolled into Universal Credit, which has already seen many recipients experience debt as a result of increased waiting times for first payment and repayments of loans against early access to the benefit.⁴³ Many landlords and agents also refuse to let property to people in receipt of Housing Benefit, because of the perceived low level of Housing Benefit income compared to market prices, and fears of delays and arrears in payment.⁴⁴

The Spare Room Subsidy, also known as the 'Bedroom Tax' has had an indirect impact that can be assumed if not proved. The intended consequence of the policy was to engineer 'rightsizing' by having people move from larger properties to smaller ones by reducing the

amount of Housing Benefit they could receive if they were deemed to have unused bedrooms in their socially rented accommodation. However, the lack of smaller social housing stock has increased demand for suitably sized accommodation in both the social and private rental sectors.⁴⁵

Conclusions

- As house prices have risen faster than wages, people need to save for longer to pay a deposit for a mortgage, with an average of 19 years of saving now needed to reach the required level.
- The demand for rented properties has risen, exacerbated by the long-term decline in the availability of social housing.
- Private rented accommodation is almost always more expensive than social housing, the greater proportion of income spent on rent makes it harder for renters to save for a deposit.
- Rising homelessness not only means that more people are distanced from the property market but creates further need for affordable social housing.
- Recent changes to Housing Benefit such as reducing the amount that people can claim and a four-year freeze on working age benefits could see people having to use more of their income to meet their rent, therefore having less of disposable income available for saving.

41 Shelter (2018) Homelessness in Great Britain: the numbers behind the story https://england.shelter.org.uk/__data/assets/pdf_file/0020/1620236/Homelessness_in_Great_Britain_-_the_numbers_behind_the_story_V2.pdf Accessed 08.01.20

42 <https://www.gov.uk/government/statistical-data-sets/live-tables-on-rents-lettings-and-tenancies> Accessed 21.02.20

43 Work and Pensions Select Committee (2019)

44 Wilson, W. (2019)

45 Department for Work & Pensions (2015)

Chapter Two: What are the impacts of renting in retirement?

This chapter examines the impact of renting on the growing numbers of people entering retirement without owning their own homes.

Paying rent or a mortgage in retirement is associated with people experiencing a lower standard of living, a significant reduction in disposable income, a higher risk of poverty and a lower capability to meet daily needs, particularly care needs as they change through retirement.⁴⁶

Paying rent is generally more expensive than paying a mortgage. There are costs that tenants do not have to meet (such as home insurance, mortgage insurance and paying for repairs and maintenance), however, by the time mortgagees reach retirement, most mortgages are paid off. This means that they have significantly lower housing related costs at that time and through retirement. Having to pay ongoing rent will generally have a negative impact on the finances of pensioners.

The reduction in the availability of social housing means that more people will be renting in the private sector, where costs are higher. Social rents are usually around 50% of local market rents.

As more people are going to be renting privately in retirement, there could be a significant expansion in the numbers claiming Housing Benefit. This extra expenditure for the State will need to be alleviated by either the State investing more in social rented housing or simply reducing the level of the benefit provided.

There is significant disparity in the British housing market between older homeowners and younger renters that may continue to expand as younger people find it more difficult to get onto the property ladder.

The numbers of people renting in retirement is expected to rise

Currently, 5.6% of people aged over 65 are tenants in the private rental sector- about 380,000 people, a rise of 130,000 - or 52% since the 2011 Census.⁴⁷

However, the numbers of younger people renting privately has risen considerably over recent years. Of those aged between 35 and 54, 21% are in the private rental sector, almost three times the proportion in 1993 (Chart 2.1).

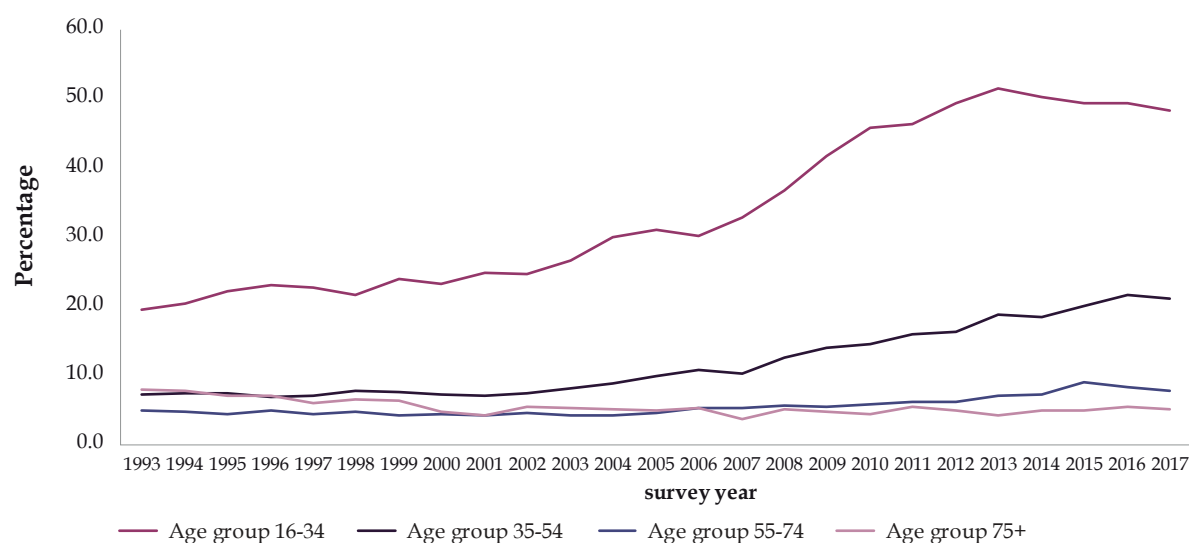
Many of these people are unlikely to get and pay off a mortgage by the time they reach retirement, though some may inherit property or move into social housing later in life (Chart 2.1).

⁴⁶ Silcock, D., Brain, A & Pike, T. PPI (2019)

⁴⁷ English Housing Survey, 2017-18

Chart 2.1⁴⁸**The percentage of younger people in the private rented sector has risen**

Percentage of population renting privately by age band



Based on current trends, the percentage of people of retirement age in the private rental sector could more than double to 12% by 2046, due mainly to changes in patterns of home ownership,⁴⁹ with fewer people buying homes.

On a monthly cost basis, renting in the private sector is almost always more expensive than paying a mortgage

Across the UK, renting is more expensive, on average, than paying a mortgage. Not only in terms of ongoing costs over time, but

also in terms of the monthly outlay. Some of these additional costs are offset by the fact that tenants are not required to pay for home insurance, mortgage insurance and necessary repairs and renovation.

Private rental costs vary significantly across the UK. In September 2019, the average monthly rent in London was £1,694 pcm, over three times the monthly rent for the North East (£535).⁵⁰ For people on a limited income in retirement, this could make accessing the private rental sector very difficult (Chart 2.2).

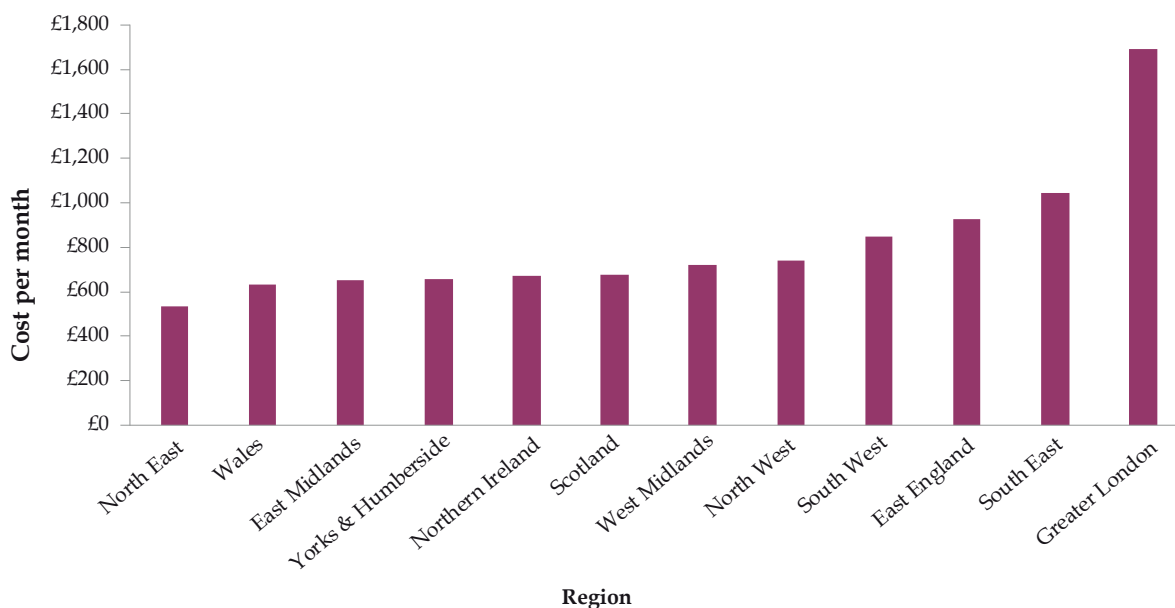
48 ONS analysis of the Survey of English Housing / English Housing Survey

49 Best, R. & Martin, D (2019)

50 <https://www.statista.com/statistics/752203/average-cost-of-rent-by-region-uk/>

Chart 2.2⁵¹
Private rental costs vary significantly across the UK

Average monthly rental costs by region, 2019



UK pensioner couples have an average income of £1,967 per month, with a single pensioner averaging £923 before housing costs.⁵² Despite the higher cost of housing, and the highest median weekly pay for those in work,⁵³ London also sees the lowest pensioner incomes in the UK, indicating that renting privately is particularly difficult to afford in the capital. This discrepancy may be explained by better-off pensioners having more geographical mobility and moving out of London in retirement.

The amount of monthly income that future generations of older private sector renters will pay in rent could represent a substantial proportion of their income

Across England, about 33% of income is spent by private renters on accommodation after Housing Benefit.⁵⁴ This is considerably more than older homeowners spend on mortgage payments as a percentage of household income, which is between 10% and 15% for homeowners aged 55 and over (Chart 2.3).

51 <https://www.statista.com/statistics/752203/average-cost-of-rent-by-region-uk/>

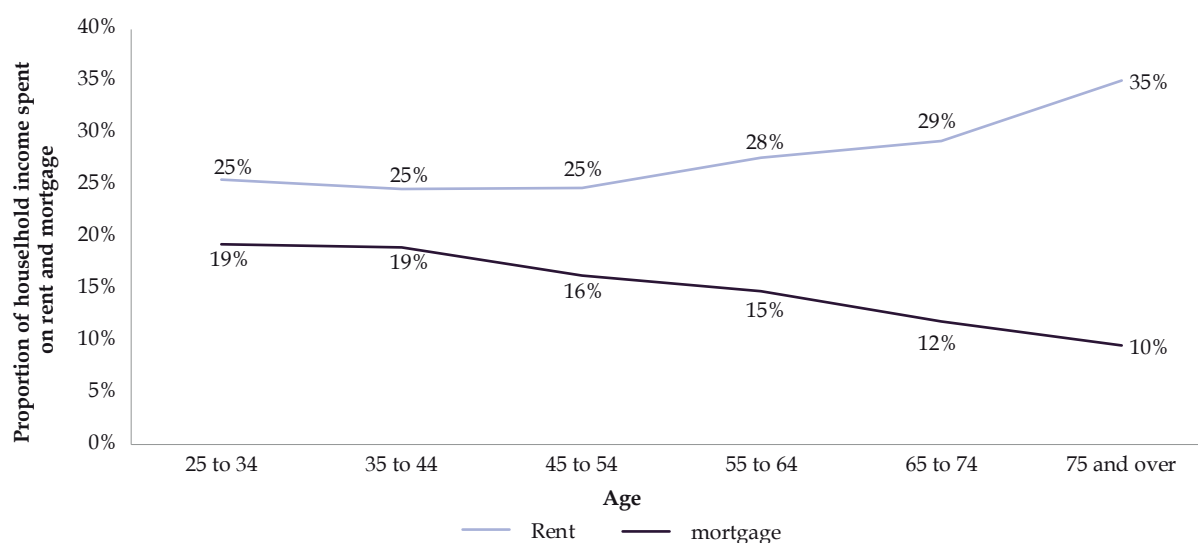
52 Department for Work and Pensions (2019), Pensioners’ Income Series

53 House of Commons Library <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8456#fullreport>

54 English Housing Survey, 2017-18

Chart 2.3⁵⁵**Older renters spend significantly more on housing costs than homeowners**

Median proportion of household income spent on rent and on mortgages, by age, GB - Date



People renting in the private sector generally have lower incomes than mortgage holders. The Affordable Housing Commission has stated that a rental cost of 33% of income is difficult to maintain, and a cost of 40% of income is “impossible” to meet.⁵⁶ Rental costs could rise by around 3% per annum over the next three decades if current trends continue.⁵⁷

Rental costs are projected to rise faster than average pensioner income with fewer future pensioners having access to Defined Benefit retirement income. As increased rents take up a greater proportion of pensioners’ income, private rented accommodation will become less affordable with time (Chart 2.4).

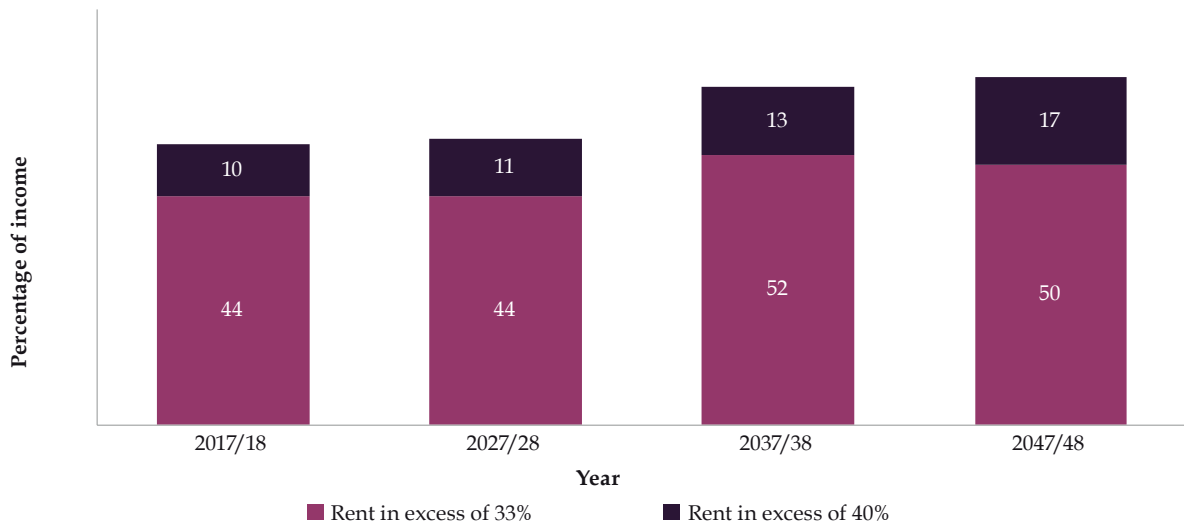
55 PPI Analysis of the English Housing Survey, 2018

56 Affordable Housing Commission, 2019

57 PPI modelling

Chart 2.4⁵⁸
Rent will account for a growing share of older people’s income

Rental costs as a percentage of average pensioner income 2017/18 to 2047/48



More pensioners will be paying off mortgages in the future, reducing their disposable income

Most people owning their own homes in retirement in the future will have paid off their mortgage, though the numbers of life-long (40 year) mortgages is growing. Those still paying a mortgage in retirement will need access to a larger proportion of their income or savings, though not as much as if they were renting a similar property on the private market. More flexible working lives may also see more people working into their 70s therefore being more able to meet mortgage payment costs in later life. However, working past State Pension age is not a possibility for everyone, as issues such as health, disability and caring may impact upon an individual’s capacity to work.

The rise in the numbers of older people renting in retirement could see more people claiming Housing Benefit, either increasing costs to the Government or prompting policy changes

With potentially large numbers of older tenants facing difficulties in meeting rent, there may be a growth in Housing Benefit claims from older people. Currently, the Government spends £5.7bn per year on Housing Benefit for older people (£17bn for working age people), a figure that has roughly doubled over the past three decades.⁵⁹

Forecasts from the Office for Budget Responsibility project the Housing Benefit bill for older people to rise by 5% over the next four financial years,⁶⁰ a figure that echoes PPI modelling of the effects on the Housing Benefit bill caused by more people renting in retirement. Taking the PPI model further into the future, Housing Benefit could rise by as much as 16% by 2034, reaching £6.6 billion annually.

58 PPI analysis of Best, R. & Martin, A., 2019

59 PPI modelling, based on the assumption that current non-owners do not purchase property

60 Office for Budget Responsibility, March 2019 welfare spending forecast.

As a result of this growth in expenditure, recent trends in Housing Benefit reform have sought to reduce the bill to the Treasury, and to use it as a proxy instrument to control rents.⁶¹ Despite this reform, private sector rents have continued to increase.

Many private landlords are reluctant to have tenants on Housing Benefit for fear of arrears or defaults and because Housing Benefit rates do not reflect market prices. This may increase further as the responsibility for making the payments reverts to the tenant rather than an automatic payment to the landlord as part of the migration of Housing Benefit for working age people into the Universal Credit system.

While it is expected that retired people on a low income will continue to have their rent met by Housing Benefit, the fact that they will likely have had to meet a greater proportion of their rent while of working age will impact upon their ability to save or make additional contributions to a workplace pension.

Renting in the private sector can be less secure than either social renting or home ownership

The introduction of assured shorthold tenancies (ASTs) as the default tenancy agreement from 1997 made it easier for landlords to obtain possession of their property without having to establish fault on the part of their tenants. Under ASTs, all tenants are subject to 'no fault' eviction after their lease expires (typically after 6 or 12 months) and has seen growing numbers of older people experiencing problems with security of tenure.⁶²

In the current private rented sector, more than half of evictions are 'no fault',⁶³ making tenancies less secure and contributing to increased instances of physical and mental health problems.⁶⁴

Recently, the Government has committed to ending 'no-fault' evictions, which should provide a greater degree of security for tenants. However, tenants will still face the threat of potential rent rises or living in below-standard accommodation that does not meet their needs as they get older.

The lack of housing supply and the difficulties associated with being able to afford to get onto the property ladder have also combined to create an intergenerational imbalance in terms of property wealth.

61 Wilson, W. & Barton, C. (2019)

62 "Living in Fear", Experiences of Older Private-Renters in London, Age UK, 2017

63 Clarke, et al (2017)

64 https://england.shelter.org.uk/media/press_releases/articles/2_million_renters_in_england_made_ill_by_housing_worries accessed 31.01.20

There is a growing imbalance in the housing market

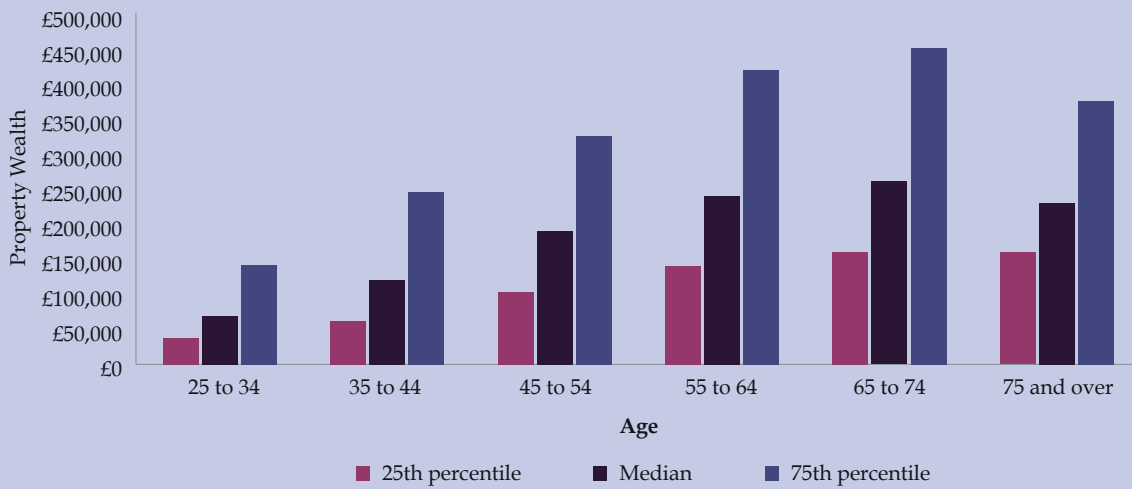
Property wealth is distributed unevenly across Great Britain⁶⁵

Home ownership among the over-65s is 78% compared to 64% across all age groups. People over 65 will also typically own their home outright with no mortgage. However, within these age groups, property wealth is again uneven, with those at the 75th percentile of income distribution having almost three times the amount of property wealth than the 25th percentile (Chart 2.5).

Chart 2.5⁶⁶

The distribution of property wealth is uneven both between and within age groups

Distribution of property wealth of home-owners (property wealth less mortgage debt), by age, GB - 2018



Older households tend to have more housing space than they need on a day-to-day basis

The English Housing Survey indicates that around three million (53%) households aged 65 and over are under-occupying their home with more space than they normally need,⁶⁷ defined as having one or more spare bedrooms. This suggests that a large amount of the property equity owned by older people is held in larger family homes that would not be suitable for first-time buyers who would generally be competing in the market for smaller properties with older homeowners seeking to downsize.

65 No data were available for Northern Ireland

66 PPI modelling

67 Savills (2015)

Conclusions

- House prices across the UK are expected to continue to rise meaning that more young people are reliant on the private rental sector, where they might have previously been able to buy.
- Paying rent or a mortgage in retirement is associated with people experiencing a lower standard of living, a significant reduction in disposable income and a lower capability to meet daily needs.
- Paying rent is almost always more costly than paying a mortgage and having to pay ongoing rent will generally have a negative impact on the finances of pensioners.
- The reduction in the availability of social housing will mean that more people will be renting in the private sector, where costs are higher.
- As more people are going to be renting privately in retirement, there could be a significant expansion in the numbers claiming Housing Benefit, which may result in future Governments having to introduce further reforms.
- Property wealth is distributed unevenly across Great Britain, and the gap between older homeowners and younger renters may continue to expand as younger people find it more difficult to get onto the property ladder.
- Greater awareness of the costs associated with renting in retirement amongst younger people could enable people to plan their savings to better meet their needs in later life.

Chapter Three: To buy or not to buy?

This chapter examines the decisions that are likely to face people as they reach retirement. As fewer people may own their homes later life, it considers what might be done to mitigate against the precarity of renting. It also looks at what homeowners might choose to do to use their property as a vehicle for retirement income and identifies some of the sources of support that might aid them.

For many people, the options are limited. If they cannot access the housing market during their working lives, then they become more likely to face the additional ongoing costs of renting in the more expensive and less secure private market in retirement.

People who can afford to buy could benefit from support to make additional pension contributions to meet a similar standard of living in retirement that they had during working life. Raising the required minimum contribution under automatic enrolment legislation to a workplace pension from employees and employers would increase the size of pension pots. Automatic escalation policies can also increase savings. These involve contributions from members (and potentially their employers) rising automatically in line with other changes, such as pay rises or length of time working. For example, a member could agree that their pension contributions will rise by 1% every two years or whenever they receive a pay rise of more than 2%, until they reach a certain total amount.

Alternatively, or in addition, they may choose to re-mortgage their property or downsize, in order to release equity from their home and supplement their retirement income, though this may affect the value of their estate.

People who could buy with help may be able to benefit from financial products to encourage saving during working life, providing greater security in retirement and enabling people to release equity in their home.

Products such as Lifetime ISAs, sidecars and rent-to-buy, could assist:

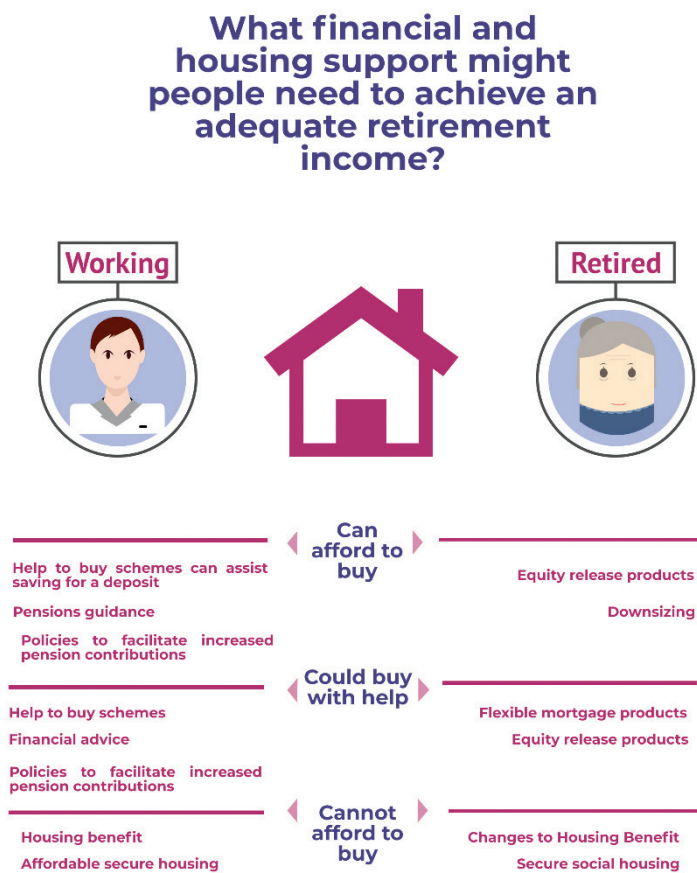
- **Lifetime ISAs** allow an individual between the ages of 18 and 40 to open an account into which they can pay up to £4,000 pa until they reach aged 50. The government adds 25% to the savings, meaning that someone with 30 years of paying in £4k will end with a pot size of £150,000 before accumulated interest and investment returns. Apart from withdrawals to help the individual make a first-time property purchase, payments cannot be made until the saver reaches 60 (or becomes terminally ill), but interest continues to accumulate.

- **Sidecar pensions** are a vehicle where an individual pays into a private workplace pension, with contributions over the minimum rate going into a separate savings pot with greater liquidity. Once a ceiling is reached, additional payments revert to the pension pot. The extent to which these can prove to be useful in saving for housing is debatable, as savings ceilings might be kept low, reflecting the original idea of the sidecar as an emergency savings pot.
- **Rent-to-buy** can help people save for a deposit on a home they are living in. Under the rent-to-buy scheme, a new build property is rented at 20% less than the local market value, enabling residents to save for a deposit over a minimum of five years. Not everyone is eligible for rent to buy, however, and the number of properties available is limited.

People who will never be able to buy could find that renting in retirement sees a significant amount of their income being spent on basic housing costs, even if they secure accommodation at affordable rent.

For these people, access to social housing would see an increase in living standards and disposable income as well as increased security of tenure, though more building is necessary to meet demand. Saving for a pension at a higher contributory level might have some benefits, but this might impact negatively upon the amount of housing benefit they might receive. Changes to Housing Benefit means testing, such as disregarding income from, or savings in, private pensions, could also allow people to achieve a more comfortable standard of living in retirement (Figure 3.1).

Figure 3.1



Working and saving behaviour during working life will affect future retirement outcomes

In order to understand the impact of access to the housing market, PPI modelled three hypothetical individuals with different life courses, who pursue different saving scenarios. The intention is to understand the effect of their decisions on their income after housing costs in retirement. PPI modelling is intended to be illustrative and are not intended to serve as projections of real-life outcomes. The modelling does not seek to account for all possible potential factors that can affect people's retirement outcomes.

Comfortable Colin would benefit from support to make additional pension contributions

Colin is a higher than average earner at the 70th percentile (£23,500 per year at age 22) and saves 8% over 20 years for a deposit. He has paid off his mortgage by the time he retires. He also saves with his employer 8% of total salary into a Defined Contribution workplace pension from age 22 to State Pension age (68).

Below shows the weekly disposable After Housing Costs (AHC) retirement income Colin receives from both State and private pensions under the following scenarios:

- After saving for his deposit, Colin does not contribute additionally to his workplace pension: a total contribution of 8% from age 22 to 68.
- After saving for this deposit, Colin contributes an additional 8% of total salary to his workplace pension: a contribution of 8% from age 22 to 42 and of 16% from age 42 to 68 (Chart 3.1).

Chart 3.1⁶⁸

For homeowners on a higher income, additional pension contributions are still important in meeting target retirement income

Weekly retirement income after housing costs in 2020 earnings terms. Male, earning at 70th percentile, under different pension contribution scenarios compared to target income



For homeowners on a higher than average income, additional pension contributions are still important in meeting target retirement income

In order to replicate his working-life living standards, Colin will need a weekly retirement After Housing Costs income of around £337 per week in 2020 earnings terms.

Target retirement income is based on replacement rate work by the Pensions Commission, which assumes that people can sustain working life living standards into retirement if they achieve a level of retirement income equal to or above a percentage of working-life income. The percentage required varies by the level of income in working life.⁶⁹

In neither scenario is Colin able to meet his target income throughout the whole of his retirement, though with additional pension contributions, he does meet the target for the first six years and remains closer to it than he would have done had he not saved more.

Assuming Colin lives to his average life expectancy of age 89, at the time of his death, his weekly disposable AHC income under each scenario would be £269 per week without additional pension contributions and £286 per week with additional contributions, representing shortfalls against target income of 20% and 15% respectively (Chart 3.1).

While buying a house has both increased Colin's disposable retirement income and security, due to his higher income during working life, he is likely to need to save a substantial amount into his pension in order to replicate his working-life living standards.⁶⁹

Capable Carol would have a lower income in retirement than Colin, as women have lower earnings and are more likely to take time out of the workplace for caring

Carol is a higher than average earner at the 70th percentile for women (£22,290 per year at age 22). As with Colin, below shows the weekly retirement income (After Housing Costs) Carol receives from both State and private pensions under the following scenarios:

- After saving for her deposit, Carol does not contribute additionally to her workplace pension: a total contribution of 8% from age 22 to 68.
- After saving for this deposit, Carol contributes an additional 8% of total salary to her workplace pension: a contribution of 8% from age 22 to 42 and of 16% from age 42 to 68 (Chart 3.2).

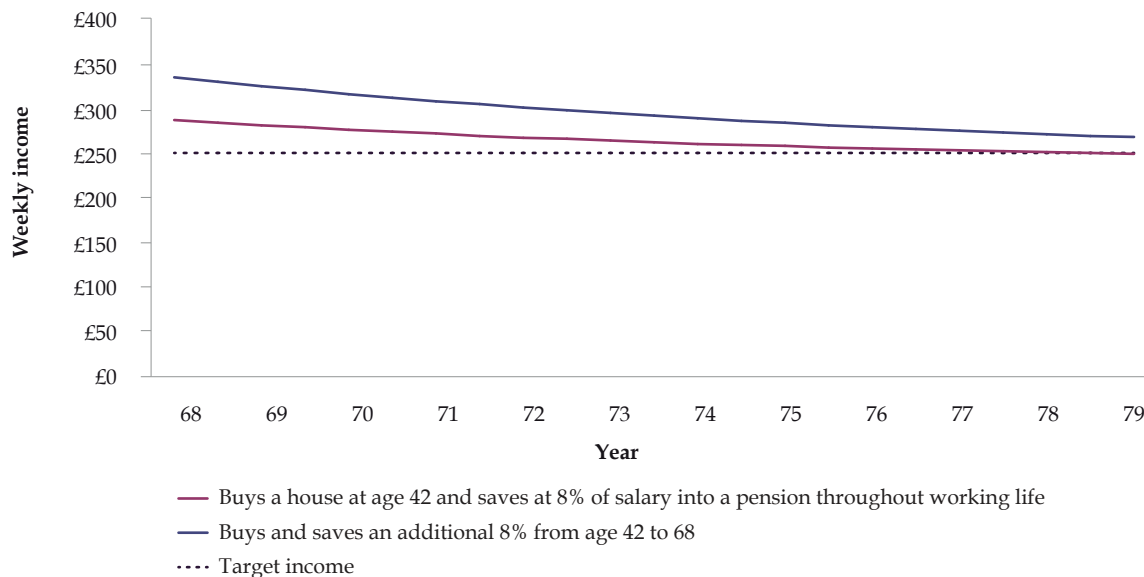
Because Carol's standard of living is lower during her working life, she does not need a high retirement income to sustain it. Even without additional pension contributions of 8% of salary after having saved for a mortgage deposit, she will meet her target income into her 80s. With these contributions, she will continue to meet them until she dies. However, because of her lower earnings when in work, she may feel that her income does not fully meet her needs either in working-life or retirement as it is at a substantially lower level than Colin's.

69 Pension Commission 2004, 2nd Report

Chart 3.2⁷⁰

Higher earning women will typically have a lower retirement income than men

Weekly retirement income after housing costs in 2020 earnings terms. Female, earning at 70th percentile under different pension contribution scenarios compared to target income



Both Colin and Carol may benefit from having increases to their workplace pension contributions made automatically. Raising the minimum contribution from employees and employers required under automatic enrolment legislation would increase the size of their pension pots.

Alternatively, automatic escalation, a policy which can be implemented in several different ways, could be introduced. Automatic escalation involves contributions from members (and potentially their employers) rising automatically in line with other changes, such as pay rises or length of time working. For example, a member could agree that their pension contributions will rise by 1% every two years or whenever they receive a pay rise of more than 2%, until they reach a certain total amount.

Because Carol and Colin own property outright in retirement, they have the option of accessing housing equity, which could enable them to increase their income, and in Colin’s case to make up some of the difference between his actual and target income. The exact amount they could benefit from will depend on the value of their homes, the means of accessing equity and their life expectancy.

For people who have bought property, and who have paid off their mortgage by the time they retire, there is the option of being able to use their property to boost retirement income.

Lifetime mortgages can be used to release income from property to supplement retirement income from pensions and other savings

The lifetime mortgage market in the UK has grown by 114% since 2013⁷¹ with more older people seeking to take advantage of the rise in property values over recent years. Lifetime mortgages can be taken through lump sum/s, or as an income. An individual (or couple) cannot borrow more than the worth of their property, and they cannot be evicted. Lifetime mortgages allow homeowners to take out a mortgage on their home, which is repaid, with interest, from the estate after death. Some products allow for the interest to be paid during the mortgage period, thereby reducing the amount that will be claimed from the estate.⁷²

Home reversion plans allow homeowners to sell a portion of their property while retaining a lifetime lease. There are no restrictions on the homeowner.

70 PPI modelling

71 PPI analysis of FCA Mortgage product sales data, 2018, 2019.

72 For example, Legal & General’s Optional Payment Lifetime Mortgage

Average Alan might need support to buy a home while also saving sufficiently into a private pension

Alan is a median earner at the 50th percentile (£20,400 per year at age 22) and rents throughout his life. He saves into a workplace pension at 8% of total salary from age 22 to 68 and rents in the private sector at median rent throughout his retirement.

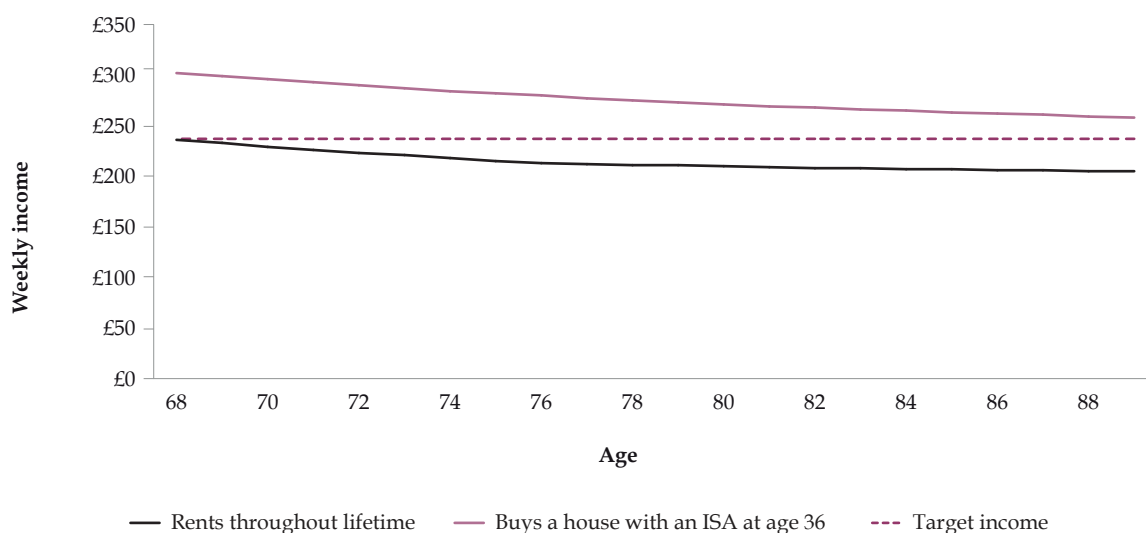
Below shows the weekly disposable After Housing Costs (AHC) retirement income that Alan receives from both State and private pensions under the following scenarios:

- Alan maintains an 8% workplace pension contribution throughout his working life with no additional savings.
- Alan saves into a Lifetime ISA (which allows him an additional 25% contribution from the government via tax relief) from age 22 and uses this to buy a house at age 36 (Chart 3.3).

Chart 3.3⁷³

For people on a median income, buying a house can help achieve a target income in retirement

Weekly retirement income after housing costs in 2020 earnings terms. Male, earning at 50th percentile, renting or buying with an ISA.



Support for buying a house can help median earners to achieve a target income in retirement

In order to replicate working-life living standards, Alan will need a weekly AHC retirement income of £237 per week in 2020 earnings terms. Buying a house with the help of a Lifetime ISA means that Alan can meet his target income throughout retirement through a combination of State and private pensions. However, if he rents throughout his working life and retirement, he will never achieve that target.

Assuming Alan lives to his average life expectancy of 89,⁷⁴ at the time of his death, his AHC income under each scenario would be £205 per week renting and £258 (in 2020 earnings terms) after having bought a property. This represents a shortfall of 14% of target income when renting and a surplus of 9% when owning property (Chart 3.2).

Buying a house increases Alan's disposable retirement income and security, enabling him to replicate his working-life living standards without additional pension contributions. Renting throughout retirement sees him fall below this target.

If Alan owns property outright in retirement, it also means that he does have options for accessing the equity in his property, which could provide him with an extra source of income.

For those people who might be able to afford to buy in the medium or long term, there are different potential sources of assistance

Some schemes that can help people to buy their homes are limited, and might not be widely understood, so people might need advice or guidance to make use of them.

Other countries have integrated help to buy schemes into their national pension saving systems, for example, New Zealand and Singapore (Box 3.1).

Box 3.1 international help to buy schemes integrated into pension systems

The **New Zealand Kiwi Saver** scheme is a current means of flexible saving that has been in operation in New Zealand since 2010. It is a voluntary (opt-out) scheme that operates by allowing people to withdraw funds from their pension pot before retirement if someone is purchasing their first home (as well as if they are in severe hardship, seriously ill, or moving overseas permanently). Contribution rates are historically low (3% default rising to 10% with additional payments possible). By the end of 2019, over 80% of New Zealand adults were in the scheme, as either active or default members, and over NZ\$1 billion had been withdrawn for the purpose of buying first homes.⁷⁵

Singapore's Central Provident Fund (CPF) is a compulsory savings scheme that covers retirement income and housing needs. Contribution rates are higher than the UK and New Zealand, at a maximum 20% for employees and 17% for employers. These relatively high contribution rates reflect the fact that rather than just providing for housing and retirement, the CPF represents a more comprehensive model, as it also covers health and disability insurance.⁷⁶

These schemes could provide a prototype template for a similar scheme in the UK, though care would need to be taken to ensure that saving for retirement is not de-prioritised too significantly.

74 Average life expectancy from age 68 for male, current age 22

75 <https://figure.nz/chart/SivbYDKR269mP12x-IXwwzoRbiKYnkCDB> Accessed 04.02.20

76 <https://www.cpf.gov.sg/Employers/EmployerGuides/employer-guides/paying-cpf-contributions/cpf-contribution-and-allocation-rates#Item587> Accessed 17.02.20

Zero Hours Zoe might need extra support from social housing and Housing Benefit

Zoe is a lower earner at the 30th percentile (£15,000 per year at age 22) and rents throughout her life. She saves into a workplace pension at 8% of total salary, making no additional payments. She continues to rent in the private sector throughout her retirement with some contribution from Housing Benefit to meet her rent.

Because Zoe has a lower standard of living throughout her working-life, the amount she would need in retirement to replicate it is unlikely to meet her ongoing needs through retirement. For this reason, she has no target retirement income in the models.

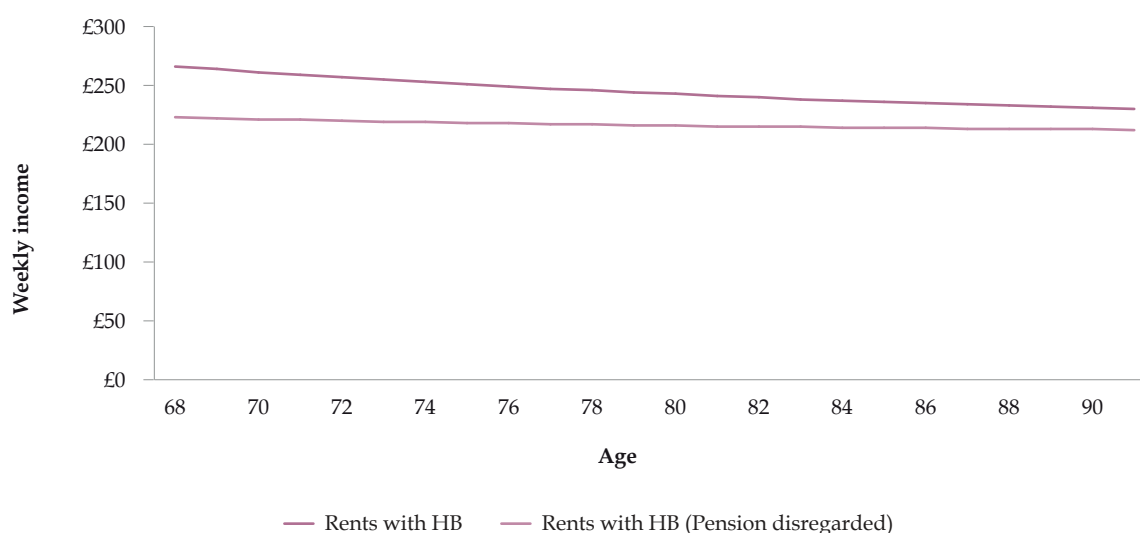
Below shows the weekly retirement income (After Housing Costs) Zoe receives from both State and private pensions under the following scenarios:

- Zoe maintains an 8% contribution to her workplace pension and rents privately throughout her life, receiving Housing Benefit in retirement.
- Zoe maintains an 8% contribution to her workplace pension and rents privately throughout her life. Her pension income is disregarded from the calculation of her Housing Benefit (Chart 3.4).

Chart 3.4⁷⁷

For people on a lower income, who cannot afford to buy, affordable housing is slightly less expensive than private sector renting

Zoe rents affordable housing at 80% of market value



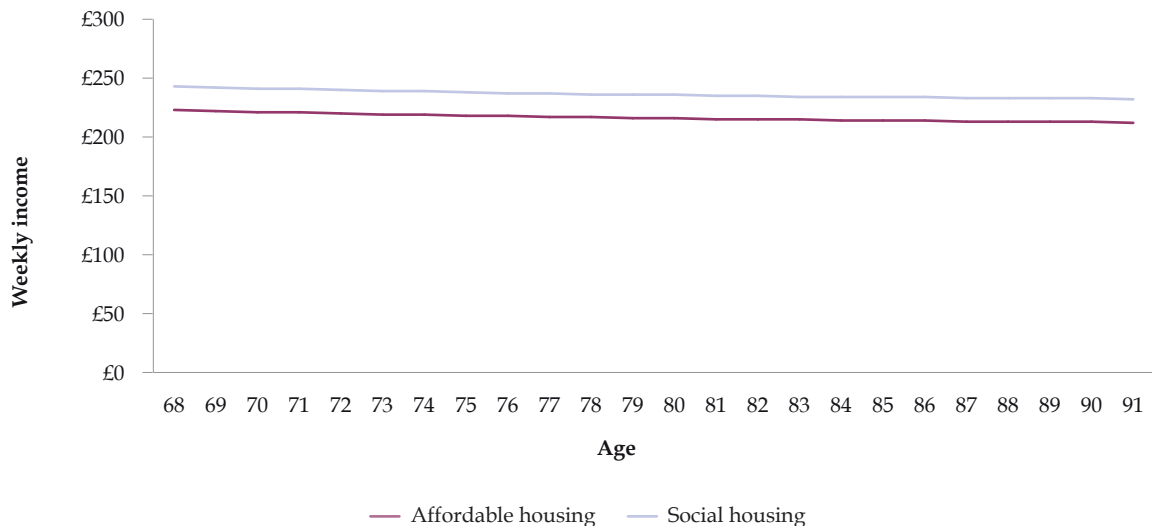
Alternatively, Zoe could rent either 'affordable housing' or social housing to reduce her rental costs. The following scenarios are modelled:

- Zoe maintains an 8% contribution to her workplace pension and rents social housing at 50% of market costs.
- Zoe maintains an 8% contribution to her workplace pension and rents affordable housing at 80% of market costs (Chart 3.5).

Chart 3.5⁷⁸

Access to social housing would provide more disposable income in retirement than affordable housing

Weekly retirement income after housing costs in 2020 earnings terms. Female, earning at 30th percentile renting in social and affordable housing



For people on a lower income, who cannot afford to buy, there are policy interventions that may increase disposable income in retirement

Zoe’s housing costs are in part met by Housing Benefit, which helps her meet her private sector rent, but her pension savings reduce the amount of Housing Benefit that she is eligible for. Without this deduction, her disposable retirement income would allow her a more comfortable standard of living (Chart 3.4). The fact that pension savings and income are means tested for Housing Benefit could also potentially act as a disincentive for people to make additional contributions to their workplace pension.

If Zoe was able to move into social housing, where rents are lower than in the private sector, then her retirement living costs would decrease and her standard of living increase.

If people are renting in retirement like Zoe, then they are likely to have a smaller pension income while also facing higher gross housing costs. This means that they will be likely to have to rely on the benefits system (currently Pension Credit and Housing Benefit) to make ends meet.

For people like Zoe, whose financial position means that they lack the agency to escape the greater cost and precarity of the private rental sector, changes to the policy landscape may be needed to increase her financial security in retirement.

Changes to the benefits system could affect disposable income for renters in future

As it is anticipated that up to 50% more people will be renting in retirement in future, it is worth reflecting on whether the current means tested benefit system is best suited to support future pensioners. A change to the benefits system, whereby private pension is disregarded in the means test for Housing Benefit, would make it easier for future pensioners who are renting in the private sector to achieve an adequate income in retirement. As it stands, the fact that Housing Benefit is reduced by pension income could be seen as a potential disincentive for people to save additionally into a workplace pension. Disregarding pension income could see people who are likely to rent in retirement continue to benefit from additional pension contributions. This would, however, represent an increased cost to Government above existing forecasts for Housing Benefit expenditure.

78 PPI modelling

If it is assumed that private pension savings and income is disregarded in the means test for Housing Benefit, this would increase Zoe's disposable (After Housing Costs) income in retirement by 20% (£44) at age 68 and by 9% (£16) by age 91.⁷⁹

Building more social housing would improve security and disposable income for older people

Social housing, whether built by local authorities or housing associations, can provide a relatively low-cost solution for retired people on a limited income. However, demand for social housing is high, with other priority groups, such as homeless families with children competing for accommodation. As of April 2018 (the latest figure available), there were 1.1 million households on local authority waiting lists for social housing.

Had Zoe been able to rent social housing in retirement, where rents are typically only 50% of the private sector, she could be around £33 per week better off throughout retirement.

Renting a home at 'affordable rent' prices does provide some improvement in retirement outcomes but will still see Zoe paying an extra £20 per week in housing costs compared to social housing.

In order to understand the options available to them, people would benefit from advice and guidance

Few people pay for financial advice services, and for those with relatively small amounts of wealth or assets, or who are near the start of their working and saving lives, the cost may be seen to be disproportionate. However, given the length of time that is now needed to save for a deposit for a mortgage, and the possible need to increase personal pension contributions from the start of a workplace pension, financial advice and guidance may be more relevant for younger people than those nearing retirement. Only 10% of UK workers earning £30,000 have sought any form of paid-for financial advice.⁸⁰

The Money and Pensions Service (MaPS)⁸¹ does provide free holistic guidance, bringing together the former Money Advice Service, PensionWise and the Pensions Advisory

Service under one roof. Use of guidance could assist those unable or unwilling to pay for advice, though not all those able to benefit from guidance know of its existence or how to access it.

Innovations such as pensions dashboards or interactive technological portals from workplace pension providers may allow some younger people more opportunity to engage with their pensions but will not provide an overview that could assist people in balancing pension and housing costs. They will also require a predisposition for engagement, and for individuals to understand how and why to use them.

Conclusions

People who can afford to buy;

- Could benefit from support to make additional pension contributions to meet a similar standard of living in retirement that they had during working life
- May choose to release equity in their property, though this may affect the value of their estate.

People who could buy with help;

- May be able to benefit from financial products to encourage saving for a mortgage during working
- May choose to release equity in their property or downsize, though this may affect the value of their estate.

People who will never be able to buy;

- Could find that renting in retirement sees a significant amount of their income being spent on basic housing costs, even if they secure accommodation at affordable rent.
- For these people, access to social housing would see an increase in living standards and disposable income as well as increased security of tenure, though more building is necessary to meet demand.
- Changes to Housing Benefit means testing, such as disregarding income from or savings in private pensions, could also allow people to achieve a more comfortable standard of living in retirement.

79 Average life expectancy from age 68 for current UK female aged 22.

80 <https://www.havenifa.co.uk/average-workers-not-seeking-retirement-advice/> accessed 07.01.20

81 <https://moneyandpensionsservice.org.uk/> accessed 27.01.20

Appendix One: Changes to tax relief for buy-to-let properties

Before April 2017, landlords with a buy-to-let property could claim tax relief on 100% of their interest payments of their mortgage offset against rental income. For example, someone with a £6,000 annual mortgage fee and an annual rental income of £10,000 could deduct the £6,000 from the rental income for tax purposes, meaning that they would only pay tax on the remaining £4,000. In this case, a basic rate taxpayer would be liable to pay £800 in tax. A higher rate taxpayer (earning £50,000 and paying 40% on all income above this level) would have their tax relief set at their appropriate income tax bracket, so in the above scenario would pay £1,600.

After April 2020, there will be no tax relief for buy-to-let landlords, as it will be replaced by a tax credit of 20% of mortgage interest payments. For landlords paying basic income tax, this will make little difference, but for those in a higher tax bracket (earning £50,000 or more and paying 40%), there could be a downside, as the tax credit has a 20% ceiling. In the scenario above, the basic rate taxpayer would be paying the same amount (£800), but the higher rate taxpayer would pay £2,400; a rise of 50% that would erode their profit.

Appendix Two: Technical Appendix

The numerical analysis undertaken by the PPI and presented within this report consists of data analysis of survey data, and individual projections using the PPI's Individual Model.

Data Analysis

Understanding Society⁸² and British Household Panel Survey⁸³ analysis

Data from Understanding Society and its predecessor survey, the British Household Panel Survey, were used to construct a time series of household tenure from 1991 to 2017 cross tabulated by age of the head of household and by government region.

Wealth and Assets Survey (WAS) analysis⁸⁴

Other data analysis for this report uses cross sectional data (WAS Round 6) to analyse the make-up of net household wealth and rental/mortgage expenditure compared to household income. Data was analysed at the household level with the age of the Household Reference Person (HRP) serving as a proxy for the age of the household.

The distribution of key metrics, such as housing wealth, is analysed according to categorical information of interest, such as age band.

82 <https://www.understandingsociety.ac.uk/>

83 <https://www.iser.essex.ac.uk/bhps>

84 <https://beta.ukdataservice.ac.uk/datacatalogue/studies/study?id=7215>

Limitations of the data analysis

Mortgage payment data is not available for all households whose tenure indicates they own with a mortgage. It is assumed that the weighted mortgage data present is representative of the whole population and there is no systematic bias present that invalidates the distributional statistics.

Analysis of the data for trends for certain groups leads to results that are not reliable due to an inadequate sample size in each cell. This was particularly acute when undertaking analysis of housing tenure by ethnic group.

Breakdowns by sex are also difficult because the data was available on a household level, and in a mixed sex household the HRP tends to be male. It was possible to do some analysis among single occupier households, but this also suffered from limited sample size.

More extensive boosting in the datasets could help improve analysis on these variables in the future.

Individual model

The Individual Model is the PPI's tool for modelling illustrative individual's income during retirement. It can model income for different individuals under current policy or look at how an individual's income would be affected by policy changes. This income includes benefits from the State Pension system and private pension arrangements, and can also include income from earnings, other State benefits and tax liabilities. It is useful to see how changes in policy can affect individuals' incomes in the future.

The case studies in the report were generated using the Individual Model from the PPI's Modelling Suite.

The PPI's Individual Model calculates streams of retirement incomes for constructed individuals. The streams of income include State Pension, private pension and various state benefits in retirement. The Individual Model uses flexible policy parameters to define the pension landscape throughout the individual's working-life and retirement. The individual is constructed by setting out the work history

in terms of working patterns and salary level throughout their working-life, along with pension scheme membership details. The salary during working life is based on age and gender breakdowns of full-time employees in the Labour Force Survey.

Key assumptions

Except where explicitly stated in the report, the key assumptions used in the report are detailed below.

The pensions system

The pension system modelled is as currently legislated. The triple lock is assumed to be maintained. Individuals are assumed to be members of a Defined Contribution occupational pension scheme.

Economic assumptions

Economic assumptions are taken from the Office for Budget Responsibility's Economic and Fiscal Outlook (for short-term assumptions) and Fiscal Sustainability Report (for long-term assumptions). Assumptions regarding the average house price purchased by a first-time buyer was based on data provided by Finance UK.

Limitations of analysis

Care should be taken when interpreting the modelling results used in this report. In particular, individuals are not considered to change their behaviour in response to investment performance. For example, if investments are performing poorly, an individual may choose to decrease their withdrawal rate and vice versa.

Key results

The key output from the model is the built-up pension wealth and entitlement over the course of the individual's work history and the post-retirement income that results from this.

The post-retirement income is presented as projected cashflows from retirement over the future lifespan of the individual. These are annual cashflows which include the following key items:

- **State Pension**
 - Reflects entitlement and the projected benefit level of State Pension components.
- **Private pension**
 - Derived from the decumulation of the pension pot, allowing for tax-free cash lump sum and the chosen decumulation style (e.g. annuity or drawdown).
- **Other state benefits**
 - Other benefits contributing to post-retirement income such as Pension Credit, Housing Benefit and Council Tax Benefit.
- **Tax**
 - Tax payable on the post-retirement income, to understand the net income available to the individual.

These cashflows are calculated as nominal amounts and restated in current earnings terms.

Outcomes are expressed in current earnings terms for two reasons; it improves the comprehension of the results and reduces the liability of either overly optimistic or cautious economic assumptions.

Incomes are expressed as After Housing Cost (AHC). The AHC calculation subtracts the net cost of housing from the income and is slightly different for a household depending on whether they are renters or owner occupiers.

For the modelled renters the net cost of housing consists of rent plus water rates, less any housing benefit received.

For the modelled owner-occupiers, who are assumed to have paid off their mortgage before retirement, the net cost of housing consists water rates plus structural insurance.

Application of output

The model is best used to compare outcomes between different individuals, policy options, or other scenarios. The results are best used in conjunction with an appropriate counterfactual to illustrate the variables under test.

Key data sources

The specification of a model run is based upon three areas:

1. The individual

The individual to be modelled is specified based upon an earnings and career profile. Saving behaviour for private pension accumulation is considered, as well as the behaviour at retirement.

These are generally parameterised according to the project in question, designed to create vignettes to highlight representative individuals of the groups under investigation.

2. The policy options

The policy option maps the pension framework in which the individual exists. It can accommodate the current system and alternatives derived through parameterisation. This allows flexing of the current system to consider potential policy options to assess their impact upon individuals under investigation.

This area has the scope to consider the build-up of pensions in their framework such as the auto-enrolment regulations for private pensions and the qualification for entitlement to state benefits.

The framework in retirement allows for the tax treatment and decumulation options taken by the individual as well as other sources of state benefits which influence the post-retirement outcomes for individuals.

3. Economic assumptions and scenarios

The model is capable of running with either deterministic or stochastic economic assumptions.

The deterministic assumptions used are generally taken from the Office of Budget Responsibility (OBR) Economic and Fiscal Outlook (EFO) to ensure consistency. They cover both historical data and future projected values.

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