

PENSIONS POLICY INSTITUTE

PPI

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



Executive Summary

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

Mark Baker – Senior Policy Researcher, Pensions Policy Institute



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.

John Adams, Senior Policy Analyst, Pensions Policy Institute



John has been the PPI's Senior Policy Analyst since 2008. In his time at the PPI John has worked in a lead role in the modelling of a wide range of pension policy project number of PPI modelling projects including a number of projects looking at public sector pensions and pension related tax-relief.

At the PPI, John is responsible for the PPI's Pension Facts and has authored briefing notes and reports on subjects such as how housing wealth can support retirement, tax policy on pension schemes, harnessing pension savings for debt alleviation, public sector pension reforms.

John joined the PPI in 2008 from Hewitt Associates. At Hewitt he worked primarily on modelling of standard and non-standard Defined Benefit pension scheme calculations for the consultants to present to the clients.

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.

John has a BSc in Actuarial Mathematics and Statistics from Heriot Watt and a Post Graduate Diploma in Actuarial Management from Cass Business School.

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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.

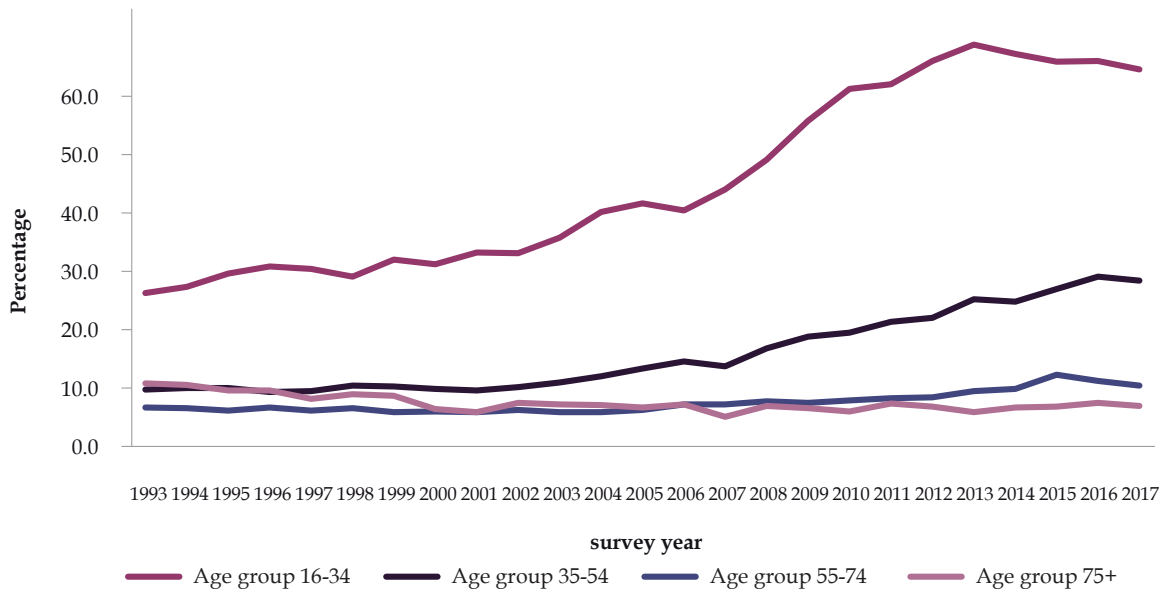
1 English Housing Survey 2018-19

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.

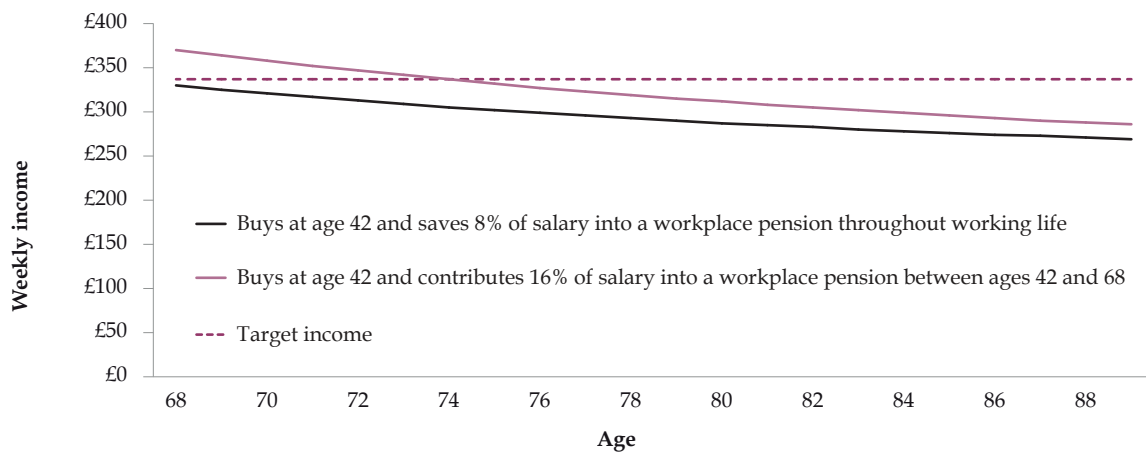
Assuming Colin lives to his average life expectancy of 89,⁵ when he dies his disposable, After Housing Costs (AHC), income under each scenario would be £269 per week without additional pension contributions and £286 per week with additional contributions, representing shortfalls against target income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

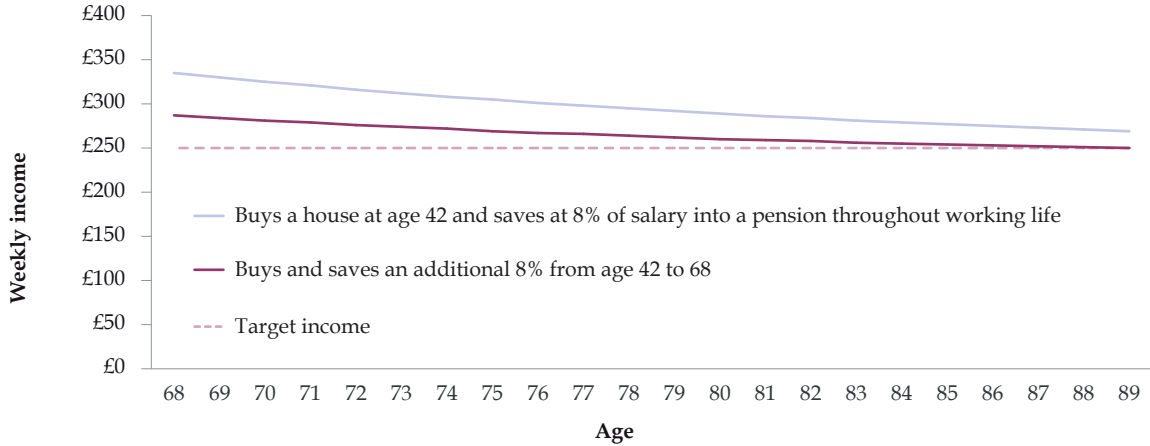
6 PPI modelling

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