

## A matter of choice? RSL rents and home ownership: a comparison of costs

### Key findings and implications

Registered social landlords (RSLs) across the country should monitor their rents in relation to the costs of owner occupation — not just house prices as it is costs not prices which determine choice.

In some areas owner occupier (OO) costs are converging with RSL rents for similar properties, especially smaller houses.

RSLs will need to be aware of where costs are converging and which factors affect OO costs. RSLs should monitor not only their overall stock but also the mix of stock in particular locations as the comparison between house sizes shows different patterns of change.

Where costs are converging, RSLs need to think in terms of other attributes that will make their properties attractive to households, both to keep existing tenants and to attract potential newcomers.

While renting was popular in the heyday of local authority housing in the 1950s, promotion of owner occupation and the residualisation of the social rented sector often means that even where the RSL property itself is well planned and maintained, there is still a desire to change tenure.

The neighbourhood also plays a part in determining people's desire to move. RSLs need to ensure that the surrounding area remains attractive enough so that when households are better off they may wish to stay rather than relocate to a better area.

In areas where the gap between the costs of home ownership and renting from registered social landlords is increasing, there is a growing problem of affordability and access to suitable housing. This can also create problems for local employers in recruiting and retaining a stable workforce.

RSLs need to consider their potential role in such districts, particularly whether they can contribute to an intermediate housing market through the provision of low cost housing without subsidy. Such initiatives might help to sustain communities both in terms of social mix and local employment stability.



## 1. Background

The Green Paper on housing emphasises opportunity and choice in housing, whether rented or owned. Recent expansion in the owner occupied sector, especially at the lower end through Government initiatives, has been aimed at making owner occupation affordable to more households. This means the owner occupied sector is more relevant to registered social landlords. House prices have risen in many areas following the recession of the early 1990s although they remain low in some parts of the country.

Registered social landlord rents have also increased in most places. Yet house prices alone are not an ideal indicator because they do not reflect the actual weekly costs of home ownership. Even where house prices are rising rapidly, the costs of home ownership could be falling, for example, if mortgage interest rates are falling. Using house prices as an indicator can therefore be misleading and instead it is important to look at the actual costs of owning a home.

The weekly user costs of owner occupation are now close to registered social landlord new let rents for similar properties in some areas. Registered social landlords will need to take this into consideration when setting rents, in order to prevent high turnover and vacancy rates.

In other areas, the gap between the costs of owner occupation and registered social landlord rents is increasing. This is creating an affordability problem for a growing group of households who are not likely to be eligible for assistance with housing costs. Registered social landlords in these areas need to explore their potential role in

providing for such households, perhaps by helping create an intermediate market for housing that is not directly subsidised but is more affordable than owner occupation.

Using data available from Dataspring, the database run by the Cambridge Centre for Housing and Planning Research, this study looks at the weekly user costs of owner occupation over the past decade in comparison to registered social landlord rents.

## 2. Housing choice and the implications for RSLs

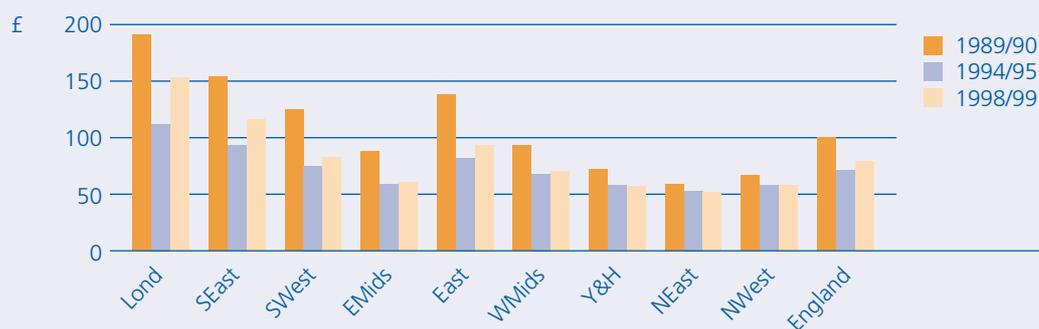
The recent Housing Green Paper aims to offer 'everyone opportunity, choice and a stake in their home, whether rented or owned' (DETR, April 2000; p.16). Any convergence between the costs of renting and owning a similar property gives opportunities to registered social landlord tenants to consider changing tenure.

Owner occupation is the preferred tenure for many people and recent expansion of the sector means almost 70% of households in England are now in owner occupation (DETR, Housing and Construction Statistics).

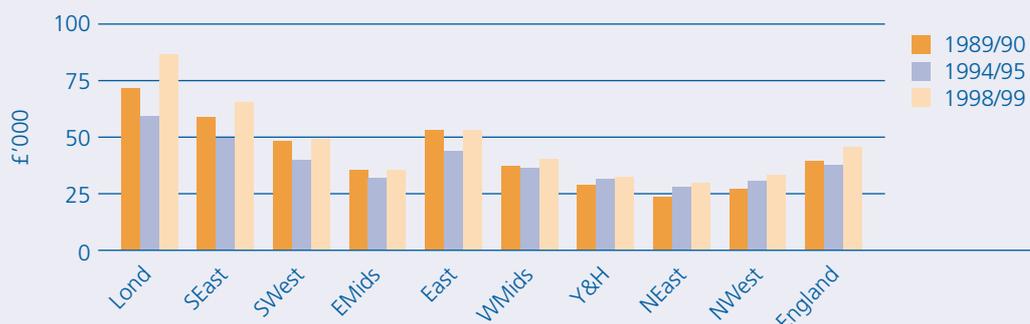
This rise in popularity has occurred despite changes in social security provision that have increased the risks for marginal owner occupiers. As a result the lower end of the owner occupied sector has become a viable alternative to the RSL sector for some people. Whereas in the past RSLs tended to compare themselves with the private rented sector to ensure their rents were competitive, they also need to consider the equivalent costs at the lower end of the owner occupation sector.

The OO costs available in Dataspring are based on the weekly costs of owner occupation at the lower end of the market. They are therefore based on the lower quartile house prices, the average loan to value ratio (LTV) for first time buyers and the cost of a 25 year repayment mortgage. Also included is the cost of life assurance, property insurance and mortgage payment protection insurance (MPPI). Details of the assumptions and recent changes to the way OO costs are calculated are found in Kiddle (2001). These data are available at the local authority district level and by property size based on the number of bedrooms. Data are scarce for some property sizes, so analysis is confined to 2 bed and 3+ bed properties to give a comparison between smaller and larger properties.

**Figure 1**  
National and regional changes in weekly owner-occupier costs, 2 bed houses



**Figure 2**  
Lower quartile house price change, 2 bed houses



In some parts of the country there is now little difference in the costs of home ownership at the bottom end of the market and renting from RSLs.

One way to examine this question is to compare RSL new let rents (hereafter referred to as RSL rents) with the weekly cost of home ownership (hereafter referred to as OO cost) at the lower end of the market. This represents the trade off people have to make in areas where the costs in the two sectors are converging.

RSLs could find themselves facing problems in such areas both in terms of marketing and in maintaining balanced communities.

The costs of owner occupation cannot be assessed just with reference to house prices and tracking house prices change alone can often be misleading. In some cases, even where house prices are rising OO costs can be falling. As the greatest proportion of OO cost consist of the mortgage repayment element, changes in mortgage interest rate have a much bigger effect on OO costs than changes in house prices.

### 3. Changes over time in OO costs

Between 1989/90 to 1998/99 (the period for which data are available from Dataspring) OO costs fell in the first half of the decade and rose in the second half in most regions. Even so, costs are lower now in all regions than they were a decade ago. Both 2 and 3+ bed houses show a steeper fall in costs in areas where the initial costs were highest, namely in London, the South East and the East of England. OO costs decreased less in northern regions. In the North East, North West and Yorkshire and Humberside costs remained virtually unchanged from the middle of the decade. Figure 1 illustrates the changes for 2 bed houses.

### 4. Factors affecting OO costs

OO costs depend mainly on four factors, the initial house price, the mortgage interest rate, the size of loan available and the insurances paid. The house price is clearly the largest element in determining the initial size of OO costs for a household, but OO costs are critically affected by changes

in mortgage interest rates. The loan size can also be affected by the amount lenders are prepared to lend against income (the loan to income ratio).

This has implications for the sustainability of mortgage repayments but does not affect the calculation of OO costs. The loan size is also affected by the loan to value (LTV) ratio<sup>1</sup>, the amount that is lent against the purchase price of the house. A lower LTV ratio means a smaller mortgage and lower weekly costs, although a bigger initial deposit has to be found.

The insurances account for a small proportion of the costs (typically 3% for life assurance, 5% for buildings insurance and 4% for mortgage protection insurance), so changes in these have little effect on the overall OO cost. Hence as house prices and the mortgage interest rate are the most important factors, changes in these are considered in more detail below.

### **House price change**

OO costs are based on the nominal average of lower quartile (LQ) house prices. The national picture of price increase over the decade conceals the fact that for some areas and some categories of house, prices are at the same level or in some cases marginally lower than a decade ago.

Table 1 shows that for 2 bed houses, LQ house prices were stagnant in the East Midlands and the East of England over the decade as a whole, while in the South West they actually fell by 2%. While percentage gains were high in the North East and North West, actual gains were less significant due to the lower starting prices.

There is not a simple linear relationship between house prices and OO costs, and the analysis shows this is more marked in the 2 bed houses than the 3+ bed houses. This is illustrated by comparing Figures 1 and 2, which suggests that for the lower priced houses, other factors have a greater

effect on OO costs than changes in house prices.

- Most regions show a fall in OO costs and a rise in house prices over the decade as a whole.
- Those regions with initially low house prices (North East, North West and Yorkshire and Humberside) do not exhibit a fall in house prices in the middle of the decade although the OO costs did fall.
- Where house prices have remained essentially unchanged over the decade, for example the price of 2 bed houses in the East of England and the East Midlands, then almost all the change in OO costs has been as a result of another factor.

### **The mortgage interest rate**

After the initial size of the loan the biggest influence on the size of OO costs comes from the mortgage interest rate. The mortgage repayment cost accounts for around 83% of the weekly OO cost. Clearly then any changes in the interest rate will have a significant impact on the OO costs. Raising the interest rate by 0.5% increases the weekly payments by an average of 4.7%, and results in an average increase in monthly payments of around £25. Thus even where average house prices remain stable OO costs can change significantly with changes in the mortgage interest rate. The mortgage rate fell rapidly in the first 3 years of the 1990s and began to rise again after 1996, but is still substantially lower than at the beginning of the decade.

## **5. The relative importance of the OO cost factors**

The relative importance of house prices and mortgage interest rates in determining the costs new owners face is shown in Table 2 below. In the first half of the decade LQ house prices fell slightly but OO costs fell much more, and this reflects the influence of the fall in mortgage interest rates. In the second half of the decade OO costs increased at half the rate of house prices,

<sup>1</sup> The CML advised a LTV ratio of 95% for calculating the OO costs until 1998/99, when this was lowered to 83%. As a result the OO costs calculated and used in the dataset are likely to be higher than the actual costs between 1989 and 1994 since the average LTV ratio for first time buyers varied between 80% and 83% then. Lowering the LTV to 83% and including the loss of interest on the deposit gives an average fall of 5% in the calculated OO costs.

**Table 2**

**Changes in 2 bed lower quartile house prices, owner occupier costs and the mortgage rate**

year\% change	LQ price	OO cost	mortgage interest rate
1989	£39,000	£109	14.1
1994	£38,000	£73	8.0
% change 89–94	-4	-33	-43
1998	£46,000	£85	8.3
% change 94–98	20	12	2
% change 89–98	16	-21	-41

**Figure 3**

**Changes in house prices, mortgage interest rates and owner occupier costs, 1989/90 to 1998/99**



while mortgage interest rate changed little. So while LQ house prices have risen nationally by 16% and 35% for 2 bed and 3+ bed houses, OO costs have decreased by 21% and 11% respectively. While changes in house prices clearly have some influence on OO costs, changes in the mortgage interest rate has a greater effect. OO costs decreased in the 1990s mainly as a result of mortgage rate change, which fell from an average of 14.07% in 1989 to 8.31% in 1998. This, together with changes in Mortgage Interest Relief At Source (MIRAS), resulted in a fall of 28%, from £155 to £111, for the weekly costs of a £60,000 property with a 95% mortgage (Kiddle, 2001).

Figure 3 illustrates how OO costs track changes in the mortgage interest rate more closely than changes in nominal and real house prices. Thus OO costs are more sensitive to interest rate changes than house price changes. In addition the average house price, adjusted for inflation, has fallen by nearly 10% over the decade in real terms. So if mortgage rates are set to fall, low cost owner occupation will be more affordable and this means more tenants face a genuine choice.

### 6. The difference between OO costs and RSL new let rents

What has this change in OO costs meant in terms of comparison with RSL rents over the decade? Table 3 shows how the gap between OO costs and RSL new let rents for 2 bed houses have decreased in all regions over the decade. The table suggests that in the North East there is now little difference between the cost of low cost home

ownership and new let RSL rents for 2 bed houses. A similar situation arises in the North West, and in Yorkshire and Humberside home ownership may even be cheaper than RSL renting for some households. The situation is less acute for 3+ bed houses, but the gap is still less in all regions than it was a decade ago.

Despite the relatively steep fall in OO costs in the south there was less change in the gap over the decade in London, the South East and the South West than in the northern regions. The problem is now more acute in the north of the country. This narrowing of the difference between the tenure costs means that more households who want to change tenures will be in a position to do so. Clearly then the costs of owner occupation are now something that RSLs need to be aware of in these areas.

The maps (Figure 4) show the changes over time at the district level (there is insufficient district level data for 1989/90).

There are now more districts in the northern half of the country where OO costs are near or below the levels of new let rent. The maps also suggest this is more of a problem in older urban areas such as around Merseyside, Tyne and Wear and parts of the West Midlands. It also affects some rural and coastal areas with low house prices, for example in some districts in Cumbria, Yorkshire and Humberside, Suffolk, Kent and Somerset.

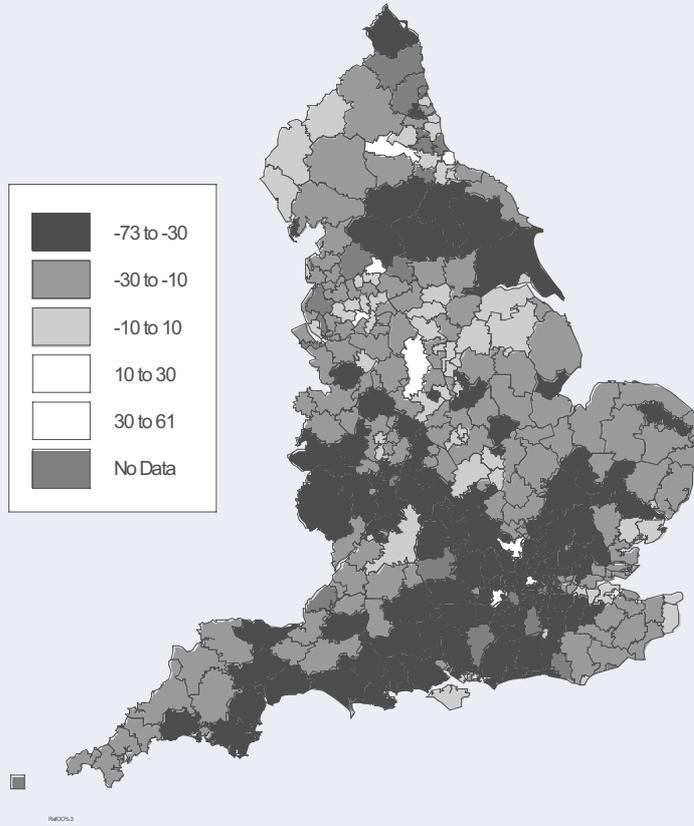
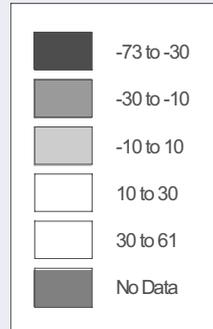
This underlines the practical implications for RSLs of monitoring new rental costs against the costs of home ownership, especially in areas of low demand for social housing.

<b>Table 3</b>	<b>Government office</b>	<b>89/90</b>	<b>94/95</b>	<b>98/99</b>
<b>The percentage difference between new let rents and owner occupier costs for 2 bed houses by region, 1989/90, 1994/95 and 1998/99</b>	Lond	-76	-43	-54
	SEast	-73	-35	-41
	SWest	-63	-27	-28
	EMids	-65	-15	-9
	East	-73	-31	-34
	WMids	-66	-24	-20
	Y&H	-61	-13	3
	NEast	-41	-5	0
	NWest	-63	-10	-6
	<b>England</b>	<b>-64</b>	<b>-21</b>	<b>-24</b>

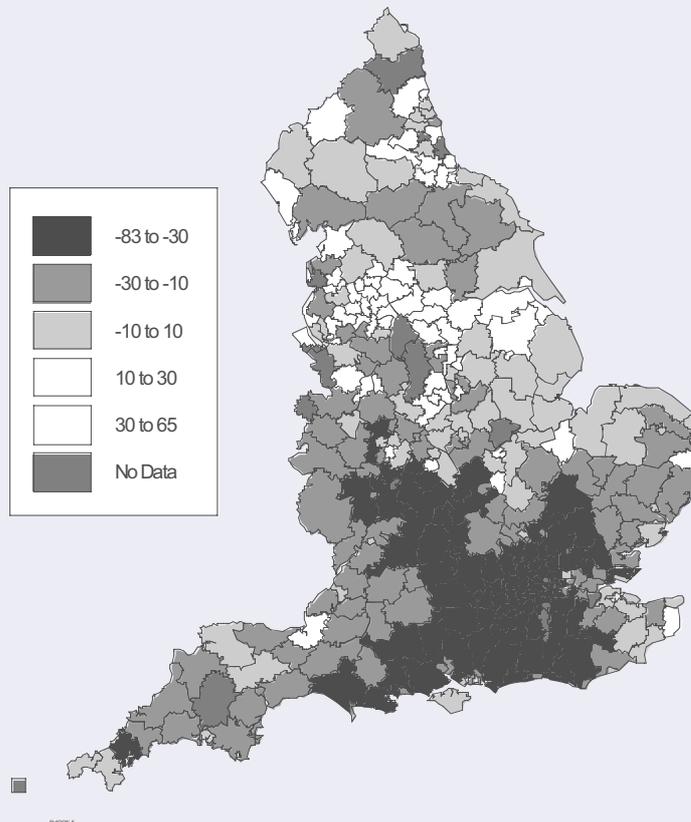
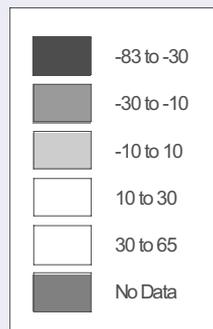
**Figure 4**

Percentage difference between new let rents and owner occupier costs, 2 bed house

1994/95



1998/99



### Additional information

Dataspring is a local housing markets database providing information at district, county, regional and national level. The basis of the database is RSL and local authority rents, private sector rents and house prices, together with socio-economic data such as population, households, housing stock and tenure, employment, incomes and earnings. Dataspring provides information services for RSLs, local authorities and others within the field of housing.

Further information on Dataspring can be obtained from:

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[www.landecon.cam.ac.uk/dataspring](http://www.landecon.cam.ac.uk/dataspring)

This study is based on the following report, to be published in Spring 2001.

Kiddle, C. (2001) *Comparing the costs of owner occupation with RSL rents: A Geographical Analysis* Dataspring Discussion Paper 3, Cambridge Centre for Housing and Planning Research, Department of Land Economy, University of Cambridge. Telephone 01223-337147 for further details.

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