

Treasury Select Committee

Household finances: income, saving and debt inquiry

Written evidence submitted by Generation Rent

Executive Summary

- Generation Rent is grateful for the opportunity to respond to this inquiry. We represent the UK's private renters, and campaign for a fair, safe and secure housing market.
- Our submission is focused on a policy to support saving among private renters and the impact of declining rates of property ownership on financial planning.
- We propose that the deposit protection system is reformed to hold tenants' damage deposits in personal named accounts where the sum required by the landlord as security is frozen for the duration of the tenancy. During this time, the interest would accrue to the tenant and they would be able to top up the balance to benefit from the higher interest rate that the fixed sum would attract. This could create a new incentive for asset-poor renters to build up a rainy day fund.
- It appears that the majority of renters will not be able to afford home ownership, with the English Housing Survey finding two-thirds have no savings. There will be a dilemma for some who are able to save over whether to prioritise home ownership and potentially sacrifice higher returns from longer term savings. The Lifetime ISA allows renters to hedge their bets, but more effort is required from the government to help renters navigate the difficult trade-offs involved.
- Ultimately the only way to enable more renters to save is addressing the wider economic problems of high rents and stagnant incomes.

Background

1. The private rented sector has doubled in population in little over a decade. The primary drivers of this are rising house prices making home ownership inaccessible, and the unavailability of social housing, rather than any relative appeal of privately rented homes.
2. The English Housing Survey 2015-16 found that 59.5% of private renters expect to buy a home. Of those, 58% expect to buy within the next five years¹. Among private renters who did not expect to buy a home, 70% said the main reason was that it was unlikely they would ever be able to afford to².
3. The main barrier to home ownership is a combination of high house prices, limited credit and a lack of savings. To illustrate this, let's imagine a typical household, the Smiths, who take home the median household income of £27,200, equivalent to a single-earner pre-tax salary of around £35,200³. Halifax would lend the Smiths a mortgage of up to £133,449⁴. However, the average first home costs £188,173 so the Smiths would need to have a deposit of £55,000 to afford it – around double their annual disposable income⁵.

¹ English Housing Survey (EHS) Household Report 2015-16, Annex Table (AT) 1.10

² EHS Future Home Owners Report 2015-16, AT1.29

³ Office for National Statistics (ONS)

<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/nowcastinghouseholdincomeintheuk/financialyearending2017>;

<https://www.thesalarycalculator.co.uk/salary.php>

⁴ Halifax, <https://www.halifax.co.uk/mortgages/mortgage-calculator>

⁵ Land Registry House Price Index <https://www.gov.uk/government/publications/uk-house-price-index-summary-october-2017/uk-house-price-index-summary-october-2017>

4. If they were in such a fortunate position, they could reduce their regular monthly housing costs from £650 (the median rent for a 2-bed home in England) to £538⁶. This would not only represent a saving of £1344 per year, but every repayment would increase their equity in their home. After 25 years they would have no regular housing costs.
5. Without that deposit the Smiths would continue to pay more rent than they would pay for a mortgage and would own nothing after 25 years.
6. There is of course a scenario between the two extremes, where the Smiths have enough in savings to buy a home of, say, between £140,000 and £150,000. Many renters experience this scenario but if the average home is unaffordable to the average local household, buying something that is affordable would very often involve moving away from work and/or family.
7. The English Housing Survey suggests that the most common scenario is in fact the second one: two-thirds (66%) of private renters have no savings⁷.
8. It is particularly hard for private renters to build up savings. One reason is that rents are high, especially compared with other tenures. After housing benefit is taken into account private renters spend 35% of their household income on rent; social tenants spend 28% and home owners spend 18%⁸. Many private renters are recent graduates who are also paying off student loans with a considerable portion of their income.
9. Another reason is that renters move more frequently than other tenures and incur the costs of moving possessions, cleaning the home, and incurring non-refundable fees from letting agents, which can eat into savings, or even tip the tenant into debt⁹.
10. These moves are usually an independent decision by the tenant, but for 16% they are a result of a request by the landlord to move, an unaffordable rent increase or a poor relationship with the landlord¹⁰. The government's proposed letting fees ban will help to mitigate the financial impact of frequent moves. Additional protections such as restricting no-fault evictions and rent increases would help minimise unwanted moves and thereby improve renters' financial positions (as well as giving them greater stability).¹¹

Savings policies

11. Even if most tenants have no money they call savings, 74% have money that is in their name and held as a security deposit on their tenancy¹². It is a legal requirement of landlords to put such deposits in a government-approved protection scheme. It is either held by the scheme itself free of charge (custodial) or kept by the landlord and insured for the duration of the tenancy in return for a fee.
12. The deposit is returned to the tenant at the end of the tenancy, unless the landlord makes a successful claim through the deposit protection scheme for damage or unpaid rent. The majority of deposits are returned to tenants.¹³

⁶ Valuation Office Agency, June 2017; Halifax mortgage calculator

⁷ EHS Private Rented Sector Report 2015-16, AT2.5

⁸ EHS Household Survey 2015-16, AT1.13

⁹ Around £568 in non-refundable costs, according to Generation Rent research for the Sun <https://www.thesun.co.uk/money/4809839/little-known-clause-in-renting-contracts-is-costing-tenants-thousands-of-pounds-extra-per-year/>

¹⁰ EHS Private Rented Sector Report 2015-16, AT3.9

¹¹ Generation Rent's proposals are set out here: https://d3n8a8pro7vhmx.cloudfront.net/npto/pages/4322/attachments/original/1477664477/Secure_tenancies.pdf?1477664477

¹² EHS Private Rented Sector Report 2014-15, AT3.9

¹³ Deposit Protection Service figures provided to DCLG 2017

13. However, there are several problems with the schemes. One is that it is possible for a landlord or letting agent to insure a deposit then put it in an interest-bearing account and make additional money from their tenants.
14. An alternative approach would be for the tenant to set up a special account with their bank or building society at the start of a tenancy. Their landlord would register the tenancy with the bank and the sum of the security deposit would be frozen for the duration of the tenancy. The money would accrue interest to the tenant (minus costs that go towards administering the scheme, which we estimate would be less than 0.5%).
15. In practice, whenever the tenant moved, they would need to deposit additional cash into the account in order to secure a new tenancy before the first deposit is unfrozen. This means that there will be cash held in the account as long as the holder is a private renter – making the account similar to a Help to Buy ISA. This money should therefore attract a higher interest rate than the renter might get for a standard savings account.
16. This new form of account would give all tenants access to a reasonable savings rate. The average deposit of £1000 accruing interest at, say, 2% would return £20 to the tenant each year. Allowing the tenant to top up the initial sum, and withdraw non-frozen sums, would turn the account into a savings account. If the tenant deposited a further £100 in the account, the interest would increase to £22 per year. Currently they might get 0.5% in a standard savings account, which would get them 50p on the same assets over the same period. With a higher interest rate than they'd get anywhere else, there would be more of an incentive for tenants to put money aside, and help build their household's financial resilience.
17. To make this a reality would require the involvement of financial institutions and existing tenancy deposit schemes, along with Parliamentary approval for necessary changes to the underlying legislation. It would also be important to treat the frozen deposit monies as lying outside of the tenant's savings for the purpose of means-testing.

Impact of declining home ownership

18. If they have enough disposable income to save more than a rainy day fund, young adults are presented with a choice of strategies: to prioritise buying a house or retirement. A realistic appraisal of their aspirations is needed: do they want to live in an area where they are likely to be able to amass a sufficient deposit that appreciates faster than house prices?
19. If the prospect of home ownership is unlikely – and based on current savings levels that might apply to two thirds of private renters – then saving for later life might be more appropriate. That means more renters might simply prefer to raise their pension contributions at work.
20. If a renter is unable to decide whether to prioritise home ownership or retirement, the Lifetime ISA offers flexibility, along with a platform for longer term investment in equities. If buying a house is possible then the saver gets the bonus when they complete a purchase. If it is not, then they get the bonus as they approach retirement.
21. Low interest rates mean savers are likelier to get a better long term return by putting their savings into equities. The risk that the value will fluctuate over the years makes a house purchase more difficult to plan. Therefore a would-be first-time buyer might decide to keep most of their savings in cash to put down as a deposit. If the house purchase is then periodically delayed, then the saver may eventually realise that they have missed out on better returns in equities.
22. There are two further considerations for those who have a realistic prospect of buying a house. First, will renting be reformed to offer greater security of tenure, thereby becoming a

genuine alternative to ownership? If it does, more renters will focus their financial planning on the longer term.

23. Second, would a larger pension pot at retirement be enough to buy a house outright? This would require equities to outperform property prices over the long term. The experience of the past 30 years suggests that this is possible: the FTSE 100 has outperformed house prices if dividends are compounded (but rents excluded). However, relying on this experience would not be sufficient in helping renters make these decisions for the next 30 years, especially without explicit government policy to have minimal house price inflation.
24. Would someone who reached retirement with no property but a large pension qualify for state support to pay their rent? Prioritising a pension over home ownership might be a costly decision if it ended up simply covering one's rent in retirement. If such an outcome is likely, it might lead renters with no hope of buying a home to question the value of saving.
25. Resolving some of these dilemmas is in the government's hands. First, they could ensure that private renting is a viable long term tenure by giving tenants greater protections over their homes. Second, they could provide certainty that equities and other productive assets will outperform property as an investment class. This would be achieved by building more homes and making property taxation more progressive.
26. Providing clarity on the housing benefit regime for pensioners in 2050 might be beyond the powers of today's government, but it will be a significant factor in how many renters approach their retirement planning. The implications of muddled incentives for retirement savings demand government attention now.
27. Building more homes would not only help to temper house price inflation and give better-off renters greater confidence in the savings system, but have wider effects on savings behaviour. Lower rents would improve renters' ability to save more generally. They would also reduce the liability facing the state as more people reach retirement with no property wealth – whether they have savings or not.