A Home Individual Savings Account, An opportunity for the English underprivileged?

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Introduction

Over the last decade, individual households in England and Wales, especially the young and the below-median income ones, have struggled to afford to buy or even rent their homes. For the most needy, income support and housing benefits are being granted to enable them to pay rent.

More recently the U.K. government established a scheme for England to help first time buyers to get onto the property ladder. The Help to Buy scheme includes four individual programs: an equity loan scheme; a mortgage guarantee scheme; a shared ownership scheme and a New Buy scheme.

Housing benefits supplement income levels for low-income families, while the Help to Buy schemes lower the savings levels needed to acquire homes at current market prices. What neither of these has done however is to establish a permanent link between savings out of incomes and house price levels. If income levels grow slower than house price increases, savings levels out of incomes - especially for the underprivileged- cannot be expected to grow faster than such incomes. House price increases are closely correlated with increasing rent levels. As a result home ownership becomes a distant dream for the low and median income families.

In a wide ranging study the Institute for Fiscal Studies[1] formulates U.K public policy housing objectives as follows: “Public policy towards the housing market has sought to achieve (at least one of) three distinguished goals: to provide shelter and accommodation for all families; to encourage home ownership and to encourage construction as a tool of counter-cyclical macroeconomic policy”.

In line with these objectives a government scheme could be set up which compensates the young and low and median income families for the reduction in values of their (small) savings when house prices rise faster than average incomes. Such a scheme can be called: the Home Individual Savings Account or HISA.

The aim of such a scheme would be to help the young and the lower income-earning individuals and families to become homeowners. The scheme will help to nullify the gap between average house prices movements and average income developments. The scheme will work counter-cyclically, as savings levels will grow with the rise in house prices, but can only be used when sufficient savings have been accumulated for the down payment for buying a home.

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[1] http://ifs.org.uk/budgets/gb2014/gb2014_ch5.pdf

1 The savings depreciation factor

Over the period 1999-2013 average wages in the U.K. moved up from £19,600 in 1999 to £26,500 in 2013 [2]. In real terms, wages increased and exceeded CPI inflation levels over the period 1999-2008 but grew less rapidly than inflation after 2008. Over the period 1999-Q1 2014 average real house prices adjusted for inflation have moved up from £71,122 in 1999 to £178,124 as at the end of the first quarter 2014.[3]

If in 1999 an income of £19,600 could buy a home costing £71,122 based on accumulated savings from previous periods, than the home value to income ratio was 3.634.

With the same multiplier applied to the average income level of £26,500 in 2013, average affordable house prices would have reached the level of £96,295. However the average prevailing real house price adjusted for inflation is currently £178,124 or approximately 85% above the level, which average incomes can afford.

Income levels need to be high enough for people to afford rents and saving levels need to be high enough for people to afford the down payment for getting on to the property ladder.

Income levels have clearly not moved in line with house price inflation. The effects of such divergence are that rents go up faster than incomes and that savings are depreciated in value as compared to house price values. The same level of savings can buy less value of homes. In the above case the depreciation was assessed at 85% over the period 1999-2014. The savings depreciation factor, which measures the reduction in purchasing power to acquire a home, is in reality even higher as over the last five years average wages have not kept pace with CPI inflation levels.

Not all individuals and individual households are equally affected by the depreciation of savings. Existing homeowners benefit, on paper, from the rapid increase in house prices: their equity base in their home grows. Higher income earners usually have a greater capacity to save and therefore are less likely to have difficulties in saving enough money to get onto the property ladder. It is the young and the below median level incomes which suffer the most. If they rent – and quite a few young people chose to stay with their parents instead- their percentage of income used to pay rents goes up, which makes saving an even harder proposition.

In a recent study, the Institute of Fiscal Studies[4] pointed out that only 21% of people born in the mid-1980s had bought their own home by the age of 25 – compared with 34% of those a decade earlier and 45% born in the mid-1960s.

[2] http://www.ons.gov.uk/ons/search/index.html?pageSize=50&sortBy=none&so
[3] http://www.housepricecrash.co.uk/indices-nationwide-national-inflation.php
[4] http://www.ifs.org.uk/publications/7282

It is in this connection that an additional government tool could have been (and still could be) useful: the Home Individual Savings Account or HISA. In line with the devolution of powers to the nations that make up the U.K. and for the purposes of this paper, this proposal applies to England only.

2 Introducing the Home Individual Savings Account

2.1 What is a HISA

A HISA is an account for the accumulation of funds exclusively to acquire a home. It therefore differs from an ISA in that the savings are for one particular use only: the down payment for acquiring a home. Funds cannot be withdrawn until the required accumulation has taken place. Once enough cash has been accumulated, such cash can only be used for buying a home. Such home or if one moves a similar type one should remain owned for at least a period of five years before it can be sold. Exceptional circumstances like death or divorce may reduce the penalty level.

For income earners on an income level of £50,000 or below, a free U.K. government interest rate subsidy could be granted. The size of the interest subsidy can be established annually, based on the movements of average house prices in a year and the average wage growth level. For instance, if average wages grow by 2% per annum and average house prices move up by 10% in the same year, than an 8% interest subsidy over the accumulated HISA savings amounts would be granted to eligible HISA holders. Such subsidy ensures that the savings values for home acquisition stay in line with house price developments. If house prices drop or their inflation level is below the wages growth, no subsidy would be granted.

The HISA is an ISA, so no tax should be taken from the interest earned, but it is also different from an ISA in that it is a cash only savings account with a special purpose. No cash withdrawals are allowed until the minimum equity level needed for the purchase of a home has been reached. The HISA is also different from an ISA in that only a specified group of savers can make use of it. The HISA can be used for down payments for first homes only.

2.2 Who could be eligible?

In principal, only individuals who have been a British taxpayer for three years would be made eligible. The second condition could be that a HISA is only available for individuals at an income level (individually or combined) of £50,000 or lower per annum. The latter amount could be revised annually on basis of average house price developments and wages growth. A HISA would only be available for individuals or couples who want to get onto the property ladder.

2.3 What are the requisite savings amounts?

With average real house prices of around £180,000 in England, the target amount of savings would be £36,000 or 20% of the purchase price. If HISA savings exceed this amount –to be revised annually- then no interest subsidy would be granted over the amount exceeding £36,000.

For the Greater London area, the higher costs of buying a home could be taken into account so that for London and the Home Counties a different average house price is used and also the maximum eligible average income levels to participate and to receive an interest rate subsidy could also be increased.

2.4 Who could contribute to HISA savings?

Parents, who would like to help their offspring, could transfer some of their savings to the HISA account holder. Of course, individuals could themselves contribute. Employers might consider paying a bonus for eligible HISA account holders directly to the HISA account in agreement with the wishes of the account holder. The tax authorities may wish to treat such bonus as a non-taxable item for the individual.

2.5 What would be the expected costs to the U.K. Treasury?

According to the Census 2011, there were 7.4 million individuals in England in the age group 25-34. Of those, 5.96 million were taxpayers. In 2001, 58% of the age group 25-34 were owners of homes. By 2011 this percentage had dropped to 40%. If one assumes that taxpayers and home owners are part of the same group, then an objective could be set that another 20% of the 5.96 million (or 1.2 million) could become home owners. They are the target group for HISAs.

On the assumption that individuals could on average save 10% of their average wages from own income and with the help of family and employers, the annual amounts of savings could total £3.18 billion. 10% of annual wages of £26,500 equals £2,650, multiplied by 1.2 million individuals equals £3.18 billion in savings. In year one of the scheme and taking into account the huge savings depreciation factor since 1999, one may suggest a tax-free 7% government interest subsidy over the amount accumulated at the end of a fiscal year, provided that regular monthly savings were paid into the accounts. This would cost the Treasury about £223 million in year one if all potential homeowners participated in the scheme from day one. To incentivize HISA account holders to saves, a further two year period of 7% annual interest subsidy could be guaranteed, which doubles the costs to £446 million in year two and £892 million in year three. After year three the wages-house price developments could be revisited. Taking the fiscal 2016 budget forecast of government expenditure of £741 billion, the £892 million would only represent 0.12% of total expenditure.

2.6 How would it change homeownership?

According to the 2011 Census, England and Wales had 23.4 million homes with 15 million homeowners and 8.3 million in the rented sector of which 4.2 million was from the private sector and 4.1 million from the socially rented sector. However, if 1.2 million were to take up a HISA and succeed in acquiring a home, it would increase homeownership over time by 8% and reduce the rented sector by 14.5%. The implications are that over time greater home ownership reduces the need for social housing and the associated costs with it. It helps families and individuals, once the mortgage has been paid off, to have higher levels of expenditure available for consumption. It also reduces the pressure on state pensions as homeowners can gradually release the value of their home in later life.

2.7 How would a HISA system operate?

All financial institutions currently operating ISAs could potentially offer HISAs. Given that the funds in HISAs cannot be withdrawn for a long period, in order to create sufficient competition between financial institutions for HISA accounts, it may be advisable to allow the HISA account holder to switch between institutions, say once a year.

3 Conclusions and Recommendations

To help young and lower income level families become homeowners in their own right should be a primary housing policy objective for any developed world government. However, the current savings depreciation levels in the context of house prices put these groups at a significant disadvantage. A flexible instrument, the HISA will work in times of boom and bust. It will help to stabilize the housing markets. In boom times, the interest rate subsidy will ensure that the young and lower income families will not see their savings depreciated and in bust times their accumulated savings levels will ensure that they can enter the housing market without a further need for an interest rate subsidy.

If implemented properly, HISAs can level the playing field for savers and pave the way for an equal opportunity for all to acquire what is the most important of fixed assets, a home.

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