BRIEFINGS

MIND THE £££ WEALTH GAP

Intergenerational Justice and Family Welfare

The costs and gains of homebuying

Introduction

Given wider changes in the socioeconomic and political context within the UK[1], including concerns about funding retirement and later life care, households' strategies have increasingly considered the owned home as an asset-base for family welfare. This shift towards increasingly portraying the family home as a route towards building up assets and wealth – and more broadly towards individual rather than collective responsibility for risk and welfare – has been questioned regarding the consequences of the unequal distribution of housing wealth across regional and local markets, between economic booms and busts, and across different social groups and age cohorts.[2] There are also questions about the homebuyers' ability to negotiate the multiple meanings of the owned house not least as a space of shelter, a place of home, an investment vehicle and an object of debt.[3] Using information gained from interviews with 80 home owners and national data on house prices and mortgages, we compare average costs and gains of homebuying via a 'typical' mortgage.

Gross costs and gains

Table 1 shows the gross costs and gains of homebuying over four 25 year periods, and subsequent house value growth to 2015.[4] No account has been taken of additional purchase costs (e.g. stamp duty) or costs of maintenance, improvements and homemaking (e.g. furnishing). Each purchase was assumed to be financed through a 20% deposit and 80% mortgage. The columns headed 'profit' are calculated as follows:

- 'Profit 1' represents the value of the home at end of mortgage term (after the mortgage has been completely repaid) minus its value at date of purchase. Profit 1 therefore represents gross growth in house value over the mortgage term. However, it represents the profit obtained in the case of a purchase made entirely with cash and not with a mortgage which carries additional costs of borrowing.

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[1] Malpass, P. (2005). *Housing and the Welfare State: The Development of Housing Policy in Britain* Basingstoke: Palgrave Macmillan

[2] Searle, BA. & McCollum, D. (2014). Property based welfare and the search for generational equity. *International Journal of Housing Policy,* 14(4), 325-343.

[3] Cook, N., Smith, SJ., & Searle, BA. (2013). Debted objects: homemaking in an era of mortgage-enabled consumption. *Housing, Theory and Society,* 30(3), 293-311.

[4] Average UK-wide house values according to Nationwide House Price Index. Mortgage costs according to a standard variable rate mortgage (Building Societies Association).

- 'Profit 2' represents the house value at the end of the mortgage term minus the total cost of purchase (this includes the costs of borrowing). Note that a homebuyer can only calculate Profit 2 at the end of the mortgage period by summing up the annual mortgage payments as shown in the annual statements.

Table 1 Gross costs and gains (£ thousands)

Mortgage period	Home value at date of purchase	Costs of purchase:			Home value at the end of mortgage	Profit 1 Gross capital gains	Profit 2: Cost deducted gains	Subsequent home value growth to 2015
		Deposit	Amount mortgaged	Mortgage payments				
	(a)	(b)	(c)	(d)	(e)	(e - a)	(e - b - d)	(f)
1975-2000	11.3	2.3	9.0	27.8	81.6	70.3	51.6	120.9
1980-2005	23.5	4.7	18.8	55.3	157.4	133.9	97.4	45.2
1985-2010	35.4	7.1	28.3	73.5	162.9	127.5	82.4	39.6
1990-2015	54.9	10.9	43.9	100.6	202.6	147.7	91.0	-

Source: computation by Dr Adriana Soaita and Mr Stewart Cowe BSc, FFA

By adding the amounts in columns 'b' and 'd' for deposit and mortgage payments, respectively we observe that the total cost charged was between 2 and 2.7 times higher than the purchase price (column 'a'). For instance, for a house value of £11,300 (period 1975-2000) a homebuyer actually paid £30,100 over the mortgage term, including the deposit. The cost of borrowing (column 'd' minus column 'c')[5] ranged from £18,800 (1975-2000) to £56,700 (1990-2015).

However, the home values over the mortgage term grew by 3.7 to 7.2 times over the four mortgage periods. Consequently, the cost of borrowing consumed about 27% of the 'illusory' Profit 1 for the first two mortgage periods considered in Table 1 and 35% and 38% for the latter two periods, respectively. Hence homebuyers made on average significant financial gains of between £51,600 and £97,400 over the mortgage term, which were indeed sustained by high growth in house values. Obviously, further gains accrued during the period of outright homeownership (column 'f').

Negotiating the multiple meanings of home

We were interested to learn more about how participants accounted for the costs and gains of buying their home. Half of participants thought about their house exclusively as a place of home – "I prefer to buy my *home* even if it makes no financial sense" (m, 35). Just under half saw their home as a dual identity of 'home-and-asset'. Some saw the eventual capital gains as just 'a nice bonus' while others believed there was a strong synergy between the role of the owned house as a place of home and an investment vehicle:

> *"Luckily they both go the same way. The better place to live is a more expensive one and a better investment. That is just the nature of the situation of social economics"* (m, 54).

Most participants had complex housing careers – having moved home on average three times – however, they all enjoyed calculating their gains in terms of Profit 1 (and even as the difference between the value of their current home less the price of their first home):

[5] This represents the amount paid exclusively in interest charges over the mortgage term.

"I bought my first house for £7,500 and I sold the big house for £315,000! You don't make that sort of money by working for a living, if you know what I mean!"(m, 58)

When asked about the costs of financing their mortgage, participants were vaguely aware of the interest rates but never on the amount paid over the period. Further probing questions suggested reasons for this lack of concern, which included:

- *Cultural dispositions*: "debt is a way of life here, the true costs of goods does not matter to people" (m, 35);
- *Beliefs in the long-term growth in house values:* "house values always go up" (f, 51);
- *Shared experiences:* "I won't be the only one in the history losing money on buying a home" (f, 60);
- *Book-keeping complexities*: "Oh, I don't read my annual statements, I don't even keep them" (m, 45).

To some extent, this 'debt amnesia' has rested on the high growth in house values, particularly after 1980 and more recently on the historical low rate of interest on the cost of borrowing. However, on the one hand, if growth in house values had only been half over each mortgage term – that is by 2 to 3 times rather than by 3.7 to 7.2 times – the cost of the mortgage repayments would have virtually wiped out the real gain (Profit 2 in Table 1). On the other hand, although the costs of financing a mortgage are set nationally (and are generally regressive), the growth in house value varies regionally. For instance over the four periods considered in Table 1, Profit 2 in the North East of England ranged from £25,300 to £71,400 whereas in the South East it ranged from £70,100 to £121,346. These are obviously outstanding differences even if purchase prices did differ regionally. However among participants, there was no sense of gains being a form of unearned or unpaid wealth but rather a sense of being lucky or buying smart even when the effect of lack of supply was acknowledged by a few participants:

"I've been just lucky really; the housing market has just ballooned. It's just the market, I mean it's just crazy, just crazy" (f, 65).

"It has gone up because we've made improvements to it, which increased the price. And we bought in a very good location" (f, 37).

"It's a commodity. It's like anything else, it's supply and demand. And the housing stock in Britain at the moment to purchase is too low for the number of people that want to buy" (m, 49).

Furthermore, we adjusted Profit 2 (Table 1) for inflation by considering the effect of general price inflation on both the value of money and the value of homes. Based on national averages, these arguably real gains[6] ranged from -£2,200 (1975-2000) to £43,500 (1980-2005). Comparing the North East with the South East of England, the lowest figures were -£51,300 and -£13,200 respectively (1990-2015) while the highest gains reached £32,500 and £67,200 respectively (1980-2005).

Participants however were not inclined to consider the effects of inflation when calculating their own housing gains – after all this would indeed be a difficult exercise – just as they were unconcerned by the amount of debt on which eventual gains must rest. There is a

[6] Please note that costs of purchase, maintenance, repair and homemaking have not been deducted.

simple explanation to this. Participants weaved the complex equation of homebuying costs and gains with the alternative cost of a privately rented space of shelter:

> *"After all it's a question of paying the bank or the landlord! So you're as well buying as long as you don't have to move around too much for your job"* (m, 65).

According to this perspective, it follows that the *overall* gains of buying the asset-*shelter*-home should include the theoretical cost of renting a similar property (also referred to as *imputed rent*). Participants usually assumed rental costs approximate mortgage payments. Consequently, these overall gains reached an impressive amount, as shown in Table 2 in gross and inflation-adjusted figures to the end of mortgage term (time periods for minimum or maximum values across columns and rows do not always coincide).

Table 2 Gross and adjusted gains over the mortgage term (£ thousands)

	National		North East		South East	
	Min	Max	Min	Max	Min	Max
Gross	79.4	191.6	51.6	112.0	99.1	222.8
Adjusted	15.5	82.4	5.7	63.0	34.9	109.2

Source: computation by Dr Adriana Soaita and Mr Stewart Cowe BSc, FFA

Homeowners' miscalculation of gains and disregard of inflation may therefore be seen as a construction of multiple identities of the owned home as home-*shelter*-asset. From a fiscal perspective, it is important however to make a clearer distinction between the framework of shelter and that of asset within the terms of homebuying in order to distinguish between what and how it was paid, and what and how it was gained. As one cannot spend the same monies twice, homebuying can be seen as either:

a) Buying an asset over the mortgage term and living rent-free over the period. This analysis showed that homebuyers made 'real' gains but also 'real' loses for some time periods and regions even though the additional costs of purchase, maintenance and homemaking were not included. Furthermore, calculating these true costs and gains would make a very complex exercise.

b) Paying 'rent' for shelter over the mortgage term and gaining an unpaid asset at the end of the period. If rents can be assumed to approximate mortgage payments, it follows that unpaid capital gains equal home value at the end of mortgage term minus the deposit paid. The corresponding figures – again without including the additional costs mentioned above – ranged from £51,600 to £222,800.

This has policy implications regarding how unearned financial gains may be taxed. Statement (a) implies taxing imputed rents during the mortgage term (and after) and for simplicity, taxing capital gains accrued only between the end of the mortgage and later sale. Statement (b) implies taxing capital gains for the home value at the time of selling with the only deduction of the deposit paid – which may seem somewhat surprising – with imputed rents being taxed only after the end of the mortgage. The concept of imputed rents may however seem culturally unfamiliar in the UK although they were historically taxed via 'Schedule A' (abolished in 1963). An alternative approach to create fiscal fairness between tenants and owner-occupiers would comprise two propositions: (1) to include tenants' cost of rent into the annual tax free income allowance ('Rent Tax Relief') and (2) to tax homeowners on capital gains accrued only between the end of their mortgage and later sale.

Contact for further information: Dr Adriana Soaita, Centre for Housing Research, University of St Andrews (ams24@st-andrews.ac.uk or asoaita@yahoo.com)