BRIEFINGS

MIND THE £££ WEALTH GAP

Intergenerational Justice and Family Welfare

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What is Equity Borrowing and who is doing it?

What is Equity Borrowing?

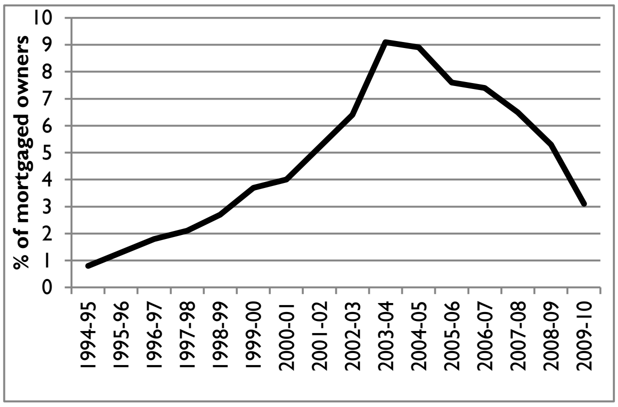
Housing equity is the value of a property minus any (mortgage) loans secured against it. Homeowners can access their housing equity without moving home through the processes of equity release and equity borrowing. **Equity release** is where owner occupiers, who have paid off any mortgage debt, undertake a financial arrangement in which they have the right to continue to live in their home but transfer ownership of all or part of it to a financial institution. The homeowner receives a loan from this transaction which is repaid when the property is eventually sold (upon relocation or death of the homeowner), see Briefing No3. In-situ **Equity borrowing** is where homeowners increase their mortgage debt, either through re-mortgaging or through the flexible options on an existing mortgage. This additional debt is then gradually repaid over the term of the mortgage.

Traditionally in the UK mortgages could only be obtained from a Building Society. During the 1980s changes to the financial regulations meant that organisations and companies, other than Building Societies, could sell mortgages. This led to new and different mortgage products gradually becoming available, many of which made it much easier to borrow equity from the home. Before the financial crisis of 2007 the amount of money that was being withdrawn from housing wealth steadily increased. Since then equity borrowing has declined, however research shows that home owners continue to borrow equity by increasing their mortgage debt. This raises concerns about who is borrowing equity and why they are doing it.

How common is Equity Borrowing?

Some social surveys which randomly sample households across the UK include questions about mortgage debt. These sources of information can give an indication of how common it is for homeowners to borrow equity from their property. For example, in the Family Resources Survey (2009-10) 34 per cent of homeowners who were still repaying a mortgage had borrowed equity from their homes at some point since they purchased them. This has risen from 8.4 per cent in 1994-5.

Figure 1: Proportion of mortgaged homeowners who re-mortgage* or extended original loan on their home



Source: Family Resources Survey, author's analysis
*Excludes re-mortgaging for better interest rates or to take out a more flexible mortgage

Breaking this data down, Figure 1 shows how the proportion of mortgaged homeowners that have borrowed equity from their homes in any one year has fluctuated between 1994-5 and 2009-10. Following the recovery from the end of the last housing downturn in the mid-1990s, less than 2 per cent of homeowners borrowed equity.

Numbers however increased steadily from this period onwards and peaked at nearly a tenth of these homeowners borrowing equity in the 2003-4 and 2004-5 periods. The percentage of home owners borrowing equity through re-mortgaging has since declined.

Why do home owners borrow equity?

Table 1: Reason recorded for equity borrowing

Reason for equity borrowing	%
Re-invested into the home	
Home improvement or repairs	55.8%
Essential repairs	2.8%
Equity leakage	
For other (undefined purposes)	22.5%
To purchase a major item	9.8%
Buy out another person's share	5.6%
To start a business	3.5%
Total	100.0%

Source: Family Resources Survey 2009-10

The Family Resources Survey records some (limited) reasons why people borrow equity (Table 1). These figures suggest that a large part of equity borrowing activity (57.6%) is used for reinvestment in the home through improvements or repairs. However this means a sizeable part of equity borrowing (42.4%) appears to be for non-housing expenditure, such as for purchasing major items (9.8%) or undefined 'other purposes' (22.5%). Separate analysis using the British Household Panel Survey shows that over time using equity borrowing to reinvest in housing has declined while spend on 'other' undefined items has more than doubled between 1991 and 2007 (Smith and Searle, 2008). Spending housing equity in this way can be described as 'equity leakage'; funds are not being used for the physical upkeep or improvement of the housing stock, instead they are used to fund a range of non-housing goods or services.

Who is borrowing equity?

Home owners who are aged in their thirties or forties appear to be the most likely to borrow equity. Similarly households consisting of couples with dependent children are more likely to borrow equity than other household types. Households that are headed by someone who is in paid work are also more likely to borrow equity than those who are not.

Table 2: Characteristics of equity borrowers

	Homeowners still repaying a mortgage who borrowed equity in past year		
	Yes	No	Total
Age band of head of household			
20-29	1.4%	98.6%	100%
30-39	3.4%	96.6%	100%
40-49	3.9%	96.1%	100%
50-59	2.6%	97.4%	100%
60+	2.4%	97.6%	100%
All ages	3.1%	96.9%	100%
Household composition			
Couple, no dependent children	2.1%	97.9%	100%
Couple, with dependent children	4.1%	95.9%	100%
Lone parent	2.5%	97.5%	100%
Single person household	2.7%	97.3%	100%
Other	3.5%	96.5%	100%
All household types	3.1%	96.9%	100%
Employment status of head of household			
Employed or self-employed	3.3%	96.7%	100%
Unemployed or economically inactive	1.8%	98.2%	100%
All economic statuses	3.1%	96.9%	100%

Source: Family Resources Survey 2009-10

The findings here are based on simple descriptive analysis, but it is consistent with more complex statistical modelling contained in additional research which shows equity borrowing tends to occur among younger home owners, rather than those nearing retirement, and is less about funding luxuries and more about meeting welfare needs. Equity borrowing is more likely to be associated with increased demands on household expenditure for example meeting the needs of growing families. It is also associated with reductions in income, for example relationship dissolution, where additional funds may be needed to buy out a partner's share in a property or to overcome the difficulty of managing households budgets following the loss of a partner's income. Equity borrowers tend to be employed, a reflection of the need to be able to service any additional debt, although they also tend to have lower incomes, higher (non-housing) debt and lower savings or investments than those who do not borrow equity from their home.

Why is this information important?

Understanding why homeowners borrow money secured against the value of their homes is of interest because: it may result in too much equity 'leaking' from the housing stock; it can put home owners at risk if they have increased their mortgage debt and house prices fall; and it shows how home owners are relying on using their housing wealth much earlier in the life course to provide welfare support for their families, rather than saving their wealth for older age.

This latter point is of policy importance given the attempts to encourage individuals to accumulate assets which they can draw on for their welfare in later life, rather than rely on state support. Equity borrowing and asset based welfare are both dependent on the value of assets retaining or increasing their value over time. However, as demonstrated in the UK recessions of the 1990s and 2000s, housing prices are very volatile, and steep rises can very quickly be followed by steep declines. A downturn in the housing market therefore has a detrimental impact on the store of wealth that homeowners have to draw on in the form of equity in their homes.

This is also important for intergenerational justice. Home owners who were are able to buy into the housing market before the 1990s will have seen the value of their property rise substantially, even with the recent downturn in prices. However, current generations of younger people are finding it very difficult to enter the market as house prices have risen at a rate much faster than incomes. The current subdued market, and return to tighter lending criteria for mortgage finance have led some to speculate that households currently entering the housing market are unlikely to benefit from the 'one off bonanza' of growth in levels of homeownership, followed by increases in house values, that many members of the 'baby boomer' generation enjoyed.

To find out more:

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Parkinson, S. Searle, B.A. Smith, S.J. Stokes, A. and Wood, G. (2009) 'Mortgage Equity Withdrawal in Australia and Britain: towards a wealth-fare state?' *European Journal of Housing Policy*, 9, 4, 363-387.

Searle, B.A. (2011) 'Recession and Housing Wealth'. *Journal of Financial Economic Policy*, Special Issue: 3, 1, 33-48

Smith, S.J. and Searle, B.A. (2008) 'Dematerialising money: the ebb and flow of wealth between housing and other things'. *Housing Studies* Volume 23 Number 1. pp 21-43.

Smith, S.J. and Searle, B.A (eds) (2010) *The Blackwell Companion to the Economics of Housing: The Housing Wealth of Nations.* Blackwell. Oxford.

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