wealth of our nation:

rethinking policies for wealth distribution

By Ashwin Kumar, Kitty Ussher and Paul Hunter

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Office for National Statistics. Social Survey Division, Wealth and Assets Survey, Waves 1-2, 2006-2010 [computer file]. 2nd Edition. Colchester, Essex: UK Data Archive [distributor], 2012. SN: 7215 , http://dx.doi.org/10.5255/UKDA-SN-7215-3

Executive summary

Executive summary

The recent decision by the Office of National Statistics to undertake large-scale data collection on the distribution of household wealth in Britain has significant implications for public policy.

We performed a cluster analysis of the latest publicly available wave of data[1] which enabled us to construct a typology of British households according to their wealth position, as shown below:

Type	Description	Households (million)
No assets	Working age: no or low earnings, no or very low pension saving, renting so no property assets, in debt or minimal savings	3.5
Renter	Working age: decent earnings but modest pension savings and no property assets	2.2
Debt burden	Working age: late 20s to 40s, lower-value home, significant mortgage (ltv 75%), above median earnings, but modest pension savings, in debt or low savings	2.1
Relying on property	Working age: low or no earnings, no or low pension savings, owner-occupier with mortgage paid off, or nearly paid off	1.7
Good progress	Working age: mainly 30s/40s, very good earnings, decent pension, middling value of property, mortgage steadily being paid down (50% ltv)	2.8
Wealth accumulator	Working age: 40s/50s, high-earnings, very good pension, high-value home, substantial progress in paying off mortgage (ltv around 25%)	2.7
Looking forward to retirement	Working age: mainly 50s/60s, higher-value home, mortgage paid off, good pension, excellent savings, still working	1.8
Happily retired early	Working age: 60s (some 50s), higher-value home, mortgage paid off or nearly so, good pension, excellent savings, not working	1.0
Renting in retirement	Pensioner: renting, no property assets, no or low pension assets, modest savings	1.9
Getting by	Pensioner: older pensioner, above-average property value, owned outright, modest pension, some savings	2.4
Silver success	Pensioner: high-value home, owned outright, good pension, excellent savings, younger pensioners, some still working	2.5

1 There are three data points in this series, relating to information gathered in 2006-10, 2008-10 and 2010-12. The detailed original data analysis in this paper uses the 2008-10 information because the Office of National Statistics has not, at the time of writing, made the full 2010-12 data files publicly available. However the ONS kindly made sufficient information available privately to us from the latest data in order to satisfy us that the overall picture arising from the analysis performed for this report remains valid. And some high-level results are available from 2010-12, which are referenced in the text where appropriate. We will refresh the analysis in this report when the full datasets are publicly available.

We then explored ways in which this segmentation might be expected to change in future decades.

This analysis so far exposes a number of key questions that policy makers may wish to consider. In particular:

(1) Changes in longevity mean that households in Britain who receive inheritances tend to do so precisely when their wealth is already at its highest. This may be an opportunity to explore ways to incentivise the distribution of wealth more widely to younger family members whose need is greater, for example through taxing inheritance at receipt rather than bequest, building a deeper market for low-risk equity release products, and exploring pro-market ways to encourage intergenerational giving for specific purposes such as education, first-time buying and childcare costs.

(2) There exists a significant cohort of people who own property but have a low income. These people are in a markedly different situation, having a degree of security and the possibility of realising their asset if needed, to those on a low income with no property assets. Yet this is not recognised in the benefit system - it is still possible to get low-income benefits if you live in a high-value home - or in discussions around income inequality.

(3) Similarly, there exists a further significant cohort who have a relatively high income but a significant amount of household consumer (non-mortgage) debt. They have a greater financial vulnerability than would be presumed by looking at income alone; there may be a role for public policy to crystallise and support people in this situation to a greater extent.

(4) It is not possible to have a meaningful discussion of equality without discussing the housing market. At the moment, financial security is strongly linked to housing ownership, and the gap between those who have housing and those who do not is expected to widen: because housing is in limited supply and the returns on ownership are so great.

This opens up a real policy choice. On the one hand a case could be made to *discourage property ownership* compared to other forms of investment to reduce speculative purchasing and encourage greater saving in support of the real economy. Tools to do so could include targeted taxation to incentivise a behavioural shift, new institutions and policies to guarantee security of tenure in other ways and proactive intervention to reduce the attractiveness of high-value areas and encourage investment in low value areas.

On the other hand a case could simultaneously be made for measures to *extend property ownership* as far as possible, widening opportunity from the middle classes out and shrinking the group of people whose overall wealth

position is constrained by the continuing need to pay for housing costs. That this choice exists is the proverbial elephant in the policy room when discussing distributional equity in Britain.

5) For those who have pension assets, they are built up during working lives and drawn down in retirement. The imminent changes to the annuity market may alter the rate at which this happens. We expect a further segmentation in future years between (a) those who purchase an annuity at an early stage of retirement (b) those who seek greater control and save for longer as a precautionary measure leading to greater inheritances, and (c) those who decide to draw down more at an early stage and so rely on others as their age increases.

Based on our analysis we make some policy recommendations for discussion, including:

- a shift to taxing inheritances at receipt, rather than at bequest, with a life-time allowance
- a re-introduction of asset-based welfare provisions to encourage life-time saving, including a consideration of savings schemes that pay out in tradable vouchers to support life events
- an equalisation of the taxation treatment between housing and other investment assets
- the creation of a "national housing bank" to promote equity release, long-term tenancies and mixed communities in high price areas
- financial incentives for landlords to shift to offering longer-term tenancies
- reform of the council tax system to reduce tax on residency and increase tax on ownership
- a supplementary charge on ownership as a regeneration tool, similar in concept as the existing varying rates of stamp duty but levied annually. It would be set at zero for low-value areas and a higher level in high-price areas to discourage speculative investment
- to support this, regular official house price valuations
- greater real-time data sharing to give vulnerable consumers access to their overall credit position.

The data analysis for this project was undertaken by Ashwin Kumar, who formerly headed the Model Development Unit at the Department for Work and Pensions (with responsibility for the Pensim2 model). He is now the chief economist at Tooley Street Research alongside his own consultancy firm, Liverpool Economics. The project was devised, written and managed by former Treasury Minister Kitty Ussher as a Smith Institute research fellow, who is also the managing director of Tooley Street Research. Paul Hunter is head of research at the Smith Institute.

Introduction

Introduction

This paper explores the implications for public policy from the new Office of National Statistics (ONS) data source on wealth distribution in Britain, and what we know about future trends in savings, longevity, property prices and inheritance. An earlier draft was discussed at a specially convened Smith Institute seminar in March 2014. This version incorporates insights gained from that discussion and also updates the analysis with the latest wave of data from the Wealth and Assets Survey that was published by the ONS In July 2014.

The case for having a greater policy emphasis on wealth - as opposed to simply focussing on income - is that a household's wealth at a given point in time is often a better indicator of its economic wellbeing. The ONS has now made this point explicitly, stating in July 2014, that "it is important to consider both wealth and income when assessing the economic well-being of households".[2] Yet the policy implications are under-explored.

For example, a person on a low income with significant savings living in a house that is owned mortgage-free faces very different economic constraints to someone on the same income with no assets to their name. Around 7% of people in the bottom 20% of income have property wealth worth over a quarter of a million pounds yet this is not taken into account when considering their eligibility for means-tested benefits.[3] Conversely a person with an above-average salary with significant consumer debt (negative wealth) is in a very different position to someone on the same salary who is largely debt-free. The same data shows that while in the lowest income quintile, 24% of households have negative financial wealth, in the three middle income quintiles, the numbers are higher at 27%, 28% and 26% respectively.[4] It appears that the poorest are not necessarily the most debt vulnerable.

Of course the two measures are intrinsically linked: income is the measure of flow whereas wealth is a measure of stock, such that households who are able to sustain high incomes will have the opportunity to build up wealth. And having sufficient income to pay the bills on a day-to-day basis - whether it comes from work, or rent from assets owned - is a necessary condition for wellbeing. However, it is the existence of assets which provides security, opens up opportunity and gives people freedom to take risks, to invest for the future, to buy time, and to give. And so without an explicit consideration of their distribution, governments are unable to achieve their stated goals, regardless of whether those goals are fundamentally egalitarian, paternalistic or libertarian.

Only when earnings are taken out of the equation, for example for people over retirement age, does the debate shift back to assets, as we worry whether sufficient savings have been accumulated to support a reasonable standard of living in retirement. We also use the language of assets when talking about non-financial capital where the relevant metric is the stock of the item in question rather than the flow, for example the skills and human capital of people, the social capital of communities, the strength of networks, the value of reputation and knowledge.

An exception is experimental forays into asset-based egalitarianism, or asset-based welfare, consisting of policy interventions designed to reduce asset inequality particularly around younger people. In Britain the now-abandoned child trust fund was a state-backed vehicle to enable more young people to be given a lump sum on reaching maturity. Individual learning accounts were another now-abandoned attempt to enable saving in order to invest in human capital.

There is scope for picking up on where the debate on asset-based welfare left off, to understand more about the distribution of assets in Britain and the forces that have led to that distribution, and so be better placed to understand how to build the type of economy that policy-makers want to see.

This discussion paper attempts to start that conversation. Using the relatively recent data source of the Office of National Statistics Wealth and Assets Survey we describe the current distribution of assets in Britain. We then explore how this might be expected to change in future years given what we know about longevity, inheritance patterns and other demographic and policy changes. Finally we draw out implications for the public policy debate focussing primarily on intergenerational transfers including inheritance, as well as issues relating to housing and consumer debt.

2 http://www.ons.gov.uk/ons/dcp171778_368612.pdf
3 ibid
4 ibid

Current wealth distribution

Current wealth distribution

The ONS has since 2006 started to compile data on the net wealth position of households in Britain, which includes levels of all types of debt as well as assets. It takes two years to conduct the surveys required to obtain one data point and three data points are now available: for the years 2006-08, 2008-10, and 2010-12 with headlines from the latter data published in July 2014.

This Wealth and Assets Survey characterises four main components of wealth, as follows:

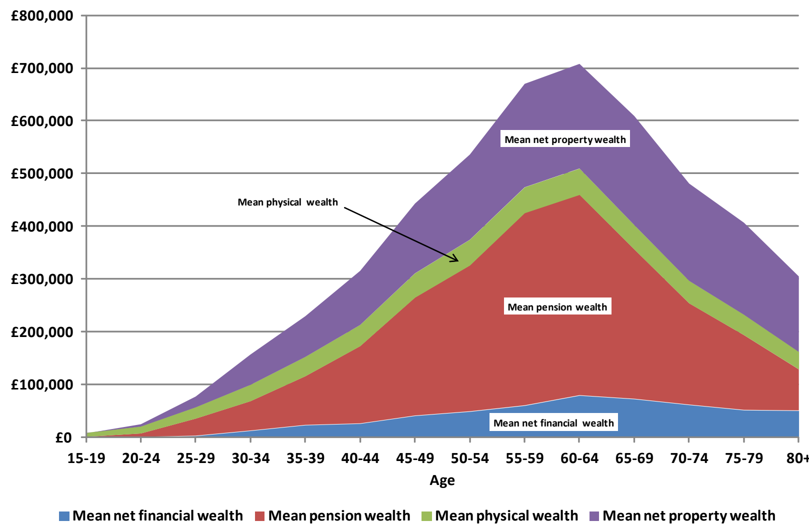
- net financial wealth for example cash in the bank, less consumer (ie non-mortgage) debts
- private pension wealth
- physical wealth, such as cars and personal possessions including valuable items
- property wealth for example value of homes less any outstanding mortgages

Figure 1 shows the typical lifetime distribution of these categories of the wealth distribution.

As can be seen, while the value of physical possessions remains roughly steady over a lifetime, people typically start to acquire some pension wealth in their late 20s, followed by property and then some cash balances building up from their 30s. The largest source of wealth accumulation over a person's working life occurs by building up a private pension. This overtakes other forms of wealth by a person's 40s rising to double property wealth on average by retirement. From retirement age, it is the pension wealth that is drawn down, with households on average usually choosing to keep their cash and property assets until the end of their lives.

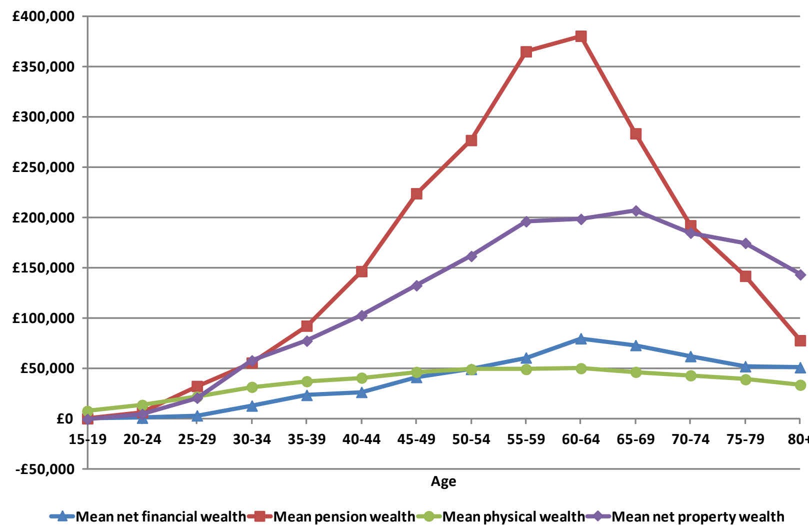
Figure 2, below, draws out these trends more starkly.

Figure 1: The age distribution of wealth



Source: ONS

Figure 2: Wealth by age and category

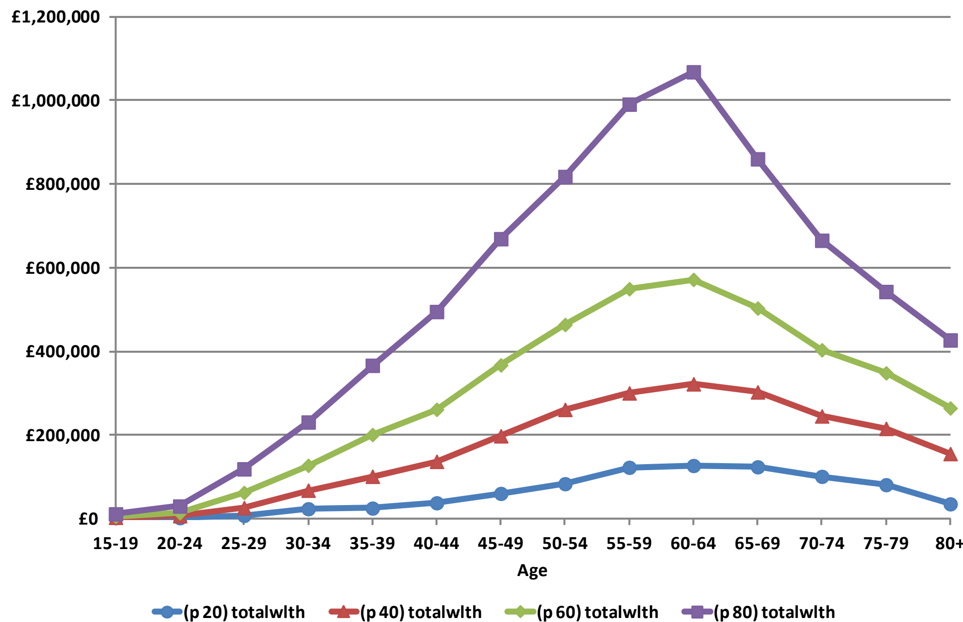


Source: ONS

Note that this data, however, represents the mean value of each asset category for each age group. There are considerable variations within the mean value. For example, honing in on the distribution of net financial wealth shows that there are around 6 million households where the level of debt (excluding mortgages) is greater in value than cash savings. For people in this group who are earning, their disposable incomes are reduced by debt repayments. Those who are not earning are in a very vulnerable cash position. By contrast, there are a further 5 million people who have physical possessions, excluding property, that are worth over £60,000. So overall, while there are clear average trends by age, within each age category different households are experiencing very different pressures.

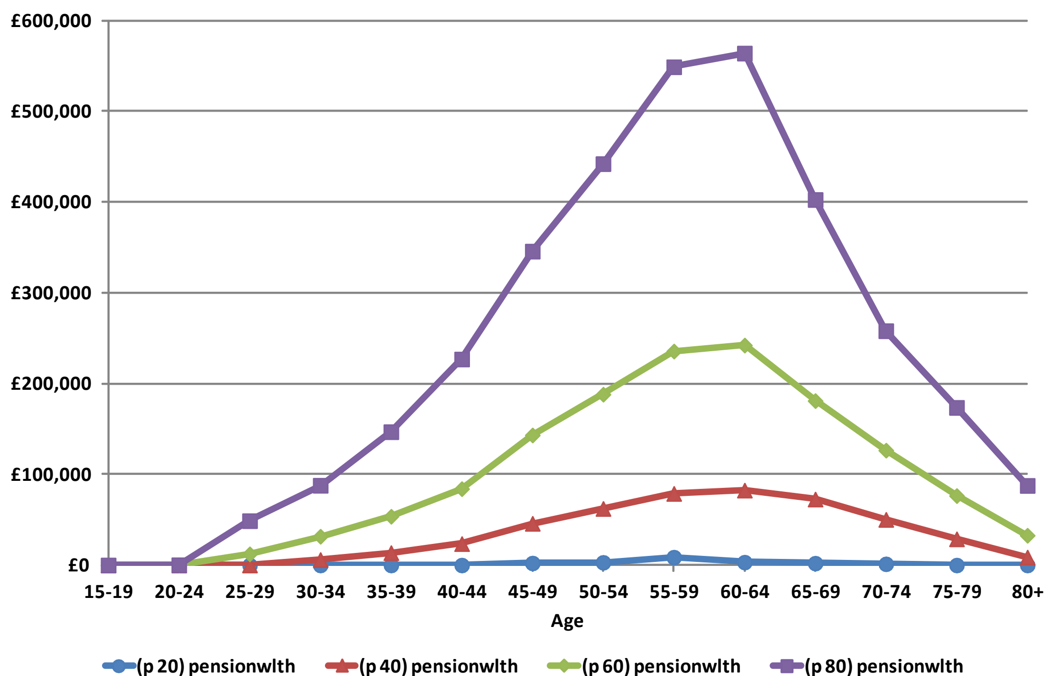
In order to tease out the range of values within the wealth distribution a little more, we separated out the position for each quintile, as shown in figures 3-7 below:

Figure 3: 20th, 40th, 60th and 80th percentile points of the distribution of total wealth



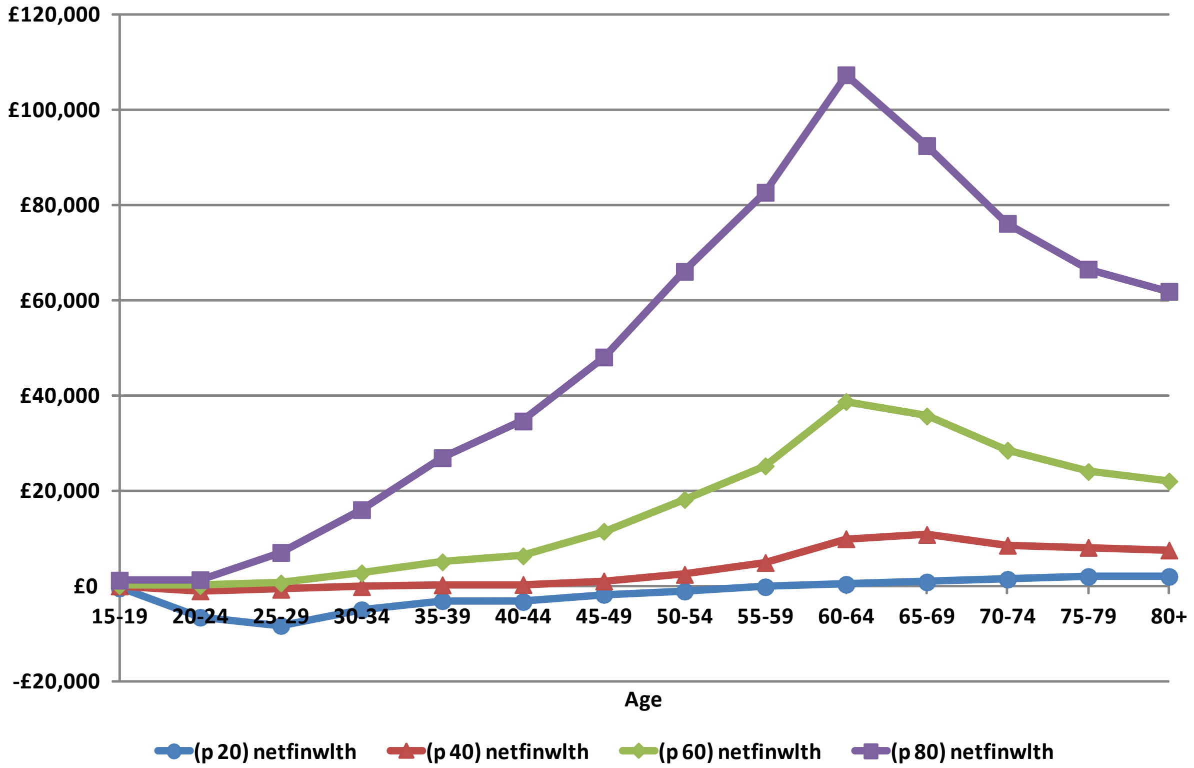
Source: Wealth and Assets Survey Wave 2

Figure 4: 20th, 40th, 60th and 80th percentile points of the distribution of pension wealth



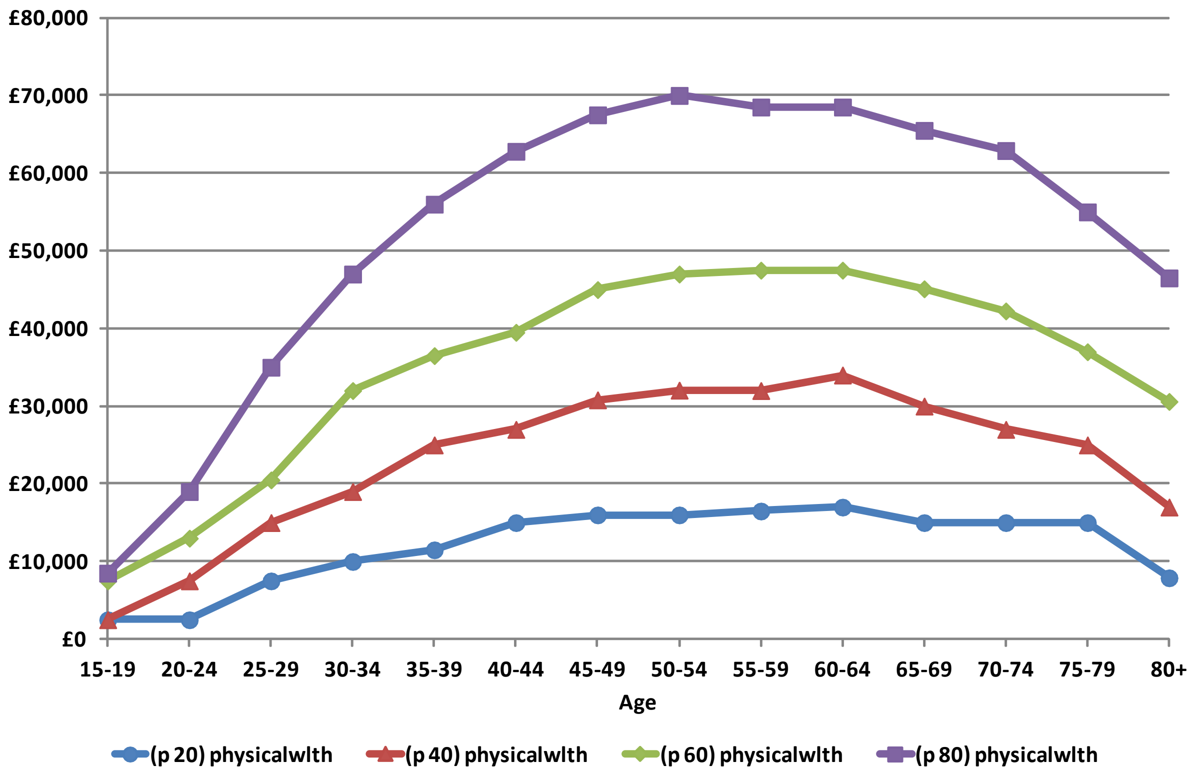
Source: Wealth and Assets Survey Wave 2
Note: Pension wealth does not include the value of state pensions.

Figure 5: 20th, 40th, 60th and 80th percentile points of the distribution of net financial wealth



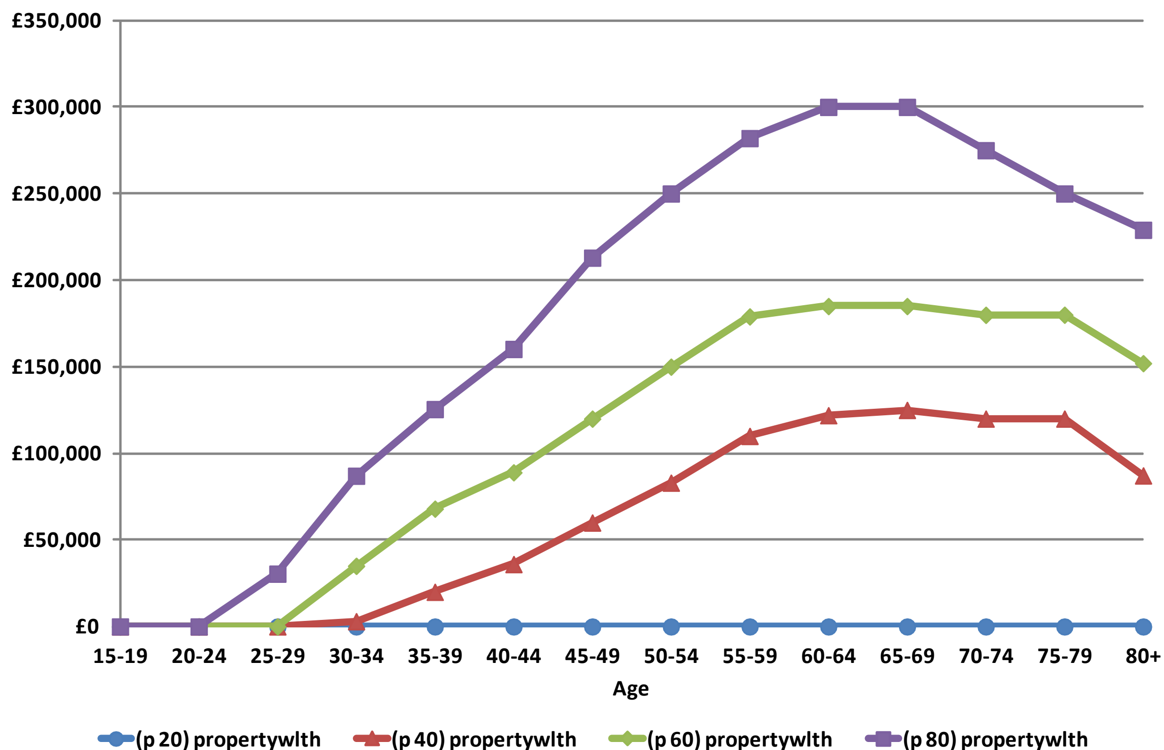
Source: Wealth and Assets Survey Wave 2
Note: Net financial wealth includes financial assets (e.g. savings, investments) less non-mortgage borrowing (e.g. credit cards, loans).

Figure 6: 20th, 40th, 60th and 80th percentile points of the distribution of physical wealth



Source: Wealth and Assets Survey Wave 2
Note: Physical wealth includes household contents, cars and collectibles/valuables.

Figure 7: 20th, 40th, 60th and 80th percentile points of the distribution of net property wealth



Source: Wealth and Assets Survey Wave 2
Note: Net property wealth equals the gross value of property less the value of outstanding mortgage debt

Looking at the overall wealth distribution, it is now possible to see, for example that households in the top 20% of the wealth distribution have built up assets worth around a million pounds by the time they retire, around ten times that of the bottom 20% of the overall wealth distribution (Figure 3). Looking at pension assets, the bottom 20% of households have built up less than £9,000 in pension wealth (or very roughly £9 per week in pension income) by the time they retire, compared to over half a million pounds in the pension pots of the wealthiest 20% of households (Figure 4).

Turning to financial assets, the effect of consumer credit can now be seen more clearly: for 20% of the population, it's not until they reach the age of 60 that their financial assets are worth more than their non-mortgage debts, and for the for the next 20% of the population, - the 2nd quintile - it's not until the age of 50 that their net financial assets exceed £1,000. The top 20% however tend to exceed this level of financial assets as teenagers (Figure 5).

The gap between the top 20% and the bottom 20% is lower for physical wealth than for other forms of wealth (Figure 6), and amongst those with at least some property wealth, inequality is less extreme than in pension wealth: the big divide is between those with no property wealth and the rest (Figure 7).

There is also an important regional dimension to the accumulation of property wealth. Analysis of the Understanding Society database by researchers at the University of Dundee showed, for example, that in 2011, 42% of the housing wealth in England was located in either London (17%) or the South East (25%) which together form 32% of the population, compared to 20% of housing wealth in the Northern regions of England (3% of the total housing wealth in the North East, 7% in Yorkshire and Humberside and 10% in the North West) and 15% in the East and West Midlands (6% and 9% respectively).[5]

As a result, the returns to landlords able to invest where properties are rising are great. Research by estate agent Savills for the *Financial Times* newspaper demonstrated that "the vast bulk of the equity gains from Britain's rising housing market over the past decade has gone to landlords and wealthier individuals who own their homes outright" with the value of housing owned by landlords rising from £384bn a decade ago to £818bn today.[6]

A typology of wealth distribution in Britain

To gain a greater understanding of these differences, we used cluster analysis to tease out the common characteristics of different groups within the overall distribution.

The variables that are taken into account are age, tenure status, property values, outstanding mortgage, pension wealth and earnings. The results are 11 distinct categories as described in Table 1 below.

5 http://wealthgap.wp.st-andrews.ac.uk/files/2013/02/WealthGap_No_03_Housing_wealth_inequalities.pdf
6 "Homebuyers left behind in Britain's two speed housing market", *Financial Times* 14th January 2014

Table 1: Typology of wealth

Type	Description	Households (million)
No assets	Working age: no or low earnings, no or very low pension saving, renting so no property assets, in debt or minimal savings	3.5
Renter	Working age: decent earnings but modest pension savings and no property assets	2.2
Debt burden	Working age: late 20s to 40s, lower-value home, significant mortgage (ltv 75%), above median earnings, but modest pension savings, in debt or low savings	2.1
Relying on property	Working age: low or no earnings, no or low pension savings, owner-occupier with mortgage paid off, or nearly paid off	1.7
Good progress	Working age: mainly 30s/40s, very good earnings, decent pension, middling value of property, mortgage steadily being paid down (50% ltv)	2.8
Wealth accumulator	Working age: 40s/50s, high-earnings, very good pension, high-value home, substantial progress in paying off mortgage (ltv around 25%)	2.7
Looking forward to retirement	Working age: mainly 50s/60s, higher-value home, mortgage paid off, good pension, excellent savings, still working	1.8
Happily retired early	Working age: 60s (some 50s), higher-value home, mortgage paid off or nearly so, good pension, excellent savings, not working	1.0
Renting in retirement	Pensioner: renting, no property assets, no or low pension assets, modest savings	1.9
Getting by	Pensioner: older pensioner, above-average property value, owned outright, modest pension, some savings	2.4
Silver success	Pensioner: high-value home, owned outright, good pension, excellent savings, younger pensioners, some still working	2.5

Figure 8, below, then shows in graphical format how assets are distributed within each of these groups. It appears that there are several broad trajectories at work here.

The largest group, comprising around 13.5 million households or a little over half the total, are either financially secure or are on a path to being so. In their 20s they will make up some of the "renters" group but by their 30s they are in the 'good progress' group, moving to becoming 'wealth accumulators' in their 40s, then either 'looking forward to retirement' or 'happily retired' in their 50s and 60s before landing in the 'silver success' group later on. This group does not need much in the way of state financial support.

A different trajectory comes to those who never manage to access property wealth and so spend the whole of their lives renting in some way or another. In working life this group is found in the "no assets" group which has very low incomes and/or high debts and so no way of saving. It also includes some people who are able to earn enough to save a little into a pension during their working lives - part of the "renters" group - but unlike others do not manage to convert this into home ownership in their 30s. In retirement, both these groups form the "renting in retirement group" where any small pension pot is drawn down, probably with state top-up support. This group consists of about 6 million households or a quarter of the total.

Of a similar nature are the two million younger households whose financial debts mean that they find it harder to make the progress of other households their age. Cash-strapped by debt repayments they defer making pension contributions and build up property assets more slowly than other people in work at their age. Depending on how this situation resolves, this "debt burden" group may either end up renting in retirement or at the bottom end of the property-owning distribution.

Meanwhile there is another group who but for their ownership of property, would find themselves at the bottom of the pile. With little earnings to speak of they are unable to build a private pension but their ownership of their own home brings some security. In total this group makes up about a sixth of all households, broken down into 1.7m working-age households in the "relying on property" group and 2.4m pensioners in the "getting by" group. This group is also likely to rely on state support to meet their day-to-day needs.

Inheritance

The ONS Wealth and Assets Survey also explores the contribution that patterns of inheritance make to the overall wealth distribution. Figure 9 shows the proportion of people in each group who in the 2008-10 survey had received an inheritance of over £1,000 in the previous two years. Figure 10 then shows the relative size of these inheritances between the different groups.

Figure 8: average wealth by component for each group

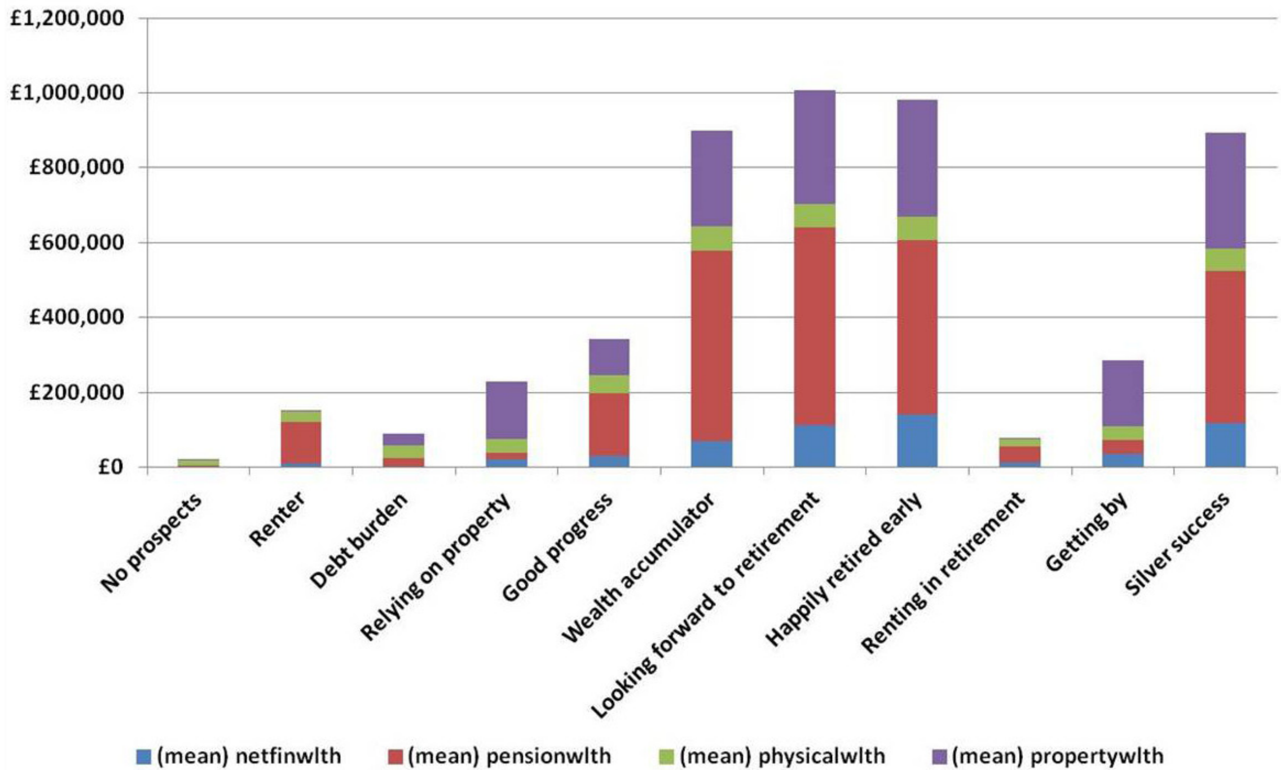


Figure 9: proportion of group who received an inheritance of at least £1K in previous two years

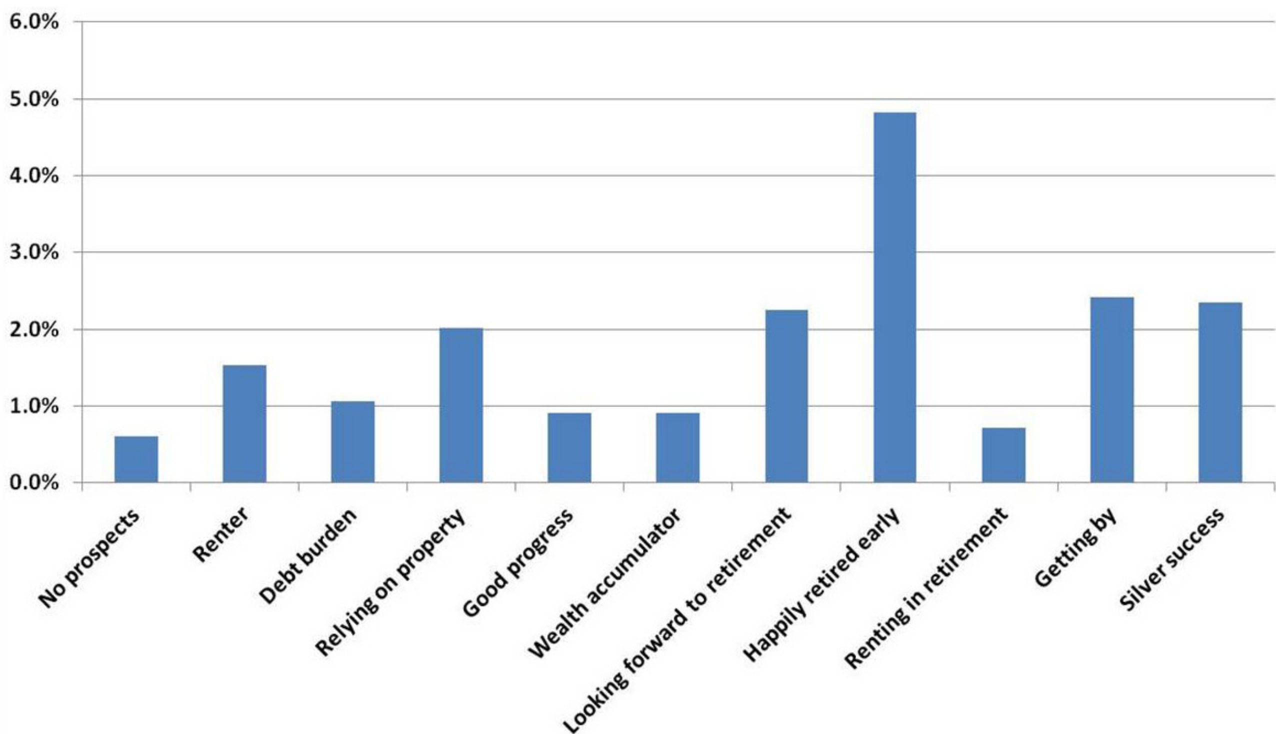


Figure 10: average size of inheritance

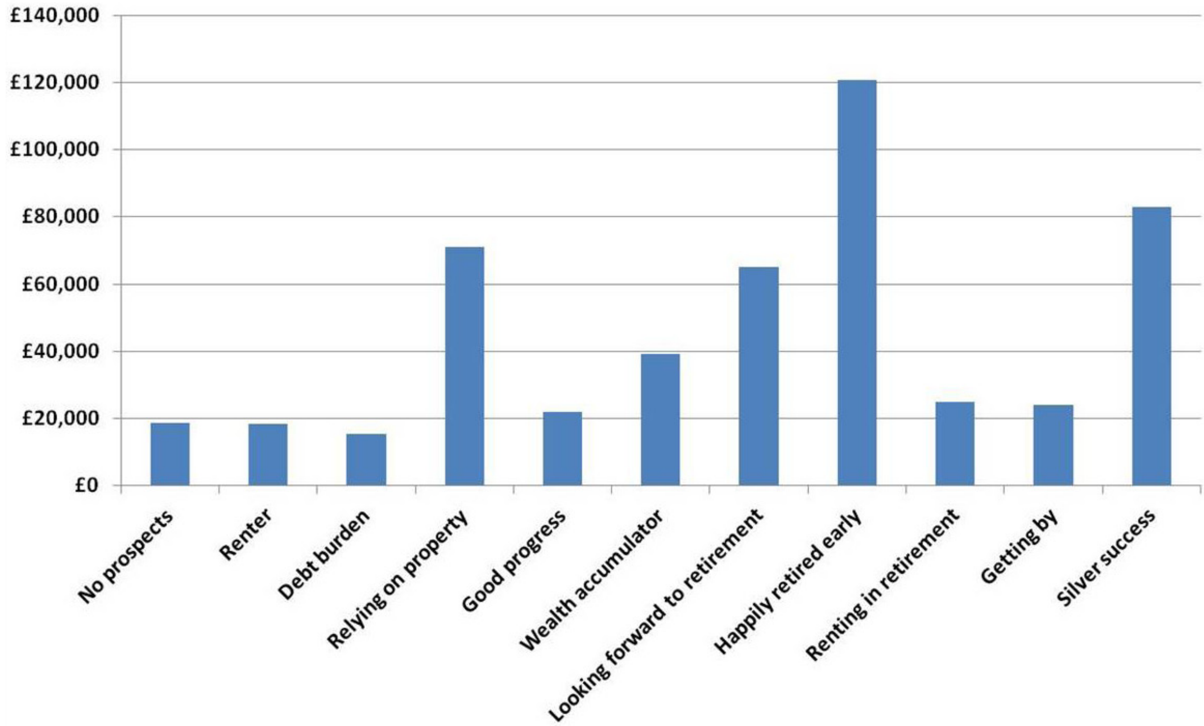
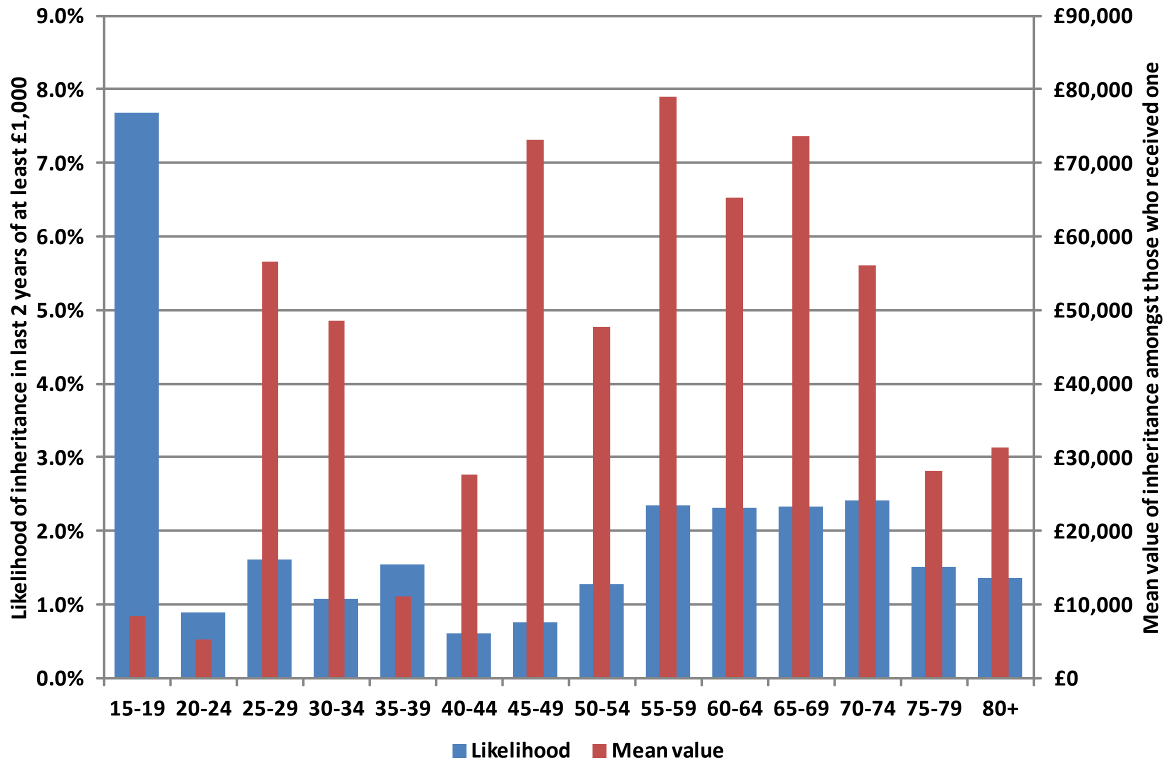


Figure 11: Likelihood and value of inheritances, by age



The key points to note are that on average people are most likely to receive a significant inheritance precisely at the stage of life when their wealth is already at its highest point, and that people who have already achieved a level of financial security are the ones that are most likely to receive a significant bequest. (An exception is the "relying on property group" whose property in question may well have come from a bequest.)

As a result, although the value of bequests is highest for the most affluent groups, the proportion of their total wealth that this represents is the lowest of all groups, as figures 12 and 13 show. These findings are consistent with prior work by the Institute of Fiscal Studies which showed that expected inheritances made little difference to the adequacy of retirement incomes.[7]

Figure 12: Chance of receiving an inheritance in the last 2 years, by total wealth

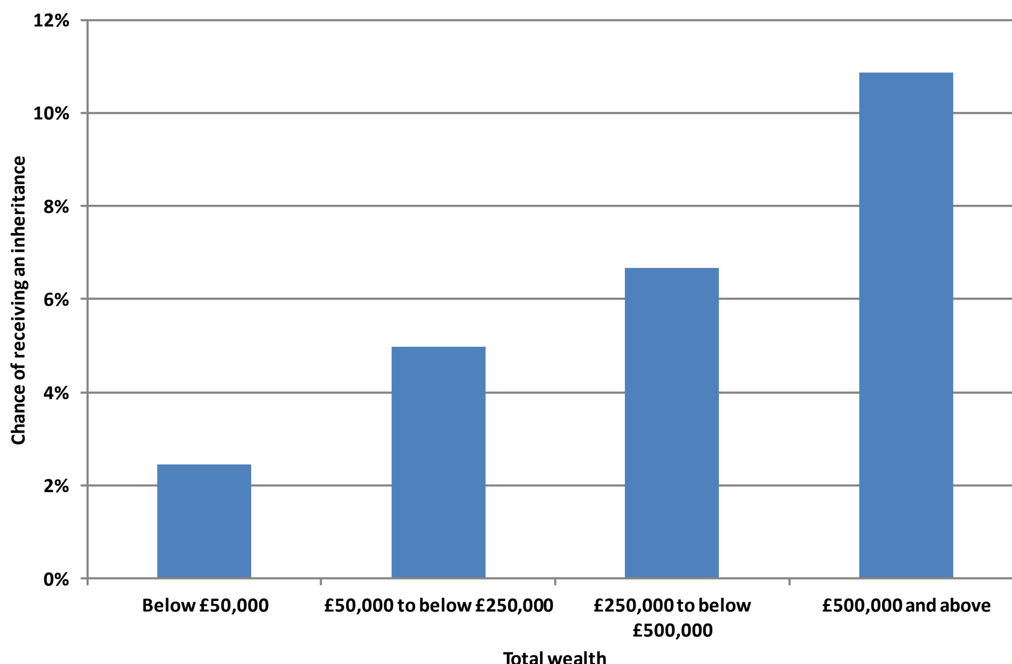
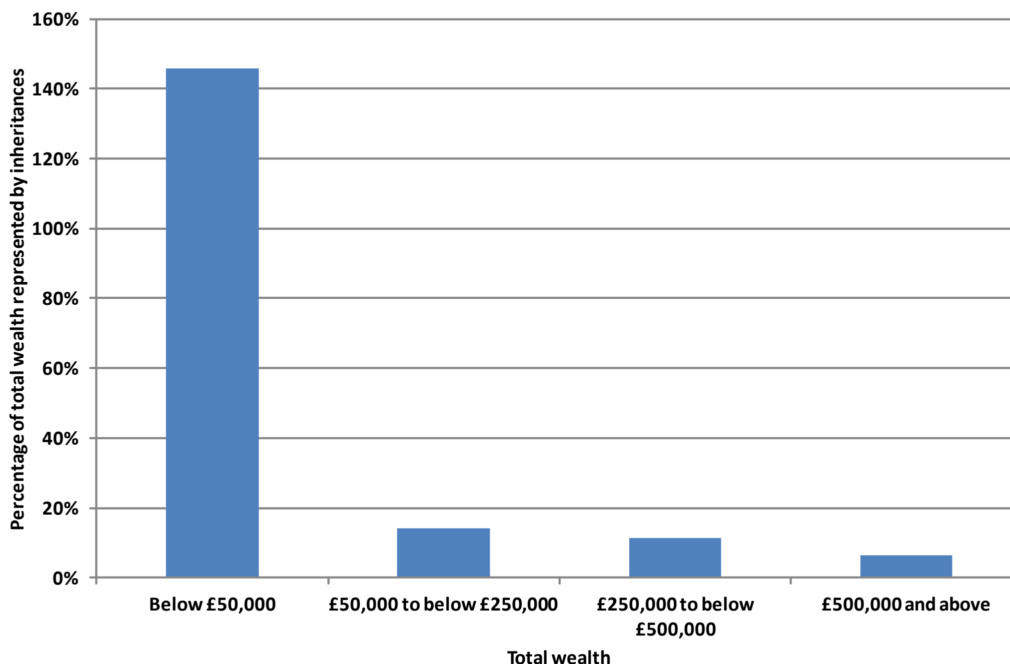


Figure 13: proportion of total current wealth represented by inheritances for those who received them.



7 *The adequacy of wealth amongst those approaching retirement*, Institute for Fiscal Studies October 2012

Drivers of future wealth distribution

Drivers of future wealth distribution

In this second section we explore how the wealth distribution we have described might be expected to change in future years, given what we currently know, and as a result how the relative sizes of the groups described in the typology above might be expected to alter. We look in turn at private pension adequacy, home ownership, the property market, household debt and the pattern of inheritances.

Pension adequacy

It is now ten years since the Pension Commission considered the implications of rising longevity on incomes in retirement. Reporting in 2004 they stated that whereas in 1950 life expectancy on exit from the labour market was 11 years for men and 16 years for women, this was expected to rise to 20 and 25 years respectively by 2005. In response to this analysis, governments have raised the state pension age and introduced legislation to auto-enrol employees into pension savings vehicles. However this followed a decade of declining membership of private pensions and even faster reductions in defined benefit pensions.[8]

As a result it seems reasonable to assume that, in the short-term, the number of people who will accumulate some form of pension wealth will fall as the effects of reducing pension membership are seen. However this is likely to be followed by a rise in the accumulation of pension wealth as the effects of auto-enrolment feed through. We expect that the amount of pension wealth amongst the working-age lower income and renter groups to rise in the medium-to-long-term, and so the stock of pension assets amongst the "getting by" and "renting in retirement" pensioner groups to also be higher over time.

Nevertheless, there is still a question mark as to whether this will be sufficient significantly to alleviate the burden on the state. Taking a definition of "adequate provision" as having an income in retirement of above the minimum state pension guarantee level (currently set at £142.70 per week for single people and £217.90 for couples) then even despite these changes two-fifths of people aged 22 and over, or 11 million people, are currently not saving enough to ensure an adequate income in retirement according to the latest estimates from the DWP, although research by the IFS suggests that the proportion of people unable to achieve an adequate income in retirement without hitting the minimum income guarantee level falls to around one in five if housing and other forms of wealth are taken into account, and about one in ten if the imputed value from owning property outright and so not having to pay rent is included. The same research shows a clear fall in all measures of inadequacy as a result of the auto-enrolment legislation.[9]

A separate question arises as to how the ending of the requirement to purchase an annuity announced in Budget 2014 will affect the draw-down of income in retirement. The first point to note is that the policy will not affect all retirees but only those in defined contribution (DC) schemes, noting that for many DC pension-holders there is already a high level of flexibility at the point of retirement. The previous legislation, for example, did not require the purchase of an annuity immediately on retirement but introduced a substantial tax penalty for not doing so by the age of 75, and did allow cash draw-down on retirement. The IFS estimates that around three-in-ten people currently aged between 55 and 59 will experience greater flexibility as a result of the budget changes, of which around two-thirds are men. Most of these people are homeowners with high levels of education who are in good health and have other liquid assets available, so are perhaps less likely to see the ending of a requirement to purchase an annuity as a windfall cash gain, although this may vary in time as DC schemes become more commonplace for people with smaller pension pots.[10]

Related analysis by the IFS suggests that "perhaps lower income, but greater wealth, is the most likely outcome" in retirement for this group particularly if they want to maximise assets available to pass on to future generations.[11] This is supported by the industry reaction following the Budget 2014 announcement: a survey by PwC suggested that the size of the annuities market could reduce by 75 per cent from £12bn to £3bn[12]; Legal and General suggested that the market would halve in 2014 and again in 2015[13] and Friends Life Group said in May it was expecting a 50-70 per cent decline in annuity sales.[14] However the same analysis also suggests there will be a significant demand for other types of fixed-income products, perhaps preserving a greater proportion of the capital. Notwithstanding some concerns that this can lead to capital depletion and greater recourse to the state when people underestimate their life expectancy,[15] overall we expect a shallower gradient to the decumulation of assets post retirement age in future and an accentuation of the inheritance effects mentioned above.

Home ownership and the property market

Having risen dramatically in the last hundred years, it appears as if property ownership has now peaked. Smith Institute calculations suggest it is likely to fall back from the current level of 67 per cent of households to 60 per cent by 2025, with the private rented sector taking up the slack. This is due to higher debts amongst the younger cohorts, more cautious lending policies on behalf of financial institutions, an expected increase in single-adult housing plus a polarisation in the real wage distribution making it harder for some people to get onto the housing ladder.[16]

In terms of our typology, this will mean that the absolute number of people in both the working age and pensioner "renter" groups

8 Office for National Statistics, *Pension Trends*, Chapter 7, 2013 Edition. See http://www.ons.gov.uk/ons/rel/pensions/pension-trends/chapter-7--private-pension-scheme-membership--2013-edition/sum-chapter-7.html

9 IFS op cit

10 http://www.ifs.org.uk/publications/7206

11 http://www.ifs.org.uk/conferences/140515_DCpensionschange.pdf

12 http://pwc.blogs.com/press_room/2014/04/pwc-uk-annuities-market-could-decline-by-up-to-75-as-consumers-look-to-alternative-retirement-produc.html

13 http://uk.reuters.com/article/2014/07/01/uk-boe-regulator-insurance-idUKKBN0F64R820140701

14 http://uk.reuters.com/article/2014/05/09/resolution-results-idUKL3N0NV36O20140509

15 see for example in Australia: http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1448&context=aabfj

16 *The End of the Affair*, Smith Institute June 2011

will rise, and also that on average the proportion of wealth held as property in the "good progress" and "accumulator" groups will fall as households find it takes longer for them to get onto the property ladder.

Within the groups who do own property, the spread in the value of these assets will also widen as house prices in London and the South East continue to outstrip the rest of the country.[17] London's continuing attractiveness in the global marketplace, plus the number of jobs and higher salaries on offer in the capital, means that demand for property will continue to be higher than supply. So for those who do still own property, the location of that property will be ever-more critical to their household's position on the wealth distribution, and for those that receive property as inheritances the location of the property will also have a big impact.

Household debt

The proportion of households with consumer debts, outside of the mortgage sector, has remained steady at 50% since 2006-08. But within this the composition of debt has changed slightly. Debts owed to the student loan company are rising slowly from a very low base - from 3% to 5% over the period. The proportion of households engaging in mail-order borrowing has also slowly fallen over the period, from 9% to 7% while those with credit card debt remains stable at about one in four. The proportion of households holding formal loans, which includes pay-day style loans, rose from 15% to 20% from 2006-08 to 2008-10 and then fell back to 18% in the most recent period, perhaps reflecting a fall in consumer attitude to risk before and after the recession.[18] Yet the value of these loans remains high: according to the Office of Fair Trading the value of payday loans rose from £900m in 2008 to over £2bn three years later.[19]

Within these figures however there is evidence that there is a minority whose personal debt position is becoming more extreme. The proportion of households who have negative financial assets of greater than £5,000 is growing, from around 9 per cent to 12 per cent over the three waves of the survey, whereas the proportion of households with net debts between £500 and £5,000 is steady at 10 per cent. Expressed in a different way, for those with negative financial assets, the median value of the net debts has risen from £2,800 to £3,500 over the same period (a rise of 25%), whereas the upper quartile value has increased from £8,100 to £10,500 (nearly 30%).[20]

Without regulatory action, there is little reason to think that the group of heavily indebted households will fall over time. As banks withdraw from riskier lending markets due to tougher capital requirements, web-based lending is on the rise making it easier for consumers to borrow at higher rates for impulsive purchases.[21] Acting against this are recent initiatives to bear down on irresponsible borrowing by the Financial Conduct Authority such as requiring payday lenders to re-register to higher standards, which has driven some out of the market, requiring all consumer credit lenders to determine whether the loan they are offering to the consumer is "affordable", and moving towards a real-time database of consumer activity that allows a more holistic picture of an individual's overall debt position to be established. However these changes have not yet reached a scale where they will alter substantially consumer behaviour.

Without further policy action, therefore, this increasing prevalence of consumer debt is likely to polarise the wealth distribution further, making it harder for more people to accumulate assets. Given the link with indebtedness and youth, this will increase the age at which assets begin to accumulate: the peak of the graph will move to the right.

Inheritance

Increasing longevity increases the age at which people can expect to receive inheritances whilst the tendency to have children later in life reduces it. Children born in 1981 were born on average to a mother aged 27[22] who could expect to live for another 59.6 years.[23] Those born 30 years later had mothers aged on average 29.7, who could expect to live for a further 60.5 years.

So over that period, increasing longevity narrowly outpaced the delaying of childbirth. If this continues, we can expect to see gradual increases in the age at which people receive inheritances. Combined with political protection of housing as an asset in older age, housing and cash bequests to children will continue to be received at exactly the moment that they are least needed. The question is whether inheritances will be saved by the recently retired who are conscious of the need to maximise their precautionary savings as their earnings potential diminishes?

Whilst there has been a dip in home ownership in recent years, this will probably not reduce the stock of property assets available for inheritance in the short-to-medium term but only in the long-term. So, for a period of time, the increases in home ownership seen over several decades will increase the property assets being passed on to the next generation, and widen the number of people who are likely to receive them.

However whilst receipt will be more widely spread, inequality in the value of assets is likely to increase. As earnings inequality has increased, the capacity to fund the acquisition of property has increased faster for some. At the same time, house price growth has been faster in some parts of the country. Both of these trends suggest that whilst more people will inherit property at all, a smaller number of people will receive much larger values.

This will be happening at the same time as grand-children and great-grandchildren will find it increasingly hard to get onto the housing ladder. An important question is whether people receiving inheritances at a time of their lives when they have little need of them will result in a change in bequest behaviour? Might we see a more substantial level of assets going straight to grand-children and great-grandchildren to help them get onto

17 *The great house price divide*, Smith Institute December 2013
18 http://www.ons.gov.uk/ons/dcp171776_362818.pdf
19 Office of Fair Trading press release 6 March 2013
20 ONS op cit
21 *Tomorrow's Borrowers*, Smith Institute November 2013

22 Office for National Statistics, *Live Births in England and Wales by Characteristics of Mother 1*, 2011
23 Office for National Statistics, *2012-based Expectation of Life, 1981-2062, Principal Projection, United Kingdom*, December 2013

the housing ladder? If so, will likely increases in the inequality of the value of property assets transmit itself even more strongly onto future generations?

Conclusions

With the exception of pension savings, where policy intervention will make it more likely that people start to save earlier and so accumulate larger pension pots over their working lives, we expect the wealth distribution to polarise in future years. At the top end, the value of housing assets in London and the South East, plus the expected incidence of inheritance receipts, will push up the wealth of the already-wealthy, while at the bottom end the increasing prevalence of consumer credit and the receding prospect of home ownership particularly for single-earner households will make it harder for others to accumulate assets.

Policy implications: Is investing in homeownership the best way forward?

Policy implications: Is investing in homeownership the best way forward?

The policy implications that arise from the data analysis on the role of the housing market in wealth accumulation are particularly noteworthy. In the following section we discuss the most significant issues, such as: Is investing is housing optimal; and how can other asset classes be put on a level playing field with housing?

Investing in housing in the UK is something of a national obsession. From weekends spent on home improvements to the property pages of local papers, housing for many is not just a home but a primary (and in some cases, only) asset. However, for an increasing number of people buying a home is a distant dream. As our analysis of WAS data has shown particular groups are unable to buy a home, and therefore fail to acquire a housing asset during their working life. Due to the way the housing market currently functions, this also means that many excluded from owning face higher rents, which acts as a barrier to saving.

There is also a significant spatial dimension to the split between the housing haves and have nots. Those in London and the South East who are homeowners are likely to reap the reward of high demand on a scarce resource, leaving a growing number of people in the capital excluded from this asset. The premium on homeownership and high rents for tenants also means fewer resources are available for other investments. For those in other regions homeownership may be more affordable but yields on the investment (and rents) have been much smaller than in London.

These trends raise serious policy questions: *is it sensible or optimal for housing as an asset to be preferred by policy makers over other asset classes? And, if not, what could be done to change this current preference and policy bias?*

Is investing in housing optimal?

Although housing alongside pensions is the preferred means of savings, policymakers rarely question whether this is optimal for the individual or for the country as a whole. Our politicians meanwhile continue to display a blindspot on the issue of housing wealth and how inequalities in an imperfect housing market lock in both national intra- and inter- generational inequalities. The political response to wealth accumulation in the housing market to date has been largely to ignore or deny problems that it brings, perhaps because of the fear of a virulent public backlash to some of the fiscal solutions on offer.

There are a number of reasons why disinvestment in housing and investment in other assets might result in more optimal and equitable outcomes.

i) GDP and investment

There is an opportunity cost to so much of household savings being tied up in property until death. If houses were not seen as such a good investment - because house prices did not rise over time, and the savings from not having to pay rent were so great - then that would make the prospect of investing in activities based on productive endeavour more attractive, or provide more of an incentive to generate wealth for retirement through investing in one's own skills and employment. By raising levels of innovation and productivity, both of these effects could increase the productive potential of the economy to a greater extent than the "wealth effect" increases in consumer spending amongst homeowners when house prices rise.[24]

ii) Public finances

The Mirrlees Review into the UK tax system (2010) argued that it is efficient to tax assets that rise in value faster than "normal" returns because doing so increases revenue without distorting behaviour. This would seem to apply to much of the higher end of the property market. Tax policy can also be used to equate supply and demand and so take the heat out of a rising market, which would affect the public finances in a positive way by raising revenue through taxing rising markets; and if it brought prices down reducing the level of government expenditure on housing-related services such as housing benefit. It could also be used as a macro-prudential tool to prevent asset-price bubbles, increasing the resilience of the economy and therefore the tax base as a whole.

iii) Equality

Definitions of inequality vary. Insofar as access to financial resources increases opportunity in the economy to take risks and invest, it would seem there is a prima facie case for a shallower distribution of wealth. Since so much of the projected future inequality comes from the difference in the housing market in different parts of the country, it seems odd that people who happen to get on the housing ladder in one place rather than another should have such different outcomes. Whereas a generation ago, status in society depended crucially on school and education, in future it could well depend on access to the southern property market.

A fairer future: the case for shifting the policy bias away from housing as an asset

Investing in housing may therefore not be optimal or equitable. As we have shown the financial gap between those who have housing and those who do not is expected to widen. This is a problem because (a) as well as an investment asset, housing is also a social good in restricted supply yet (b) the strong financial returns that are often achieved through investing in housing make it more attractive than other asset classes, at least in some parts of the country.

This opens up a real policy (and political) choice. Should policymakers seek to make it *less attractive to purchase housing* and normalise life-long renting instead, or *extend property ownership* as widely as possible so that even more people can obtain the advantages from home ownership, spreading prosperity from the middle classes out and shrinking the group of people whose overall wealth position is constrained by the continuing need to pay for housing costs?

Public policy for the last few decades has favoured the latter option. Policies such as right-to-buy, MIRAS and help-to-

24 See for example, *Making Markets Work* by Thomas Aubrey, Policy Network October 2013

buy have proved popular amongst families seeking the security and status of home ownership, as well as the windfall gains that can come from buying with a government subsidy and then selling in a rising market.

However on balance, taking a long-term sustainability perspective, there is much to be said for the former option. The possible prize on offer in the long term could be a situation where security at home is less dependent on ownership, where interest rates can be set with reference to the wider economy rather than the housing sector, where spare household cash is invested in other forms of assets in support of national wealth generation rather than being tied up in housing. And, where rents can be brought down to alleviate the taxpayer's burgeoning housing benefit bill, and new policy tools established that could enable a government not only to bear down on speculative housing bubbles and support mixed communities in high-price areas but also, if it chooses, use the price of housing as a regeneration tool in low-price areas.

Creating a level playing field?

How could the tax system and regulation make investment in other assets than housing a much more attractive proposition? A starting point for such a package is to make people **indifferent as to whether they invest surplus income in housing assets or other classes of assets**. The Mirrlees review of taxation proposes part of the solution, namely that any returns - including capital gains - on any asset that were above a "normal" rate, akin to the rate of return on a government bond, should be taxed at a far higher rate. If this included capital gains on primary residences it could (all things being equal) create a level playing field between housing and other assets.

Introducing retrospective capital gains tax on primary residences is not desirable or politically possible. However a move to a Mirrlees-style system could be eased if:

- there was reassurance that any past gains would not be taxed
- the baseline date for any future capital gains was pre-announced and linked to a new valuation exercise
- the rate in question was highly progressive, so that most people were exempt, with this rate applying to all capital gains not just housing
- wider reforms to inheritance tax including shifting to taxation on receipt of bequests rather than on the estate as a whole (as outlined above)

However, this would require a **valuation exercise** that could take a number of years. Such a move is likely to prove politically difficult – since 1991 governments of all persuasions have chosen not revalue properties for council tax. Nevertheless, there arguably is a strong case to suggest that the changing property market demands that the property tax system is updated. Some of the objections could be lessened as suggested above by phasing the tax reforms and basing them on future rather than past gains.

Even if the capital gains advantage of investing in (your own) property as compared to other classes of assets is removed, there remain other reasons why investing in housing remains more attractive than, for example, shares or bonds. The first is control: if you own your home nobody can force you to move. The second is cashflow: paying off a mortgage dangles the potential prize of being able to live for free in your asset when there are no debts remaining, eliminating the need for housing expenditure in the future. The third is speculative: in some parts of the country at least, housing is in restricted supply, meaning that the anticipated capital gains may still be higher than for other asset classes. This makes housing a more lucrative investment even if the rate of taxation is equalised - and, of course, the more people who believe this to be true the more demand will rise: a self-fulfilling prophecy.

Control: it could be an explicit policy aim to encourage long-term tenancies, including those that can be included in inheritance bequests. This would mean there is more parity in security between the PRS and other two main tenures, which is particularly important given the increasing number of families living in the PRS.

Rather than mandating for longer tenancies one possible solution is to make it attractive to landlords to cede long-term management of their properties to a regulated intermediary in return for a guaranteed stable income, linked perhaps to the best rates available on the money markets over time. Such an offer could be made attractive to landlords because of increased regulation which might demand more professional property management services. Moreover, the sort of tax changes set out below could make being a landlord that does not offer longer tenancies through an intermediary less financially attractive.

Equity release and a national housing bank?

It should be easier to release housing equity without losing tenure: all homeowners and private landlords should know how to sell a proportion of their home either into a private market, or a government-backed agency - a "national housing bank" - in return for a charge taken against it.[25] There are a number of occasions where this may be useful. It would help prevent people from getting into unsustainable debt situations if cashflow dries up. It would make it easier for intergenerational transfers without the older generation needing to face the disruption of leaving their home; at present while people in theory like the idea of equity release, in practice they find current provision "complex, risky and difficult to understand"[26]. The purchaser can structure the arrangement to protect their own position, for example ensuring they share in any capital uplift and/or use the capital released to arrange an income stream to be allocated accordingly between the lender and the owner/tenant. Given the timescales involved there may be a role for intermediation in the financial markets, with institutional investors potentially expressing an interest in acquiring bundles of housing assets released in this way. Alternatively the creation of a non-profit making "national housing bank", to purchase all or parts of houses has considerable advantages, not least to ease intergenerational transfers.

However, setting up a bank would face considerable challenges. Beyond the cost and time setting up the bank, it would need to

25 Professor Danny Dorling in *All that is Solid* (Allen Lane 2014) calls this a "right to sell"
26 JRF 2005 ibid.

offer something which lenders currently do not. Whilst a national bank could overcome current problems around complexity and products being bespoke and small scale, there would be questions about whether products could be offered to those in low demand areas (where house prices are more volatile and lending more risky). Moreover if the long-term aim is to make housing a less attractive investment then a national housing bank could be left exposed if house prices fell. Another challenge would be that the national housing bank debts would be on the public finance balance sheet. This could change over time as was the case with Fannie Mae in the US (which was converted into a private corporation) but the national debt would constrain activity in the short term. Nevertheless activities could focus on particular types of lending which met the objective of reducing housing costs.

If combined with the ability to sell all or part of the property in future - possibly to the same kind of national housing bank as described above - this could enable more tenancies to be offered to standardised longer terms whilst retaining the ability of landlords to extract their capital if needed by selling the tenancy at net present value. Making housing a less attractive investment could also help to reduce the price (and rental value) of housing. New provision of public housing would also become cheaper as land values fell). However it could reduce the supply of new private homes.

The nearest equivalent to a regulated intermediary at present is where local authorities manage properties on behalf of private landlords, specialising in providing suitable properties for low income tenants. Such an institution would also prove valuable in ensuring some low-income families with links to expensive areas have the means of remaining in their neighbourhoods thus preserving mixed communities. However, this would depend on the ability either to reduce prices in high-demand areas or it would mean more subsidy from government. Moreover, a careful balance would need to be struck – if the rental stream was reduced dramatically or taxes raised too steeply then there would be fewer resources to invest in maintaining the housing stock.

Cashflow: Shifting away from taxing residency towards taxing ownership could over time provide an incentive for householders with spare cash to invest in assets other than housing; indeed the rate of the tax should be set to ensure this is the case. In the long-run the situation for those with cash to spare would be the same: the investments in other securities would yield an income that could cover living expenses including housing, but it would take the heat out of the housing market to the benefit of those with fewest assets or in lower demand areas.

The role of the national housing bank (see above) would be crucial to ensure the tax was not simply passed on to tenants. Landlords, could be allowed an exemption from the tax if they sign a long-term management contract with the new bank which could offer tenants longer leases and help reduce housing costs.

Speculation: The principle of levying a form of council tax on the owners of a property, and not just those who live in it, is valid without prejudice to the rate at which that tax is set. However a progressive government that wishes to dampen property speculation in some areas and encourage regeneration in others could ensure that the level of so-called council tax could be varied by geography to even out disparities in the market. The aim would be to disincentivise investment in wealthy areas and incentivise it in regeneration areas so as to act against the tendency of the market to produce the house-price bubbles that give windfall gains to owners and increases housing speculation. This may prove difficult to achieve through the housing market alone. Housing costs reflects the demand on a limited supply and is driven by the economic performance of the area. However, there is a case for trying to dampen the wide house price, and therefore wealth, disparities. In practice it would mean that council tax overall is set in strict proportion to house price value, including zero bands in low value areas.[27]

The implication of these proposals are that there would have to be a national netting-off system between councils. This already exists to some extent in that local authorities already obtain a substantial proportion of the tax revenues from national government.

Area based taxes could prove highly controversial. At present there is a tendency amongst London's media for example, to describe stamp duty as a 'tax on London'. Moreover, there is greater emphasis on more devolution and, especially in London, to have more powers over taxes on housing to help build much needed homes. Any shift in taxes would need to be gradual, safeguarding those already on the lowest incomes in high demand areas, which would initially affect the efficacy of the tax. However over the longer term it could help to calm the worst excesses in the housing market.

In summary, the basic elements of the new taxation system could be:

- a residual (possibly much lower) charge on all residents paid to local authorities, with the usual means-tested exemptions.
- an ownership charge based on the value of the property owned, linked to regular valuations, collected by local authorities and paid to national government.
- a supplementary ownership charge based on the situation in the local housing market, set at zero for regeneration areas, and used as a countercyclical tool to temper the housing market in high-demand areas, collected by local authorities and paid to national government.
- redistribution from national government to local authorities depending on need through an equalisation formula similar to that currently in operation.

Taken together, introduced gradually, and adapted over time as the behavioural responses are understood, these tools could be sufficient to incentivise a shift from investing in housing over other forms of assets. Some of the proposals raise tax and reduce spending (for example on housing benefit), others will see reduced tax bills. However, the overall fiscal effect will depend on the details of the design and may not necessarily be either more or less expensive for the taxpayer.[28]

27 Or indeed negative bands.
28 There are national accounting implications from the shift between capital holdings and current spending through the intermediary of a national housing bank, but these are not insurmountable.

Other policy implications and ideas

There are no simple short term solutions to rectifying the wealth inequalities in the housing market. Moreover policy efforts to deal with housing wealth would need to be supplemented by other policy initiatives, not least around inheritance and savings. In addition reforms would be needed in regard to the consumer credit market. In particular, enabling people to take greater control of their finances.

- Over time, government could encourage a transition to an **inheritance tax system that taxes receipts rather than bequests.** Those on lower incomes could have a generous life-time, tax-free allowance for gifts and bequests. Such a change could incentivise a wider distribution of inheritances within families and lessen the effect of people inheriting just at the moment when their assets are greatest. There is evidence to suggest reform would be popular: inheritance tax in its current form is extremely unpopular even though very few people are affected.[29] Taxing receipts rather than bequests would not support poorer families with no assets but could benefit some people on low-to-medium incomes. Such transfers could increase consumer spending. To mitigate the phasing effects on the Treasury's coffers it could be combined with offsetting measures such as eliminating the forgiveness of capital gains tax on second properties on death, which has the perverse effect of encouraging hoarding of housing wealth.

- Government could **re-introduce asset-based welfare provisions** learning from the lessons of the scrapped child trust funds, individual learning accounts and savings gateway products from the period 1997-2010. In essence, markets should be encouraged to incentivise people to start saving as early as possible, with particular emphasis on low earners, and for particular purposes. Alongside incentivising greater cash savings amongst the young and/or low income groups, as part of this mix consideration should be given to creating bespoke retail financial products redeemed in the form of vouchers for specific purposes such as adult education, childcare vouchers or housing vouchers that would be attractive for older members of the family to invest in, in order to support future generations through challenging life stages.

- The Financial Conduct Authority is currently making considerable efforts to **re-regulate the market for consumer credit** including putting a greater emphasis on affordability when products are offered. Individuals would be able to take more control of their finances by having more information about their overall financial solvency. This requires real-time information sharing including between public bodies (including housing and tax bodies), utilities and lending organisations so that problems are flagged up at an earlier stage giving people the opportunity to resolve them. There are data privacy implications, but regulators should be clear: access to credit should be denied if wide ranging and holistic credit checks cannot be undertaken.

- One possible way to help more people to acquire a property asset could be the creation of **the 100 year mortgage**. Such mortgages have been introduced in Japan and Switzerland. Because of their length they had lower monthly repayments making homeownership more affordable at a time when prices were racing ahead of wages. While there were some attempts at introducing them in the UK in the mid-2000s they never became a mainstream product. Supporters argue that such mortgages could allow homeownership to be extended to those on lower incomes enabling them to put a foot on the housing ladder. The repayments would be cheaper than paying rents in the PRS and an asset could be accumulated over the longer term. This could offer another route to ownership similar to shared ownership, which research has shown to be in effect a tenure in itself with the vast majority not staircasing up to full ownership.

  However, these mortgages are not without their critics. The money repaid to the bank would be more than under a conventional mortgage (but it could offer better value than paying rent to landlord). A mortgage would need to be paid into retirement although households would still have to pay rent in retirement if they were not home owners. Perhaps, however, the biggest drawback (as highlighted in this section) is the tendency for speculation and bubbles in the housing market because of the fixed supply. One of the likely effects, if there was an appetite from lenders and the public (regulations permitting), would be to raise house prices as all potential buyers could afford to borrow more.

  Depending on the level of popularity it could help stoke-up a house price bubble, especially in already high-demand areas. If like Japan the market collapses homeowners could more easily find themselves in negative equity as more people would own smaller proportions of their homes. Recent moves away from risky lending practices such as interest only mortgages and higher deposits could ensure safeguards are in place. However, deposits are already the main, or at least initial, barrier to homeownership. And if house prices rose to even higher levels larger deposits would be needed further locking out those with small levels of savings. The end effect would be to suck even more capital into housing. One way to limit the possible inflationary effects would be to restrict the availability of mortgages to those on lower incomes for whom homeownership is just out of reach. Government, working with industry, could support such a move. This could help lower housing bills leaving money free to save and invest in non-housing assets. Alternatively, scaling-up the shared ownership market and making it function better could offer a solution. Lower deposits are required in shared ownership schemes. They are also less likely to ratchet up prices. However, increasing the number of shared ownership schemes and staircasing up remain challenging.

29 Rowlingson, K and McKay, S; *Attitudes to Inheritance in Britain*, Joseph Rowntree Foundation (JRF) 2005

Appendix: Attendees at March 2014 seminar

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Name	Job Title	Organisation
Matt Cavanagh	Director of Group Government Relations	Prudential Plc
Nicholas Garrett	Special Assistant to the Chief Economic Advisor, Mayor of London's Office	Greater London Authority
Paul Hackett	Director	The Smith Institute
Ashwin Kumar	Director	Liverpool Economics
Stephen Lowe	Group External Affairs & Customer Insight Director	Just Retirement
Adam Maddock	Corporate Affairs Officer	City of London Corporation
Gregg McClymont MP	Shadow Pensions Minister	
Paul Mortimer-Lee	Global Head of Market Economics	BNP Paribas
Steve Stillwell	Business Development Director	pfeg
Dr Paola Subacchi	Research Director, International Economics	Chatham House
Kitty Ussher	Research Fellow	Smith Institute
Sally West	Strategy Adviser - Income and Poverty	Age UK
Sam White	Group Public Policy Advisor	Aviva

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