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Negative Equity and British Housing in the 1990s: Cause and Effect

Christopher Gentle, Daniel Dorling and James Cornford

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Summary. This paper is concerned with the emergence in Britain in the early 1990s of a large group of domestic mortgage holders with negative equity (i.e. whose property had fallen below the value of the mortgage advance used to purchase that property). The emergence of negative equity is traced to the conjunction of the long-term trend towards wider home-ownership in Britain and the effects of deregulation of the financial system in the 1980s. Using individual records from a major building society, the temporal, geographical and social distribution of negative equity is assessed. The results suggest that negative equity was far more likely to affect certain social groups living in particular places and that these appear to be the people least well placed to 'help themselves' out of debt. The concluding section attempts to draw out some of the policy conclusions from these findings.

Introduction: Negative Equity

Housing is the largest single item of expenditure (and the largest single presumed investment) for the majority of households in Britain in the 1990s. The behaviour of the housing market can therefore be seen as a barometer of the economic state of the nation. No one could deny that the early 1990s have seen a general crisis in the British housing market. Prices have fallen dramatically. Repossessions, increased homelessness and mortgage arrears have replaced the concepts of gearing, equity withdrawal and 'moving up' as the topics which now dominate the newspapers. Since the heady days of the 1980s when a constantly expanding mortgage-financed private tenure fuelled talk of a 'property-owning democracy', we have become more and more aware of one of the consequences of the collapse of the house price boom: the existence of a nation of debtors. Indeed, some commentators have even suggested that the house price crash of the early 1990s may have significant long-term effects on the whole culture of home-ownership which has emerged in post-war Britain (Nicholson-Lord, 1991).

In this paper, we concentrate on the most widespread effect of the house price crash: the phenomenon of negative equity in the British housing market. We argue that it is the coming together of a long-term crisis in housing related to the increasing reliance on the single tenure of owner-occupation (see Malpass, 1986), combined with the deregula-

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tion of housing finance in the 1980s, that has resulted in the phenomenon of negative equity in the 1990s. We then define the extent and distribution of negative equity and give a preliminary assessment of its social impact, before drawing some of the policy conclusions from our analysis. First, though, we need to describe exactly what is meant by negative equity.

Negative equity is defined here as the situation in which the (estimated) market price of a house has fallen below the original mortgage advance that was used to buy that house. Hence the owner finds that the size of her/his outstanding mortgage is larger than the value of her/his home, and therefore that a portion of that mortgage is 'unsecured' from the point of view of the lender. This, of course, has little practical effect in the short term as long as the mortgagee continues to make payments. However, the moment that a mortgagee with negative equity wishes to move house, (s)he is confronted with a severe problem. As the market value of the property is insufficient to repay the outstanding mortgage, (s)he must make up this shortfall, either out of savings or by further borrowing, if (s)he is to discharge her/his mortgage commitment. If the value of her/his negative equity is above her/his capacity to save or borrow (s)he is effectively trapped in her/his current property. The duration of negative equity is, then crucial. The longer large numbers of people have significant negative equity, the greater will be the backlog of those households wishing to move, but unable to do so.

We concentrate on negative equity, then, rather than the more tangible issues of repossessions, mortgage arrears and homelessness, because it affects the largest number of people and because it has the most significant economic effects on the country as a whole. The negative equity crisis matters to all households in Britain because of its effects on broader patterns of consumption in the economy, on mobility in the labour market, and because of its limitation of social choice and its potential for increasing economic divisions.

First of all, there is the so-called 'wealth effect'. Individuals with rising property values tend to be confident consumers and are able to borrow for consumption against the (rising) value of their property. Thus a house owner in the South East during the period of rising house prices in the mid to late 1980s would have seen the market value of their 'prime asset' increase dramatically. This situation, coupled with the liberalisation of housing finance markets, encouraged individuals to borrow money against the value of their home. Rising house prices, therefore, encouraged the growth of consumer credit which in turn fuelled a consumer boom. If we run the same logic in reverse, falling house prices (seen as declining personal wealth) tend to inhibit taking on new credit and thus tend to deter consumer spending. Negative equity effectively puts a brake on further significant consumer credit, thereby reducing the propensity of consumers' purchasing power. This is the chain of events that took place in the British housing market in the early 1990s and which has been claimed to have deepened and sustained what has been the worst recession since World War II (Muellbauer, 1993).

A second reason for considering the impact of negative equity concerns spatial mobility (Salt, 1991). In particular, labour migration is inhibited by a depressed housing market. Under the regime of rising house prices, people were deterred from moving between the North and the South. Rising house prices created two, partially separate, domestic property markets in Britain, thereby exacerbating skills shortages in the South and unemployment in the North. Falling house prices and negative equity have had an even more disastrous effect, literally locking people into homes which they cannot sell (unless they can raise enough money to cover the unsecured portion of their loan). By limiting the geographical mobility of people with skills essential to a modern economy, labour market flexibility has been seriously undermined.

Under the falls in house prices experienced in the early 1990s, many of those with negative equity simply cannot move at all.

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This situation has wider implications for personal mobility. People's freedom is restricted if they are unable to transfer to another home when they need to. Renting also becomes more difficult due to the sudden growth in demand for that tenure (as young people wait to buy houses). A stagnant market is an inefficient market: more homes are empty, more people are homeless or unsatisfactorily housed.

A final problem is the potential for economic division along social and geographical lines. After all, most 'home-owners' can still sell, if at a loss, without carrying forward debt. For a minority, however, negative equity may be the beginning of the kind of downward spiral of debt which has been described by Janet Ford (1988) in which they slip into arrears and cannot trade-down to a cheaper property or renting. These people are losing most of the benefits of owner-occupation, while gaining none of the advantages of being a tenant. A new stratum of households is emerging—unique to this decade—'debtor occupiers' with insufficient assets to back that debt.

The Origins of Negative Equity

The emergence of mass negative equity in the 1990s—the first time this has ever occurred—is the result of two phenomena: the long-term restructuring of the tenure system; and the changes that swept through the housing finance market in the 1980s. In short, the restructuring of tenures since World War I has been characterised by a gradual shift from one majority tenure—private rented accommodation—to another tenure—mortgage-backed owner-occupation—via the intermediate tenure of local authority housing. Preliminary results from the 1991 Census make the dominance of owner-occupation clear. Of mainland British households, 67 per cent were owner-occupiers by April 1991. These levels of owner-occupation have, during the 1980s, been underpinned by a liberalisation of the domestic mortgage finance market. However, this has linked the fate of the housing market (and thus of the economy as a whole) to the international financial markets via the mechanism of interest rates. When the government attempted to defend the value of sterling within the Exchange Rate Mechanism by raising interest rates, the impact fed through directly into the housing market in terms of a collapse in prices and turnover.

First, then, the rise of owner-occupation in Britain. Two phases of government housing policy can be identified in this century. In the first phase—from the end of World War I until the late 1960s—policy was principally concerned with the actual deficit of homes in comparison with the number of households. During this period, there was a gradual shift in tenure structure from one based on private renting to public (local authority) housing. Governments of both the main parties, especially after World War II, made an attempt to capture the popular vote by promising to build more public housing. For example, in 1951, the Conservatives promised to build 300 000 houses per year; by 1965, Labour had bid-up the stakes and talked of constructing 500 000 homes a year.

It was around this period, however, that the growing relative improvement in Britain's housing stock and the increasingly prohibitive cost of building such vast numbers of houses, forced a change in government policy. The new policy was characterised by a switch away from high output towards a focus on rehabilitation of existing dwellings. This sea-change in policy was coupled with the steady growth of owner-occupation. Contrary to popular perception, both main political parties have pressed forward the idea of wide home-ownership when in government. For example, it was the Labour government which, in 1965, described owner-occupation as a 'long-term social advantage'.

Owner-occupation has, since the 1960s, grown at the expense of all other tenures, although only some 37 per cent of so-called home-owners have finished paying for their homes (OPCS, 1992). From the provisional results of the 1991 Census, we know that, in April of that year, 42 per cent of mainland

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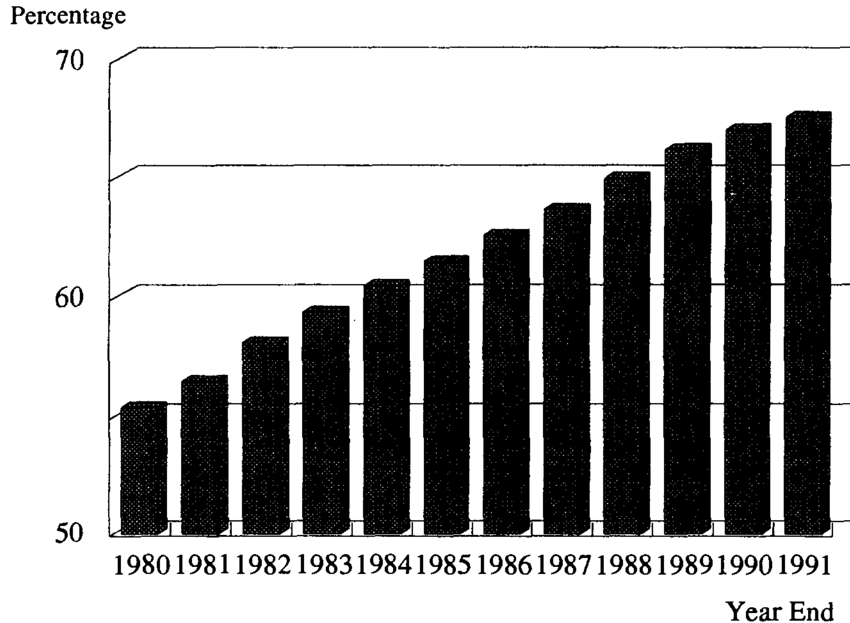

Figure 1. The growth of owner-occupation in Britain, 1980–91 (proportion of all dwelling stock per year). *Source*: Table 9.3, *Housing and Construction Statistics* 1980–90 (annual edition), and Table 2.23, March 1992.

British households were buying their main residence.

Since the 1970s, a second phase of public policy on housing has reinforced the movement towards owner-occupation, a movement accelerated throughout the 1980s by the actions of the Thatcher governments (Figure 1). Dramatic reductions have occurred in the building and renovation of public-sector (council) housing, which have been only slightly compensated for by the growth in the number of housing association properties. In particular, roughly two million local authority dwellings have been sold under the first Thatcher government's 'right-to-buy' legislation.

The argument that future governments should support further growth in owner-occupation is still made today: a survey by the Council of Mortgage Lenders (CML, 1992a) estimated that, even with prevailing falls in house prices, 84 per cent of people still desire to be home-owners. These desires are, however, based on expectations shaped by years of house price inflation and massive public subsidies to owner-occupiers. As these conditions wane, the desirability of owner-occupation can be expected to diminish. Indeed, the nature of owner-occupied housing as an ambition has changed. As more people own their houses, this tenure quickly lost its élitist image (Hirsch, 1977).

The questionable point is whether the present proportion of 67 per cent 'owner-occupiers' is already unsustainably high. Many argue that this trend towards an ever-expanding tenure is now approaching a watershed:

> Speculation on how far owner-occupation can grow depends crucially on how far government is prepared to finance and subsidize the sector. However, most commentators have been sceptical about expansion beyond a 75 per cent figure. This implies that, in the not too distant future, one key consistent feature of the tenure—its numerical and proportionate growth—will be transformed. (Forrest *et al.*, 1990, p. 180)

The implications of the end of this long phase of expanding home-ownership are not well established. We can, however, identify

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some of the most obvious outcomes. First of all, as home-ownership has become more prevalent, the experience of home-owners has become more diverse: "As more of the nation become home-owners, so there are more nations within home ownership" (Forrest *et al.*, 1990, p. 217; see also Doling and Stafford, 1989). In particular, as owner-occupation has grown over the years it has acquired increasing numbers of low-income owners (Malpass and Murie, 1990, p. 293). As owner-occupation has become the predominant tenure in Britain, the state of the housing market has become ever more entwined with the state of the wider economy. And as the tenure has absorbed more low-income earners, the resilience of the housing market to economic downturns has declined.

The emergence of mass negative equity, however, required the conjunction of two phenomena—the long-term secular trend towards greater home-ownership (Malpass, 1986) and a (relatively) short-term, acute, crisis associated with the end of the 1980s house-price boom. The underlying force behind this latter development, we shall argue, has been the deregulation of the market for housing finance.

The Deregulation of the Housing Finance Market

> Any radical reform, even if it achieves its objectives, is likely to bring about unforeseen side effects. This has proved particularly true of financial deregulation. (Lawson, 1992a)

The crisis that has affected the UK economy in the early 1990s, and the housing market in particular, had its immediate causes in the revolutionary changes that have swept through the financial services industry during the 1980s. The regulation and paternal lending traditions of decades, which had restricted the rise in home-ownership and prevented very heavy borrowing, collapsed as capital was allowed to flood into the housing finance market in the early 1980s. Successive governments in the 1980s were central to the introduction of this liberalised financial regime. Indeed, the financial services revolution occurred in spite of significant resistance from some of the financial community itself:

> The changes of the 1980s happened because state power was used to override those business interests hostile to radical reform in financial markets. (Moran, 1991, p. 1).

The UK financial system has for a long time been characterised by the tension between the international markets of the City of London and domestic financial markets, such as those for mortgage finance. Prior to the reforms of the 1980s, the principal feature of the UK financial system was a contrast between the loosely regulated international capital markets and the heavily controlled domestic financial markets (restricting credit available to individuals). The incoming Conservative government in 1979 removed a battery of regulatory controls on financial activities in order further to enhance the reputation of London as an international financial centre and as part of an attempt to allow market forces to reinvigorate the flagging UK economy.

The significant changes that transformed the UK financial system are summarised in Table 1. The removal of these controls transformed the domestic financial system from a set of self-contained markets into a far more interconnected system (Gentle, 1993). In this way, the UK housing finance market was linked more closely into the dynamics of international capital markets. This has been a key factor in bringing about the synchronisation of the macroeconomic and microeconomic crises in the early 1990s.

The Building Societies Act 1962 stipulated that the role of building societies was to provide loans for the purchase of domestic properties (see Table 2 which lists government legislation enacted on the building societies). In the 1960s and 1970s, the major UK clearing banks—the other main source of domestic lending—largely eschewed the housing finance market because of the re-

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Table 1. The financial services revolution: the liberalisation of the UK financial system

1971	Competition and Credit Control (CCC)
1979	End of mortgage guidelines delimiting size of mortgage
1981	End of the Corset (Supplementary Special Deposit Scheme) introduced to curb bank lending in the mortgage market
1981	Scrapping of CCC
1982	Ending of hire-purchase restrictions
1983	Collapse of building societies' interest-rate cartel MITR limit increased from £25 000 to £30 000
1986	Building Societies Act (see Table 2) Withdrawal of mortgage lending guidelines
1989	Abolition of Control of Borrowing Order

Source: Gentle (1993).

strictions placed on them by the Corset. The Corset (a technical device introduced in 1973 and designed to control lending by the banks to certain parts of the economy) meant that the banks were penalised in the form of monetary fines for lending in the housing market (Grady and Weale, 1986). These restrictive practices were supported by the Building Societies Association in return for the right to establish a cartel which could set interest rates at below bank and money market levels. The cartel was exempt from restrictive practices legislation as it helped to maintain an artificially low mortgage rate, even though this did cause an imbalance between the supply of, and the demand for, finance, resulting in the rationing of mortgages (Gentle *et al.*, 1991).

In 1979, this position was radically altered in two ways. First, the guidelines restricting mortgage lending by the building societies were removed. Secondly, the abolition of foreign-exchange controls in 1979 made the operation of the Corset unworkable and led to it being scrapped in June 1980 (Gowland, 1990). In this way, the controls that had prevented the banks lending in the mortgage market were removed. The entry of the banks (and other financial institutions) into housing finance led to major changes in the structure of the market, in particular enhancing the volatility of mortgage supply (Table 3). The combination of these two policy changes towards the housing finance market had a number of implications for the building societies, leading ultimately to the breakdown of the building societies cartel in 1983 (Mullineux, 1987; Drake, 1989).

Once all of these changes had taken effect and created a more open market for housing finance, a number of reforms were introduced to stimulate a reciprocal relationship between expanding home-ownership and the expansion of the financial services sector. Of particular significance were the increase in the value of a loan covered by mortgage-interest tax relief from £25 000 to £30 000 in 1983, the dismantling of restrictions on equity withdrawal (allowing home-owners to borrow further against any rise in the market value of their house), and the removal of controls on unsecured lending. These alterations enabled the mortgage market to boom and provided a major stimulus for retail demand in the UK economy as this additional consumer credit was unleashed (Barclays Bank, 1992).

The assumption was clearly that this collective credit-fuelled shopping spree could be underwritten by continuous rises in the value of the main household asset—the home. The deregulation of the financial services industry, the opening up of the mortgage market and the lowering of personal taxation to 25 per cent, further fuelled consumer credit towards the end of the 1980s. But at the centre of this spiral of growth in personal-sector debt was the removal of the guidelines on the

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Table 2. Government legislation and the building societies

1962	Building Societies Act	Limited the activity of mortgage lending to Building Societies
1973	Introduction of Corset	Introduced to curb the amount of credit in the economy, especially the mortgage market
1980	Report of the Committee on the Functioning of Financial Institutions	Reported that building societies had an artificial competitive advantage through the Building Societies Association (BSA) cartel
1983	Future Powers of Building Societies	BSA report that argued that building societies should be allowed to undertake a wider range of activities
1984	Building Societies: A New Framework	Green Paper that closely followed the BSA report
1986	Building Societies Act	Set up a new body, the Building Societies Commission, and brought the proposals of the 1984 Green Paper into law
1988	Schedule 8: Building Societies Act (1986)	Amended the 1986 Act making it possible for Societies to raise up to 40 per cent of their funding on the wholesale markets and add to the range of financial services which societies could offer

Source: Gentle (1993).

withdrawal of equity from domestic property resulting, according to one estimate, in £24bn extra mortgage-related debt in 1988 alone (Barclays Bank, 1990). Consequently, average household debt as a percentage of household annual income rose steadily throughout the decade from less than 50 per cent in 1980 to over 100 per cent in 1990 (Barclays Bank, 1990).

In 1990, this spiral of growth collapsed under this colossal strain of personal-sector debt.[1] At first rises in interest rates—and later entry into the Exchange Rate Mechanism (ERM)—were sought as a 'quick fix' to control the inflationary effects of such a massive binge of credit creation and to prevent the economy overheating (Muellbauer, 1993). However, the fundamental weakness of the UK economy turned the planned economic slow-down into a deep recession. The result has been to precipitate what is widely regarded as the worst economic slump since the 1930s and the most depressed housing market on record.

The liberalisation of the market for housing finance was central to the Thatcher government's policy of creating a home-owning democracy (Lawson, 1992b). The promotion of market forces within the financial markets was explicitly conceived and justified as an attempt by the government to foster economically responsible firms and individuals (Lawson, 1989). A further clear rationale for the policy, however, was to use state power to encourage the expansion in the numbers of home-owners—individuals who were expected subsequently to vote predominantly Conservative (Dunleavy and Ward, 1985). The liberalisation of mortgage finance was a necessary prerequisite to allow more people access to the finance required to purchase a house.

After its election in 1979, the Conservative government quickly instigated two principal strands of policy to bring about, and strengthen, a home-owing culture in Britain. First, it introduced a range of changes to public-sector housing. The central plank of

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Table 3. Institutional market share of total net UK mortgage lending, 1960–91, in percentages

Year	Building societies	Banks	Other financial institutions
1960	63	8	29
1970	88	3	9
1980	78	8	14
1981	77	15	8
1982	58	36	6
1983	76	25	—
1984	86	14	—
1985	77	22	1
1986	72	20	8
1987	46	37	15
1988	60	29	10
1989	76	13	11
1990	75	20	6
1991	77	21	2

Source: Council of Mortgage Lenders (1992b).

this policy was the introduction for council tenants of the 'right-to-buy' their council houses at significantly discounted prices. In addition, local authorities were not permitted to reinvest the bulk of the revenue from the sale of council houses into building new homes or maintaining their stock, but rather were forced to use the receipts to pay off other 'debts'. The result of this policy was to restrict severely the main alternative to mortgage-financed home-ownership. In this way, it has been argued that "the decision to buy rather than rent became increasingly coerced" (Dunleavy and Husbands, 1985, p. 143) as suitable alternatives were made ever harder to obtain. Owner-occupation was offered up as the 'only' alternative to renting from what was becoming an ever-smaller pool of increasingly poor quality housing.

If the run down of local authority housing was the stick with which people were encouraged into mortgage borrowing, the 'carrot' to encourage people to buy privately was tax relief on mortgages. The second plank of government policy to promote the take-off of a home-owning culture was a range of changes in the fiscal status of home-owners. The increase in the value of a mortgage eligible for mortgage-interest tax relief (MITR) from 25 000 to £30 000 in 1983 was the most significant change in this period. The importance of MITR is illustrated in Figure 2, which shows that the cost of private housing was subsidised to the tune of £7.8bn by 1991. The recently proposed reductions in this subsidy are commented on in the conclusion.

The Conservative government thus sought to intertwine the economic fortunes of individual home-owners with the electoral success of their party. Although there is no consensus as to the degree to which, or mechanism by which, owner-occupation is related to Conservative partisanship in the voting booth, it is clear that Conservative politicians believed that owner-occupation encouraged values held dear by that party. Hence Conservative Central Office claimed that:

> Home ownership gives personal mobility, personal pride, and stimulates the natural instinct of care over, and preservation of, what is one's own. It helps create greater responsibility and stability in society. (quoted in Forrest *et al.*, 1990, p. 79)

Few would now disagree with the assertion that "The Conservative Party is convinced that its policy of selling council houses at a discount to all tenants who wish to buy has

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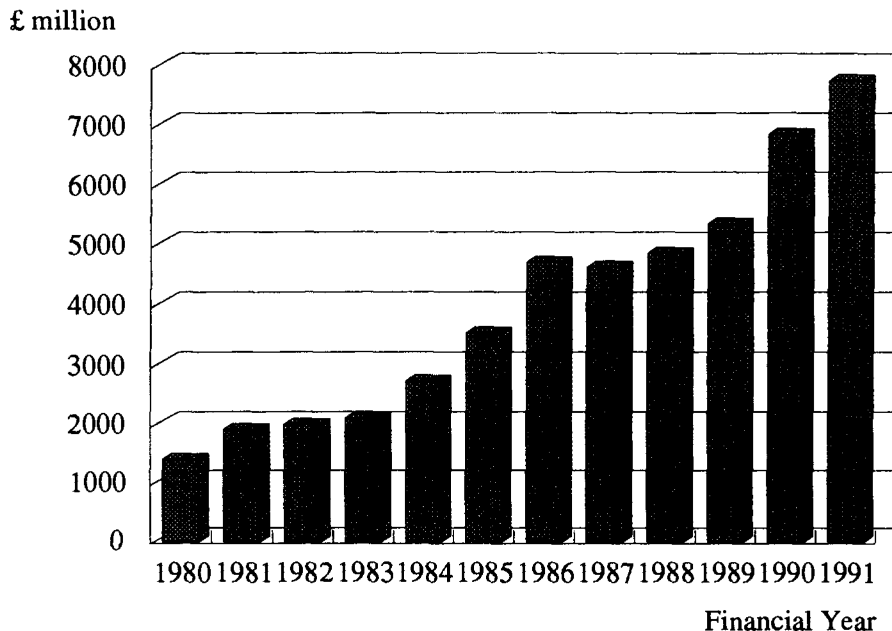

Figure 2. The estimated annual cost of MITR in the UK, 1980–91. *Source*: Newton (1991, Table 34).

won it substantial numbers of working class votes" (Saunders, 1990, p. 234). However, by 1986 some academic commentators were warning that, although "home ownership has proved to be highly popular with consumers, producers and governments ...",

> its continued growth has come to depend on absorption of more older, cheaper houses in inner city areas, and more purchases on low incomes. This process has changed owner occupation into a much more diverse and socially mixed form of tenure, about which it is no longer safe to generalise on the desirability and financial advantages of ownership. (Malpass, 1986, p. 15)

Negative equity is the principal financial disadvantage that has come to characterise many of those owners who have entered into owner-occupation during the late 1980s. The emergence of such disincentives to wider mortgaged-financed home-ownership may make politicians more wary about encouraging further growth of that tenure.

In sum, this section has provided some of the background to the negative equity crisis. The over reliance on a single tenure to fuel economic growth (and political fortunes) resulted in house prices rising to previously unknown heights just at the time when less affluent households were being encouraged to enter the market for the first time. As the market crashed, negative equity emerged as a significant issue. What we now want to explore is its dimensions, and what can be done about it. In the following section, we estimate the proportions of those with negative equity, distinguishing between regions and between different types of housing.

The Extent of Negative Equity in the British Housing Market

Methodology for Estimating Negative Equity

This study used a sample of nearly one million records of mortgages issued over the 1980s by an anonymous national building society. It is known that the sample had an unrepresentatively higher proportion of mortgages in the South East of England, but that it represented a smaller proportion of total mortgages in the last few years of the house-

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price boom. This sample is thought to be representative of the borrowers of a reasonably typical mortgage lender (for further details see Champion *et al.*, 1987).

Gathering a sample of sufficient size for each type of housing in each area at each time-period was essential in determining which types, regions and temporal periods were used as categories. The number of housing transactions has fallen dramatically since 1989 and it has been this fall which was the main factor in determining the choice of statistical techniques. Due to the small sample size at the sub-regional level, only four categories of dwelling could be distinguished for this study, based on number of bedrooms, detachment, and heating facilities (see Brunsdon *et al.*, 1991; these are defined in detail below). Similarly, whereas in the past it has been possible to estimate price trends for several hundred areas, a set of just 112 housing market areas had to be specially constructed to deal with predicting price geography into the 1990s (Dorling and Coombes, 1992). Further, the traditional time-period of a year was used in order to encompass seasonal fluctuations and to ensure that there were sufficient transactions at this level of geographical detail.

Together, however, these decisions resulted in samples of usually well over one hundred transactions for each of 12 years × 112 areas × 4 types of housing. Once these 5376 housing price categories had been determined, it was possible to estimate an average housing price for each—an average price for each category of housing in each area at each time—with a known degree of accuracy. A market value for 1991 could then be estimated for each house in the sample based on this trend. For example, if a three-bedroom semi-detached house (with full central heating) was bought in Oxford for £80 000 in 1988, and the average price for that type of house was £82 408 in 1988 and £75 382 in 1991 (a fall to 91.5 per cent of its 1988 value), an identical percentage fall in the price of our notional house is assumed, (i.e. that its value in 1991 was £73 179).

Our sample of mortgage lending only takes us as far as December 1991. Housing prices continued to fall in 1992 and so to take these changes into account another source of information had to be used. The Halifax house-price bulletin list of average prices by county was chosen as the most spatially detailed current record. For our calculations, we have used third-quarter house-price figures and have included the estimates where applicable. Using these, our hypothetical Oxford house would have fallen in value by 10.6 per cent in the year to October 1992 and would, by then, have had an estimated value of just £65 422.

Using this methodology, we calculated negative equity for each mortgage record in the following way. First, suppose that our 1988 purchaser brought a house with an advance of £70 000 (an unexceptional 87.5 per cent mortgage). Were the purchaser to sell at our estimate of the October 1992 market price (s)he would need to find, or borrow, a further £4578 (£70 000 minus £65 422) in order to pay back the sum outstanding to the mortgage lender. This represents negative equity of £4578. To assess the overall situation, we aggregated each of the negative equity findings into the output areas of our choice. In the next section, we estimate the extent of negative equity in the British housing market of the early 1990s (see Dorling *et al.*, 1992, for a more detailed discussion of this methodology).

Estimating the Extent of Negative Equity

Using this methodology, we have attempted to determine a number of parameters relating to negative equity. First, we have attempted to calculate the total value of negative equity outstanding in Britain. Secondly, we have attempted to estimate the proportion of recent mortgage holders with negative equity. Thirdly, we have attempted to determine where there is the greatest concentration of households with negative equity. And finally, we have attempted to identify which part of the market (i.e. what kinds of properties) has

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Table 4. Estimated total negative equity, October 1991–1992, disaggregated by year of individual's house purchase

	By October 1991		By October 1992	
Year of purchase	Borrowers (percentage)	Equity (£m)	Borrowers (percentage)	Equity (£m)
1986	0	0	0	0
1987	0.1	− 1	1.6	− 19
1988	13	− 335	18	− 769
1989	12	− 445	15	− 707
1990	19	− 418	30	− 929
1991	0.1	− 1	20	− 256
Total (1988–91)	11	− 1200	21	− 2680

Source: Unpublished building society records and the third-quarter Halifax Building Society price estimates.

seen the highest concentrations of negative equity.

Negative equity is time-limited in terms of when purchases were made. For negative equity to occur, the current value of the property must be below its original purchase price. Long-term inflation in house prices thus limits the possible extent of negative equity (as does the progressive repayment of mortgage advances). The results of our calculations show that by the third quarter of 1992 virtually all households (over 99 per cent) which had negative equity had taken out a mortgage between 1988 and 1991 (inclusive). We will, therefore, concentrate on this group of purchasers (from now on termed 'recent buyers'). Due to the high turnover in the boom conditions of the late 1980s, these recent borrowers represent a large proportion of all borrowers.

Total negative equity in Britain, we calculate, increased from £1.2bn to £2.7bn in the period October 1991 to October 1992 (see Table 4).[2] Similarly, the proportion of recent buyers (1988–91) who held negative equity rose from 11 per cent in October 1991 to 21 per cent in October 1992.[3] These rapid increases in negative equity reflect the precarious balance of the housing market at that time.

However, these averages are very sensitive to slight price fluctuation. Negative equity is a threshold figure and to look at its meaning for individual home-owners it is often better to take thresholds other than zero. For example, 4.2 per cent of recent (1988–91) buyers had negative equity of over £3600 (the mean average) in October 1991; the proportion of recent purchasers with negative equity of more than £3600 had risen to 10.7 per cent of the sample by October 1992.

It is also important also to stress that, at the time of the study, a uniform rise in house prices of around 5 per cent would remove much of the negative equity in the market. Indeed, at the time of writing, the latest headline figures for March 1993 show a slight monthly rise in house prices, although there has been a quarterly fall overall (Halifax Building Society, 1993). This has been widely (if wishfully) taken to indicate the first 'green shoots' of a housing market recovery. Prices, are, however, unlikely to rise in a uniform manner over different areas and different types of housing. Hence, Wriglesworth (1993) has estimated that, six months after our initial 1992 study, as many as 2m households were affected by negative equity and that this may present a major blockage to a long-term stabilisation or recovery of house prices.

Who Holds (Most) Negative Equity?

Negative equity is, of course, not evenly distributed through Britain. In the following

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Table 5. The distribution of negative equity by mortgage advance proportion

Mortgage advance as a percentage of purchase price	Percentage of recent buyers (1988–91) with negative equity	
	October 1991	October 1992
< 70	0.02	0.1
70–74.9	0.6	2
75–79.9	2	5
80–84.9	4	9
85–89.9	8	21
90–94.9	15	36
95–99.9	25	43
100	37	64

Source: Unpublished building society records and the third-quarter Halifax Building Society price estimates.

section, we have sub-divided our sample by the size of the initial mortgage advance, by region and by housing type in order to get some idea of who holds most negative equity.

As might be expected, it has been the buyers with the largest initial mortgage advances (and therefore the smallest initial deposits) who had accrued the most unsecured debt at the depth of the house-price slump of 1992 (Table 5). This group, however, makes up a surprisingly large proportion of all buyers. In 1989, according to one report, 69 per cent of first-time buyers received loans that covered more than 90 per cent of the cost of the houses they were buying and as many as 36 per cent had loans over 100 per cent (Nicholson-Lord, 1991). By our calculations, in October 1992, 43 per cent households with an advance of 95 per cent or more of the purchase price had some negative equity compared to less than 1 per cent of those with advances of 70 per cent of purchase price or less.

A regional breakdown of the results illustrates geographical disparities in the distribution of negative equity (see Figure 3 and Table 6). Once again, these results are unsurprising at the regional level. For example, our calculations show that almost one-third of people who brought since 1987 in the 'Outer South East' held negative equity in October 1992 compared with just 1 per cent in Scotland.

Use of such standard regions is, however, crude. In this context, it is more interesting to look at the sub-regional level for those places which saw the greatest concentrations of unsecured mortgage debt. For this part of the research, we identified the most appropriate geographical unit to use as the parliamentary constituency. House price changes were still calculated using the 112 housing market areas (ensuring sufficient sample sizes to estimate price changes accurately), but the extent and value of unsecured debt is totalled for each constituency. This is achieved by taking each individual mortgage record (geographically referenced at local ward level), calculating average price change using its housing market area and housing type, but totalling the extent and value of negative equity estimated by its constituency. The results revealed a dramatic geographical contrast which is obscured at the regional level. Those areas which had fared worst were almost exclusively in what are commonly recognised as the poorer parts of the South East and South West. Figure 4 shows the South East inset, illustrating a clear sub-regional divide. Further, it is possible to list the constituencies which contain the highest proportions of voters with negative equity and to estimate what the average amount per

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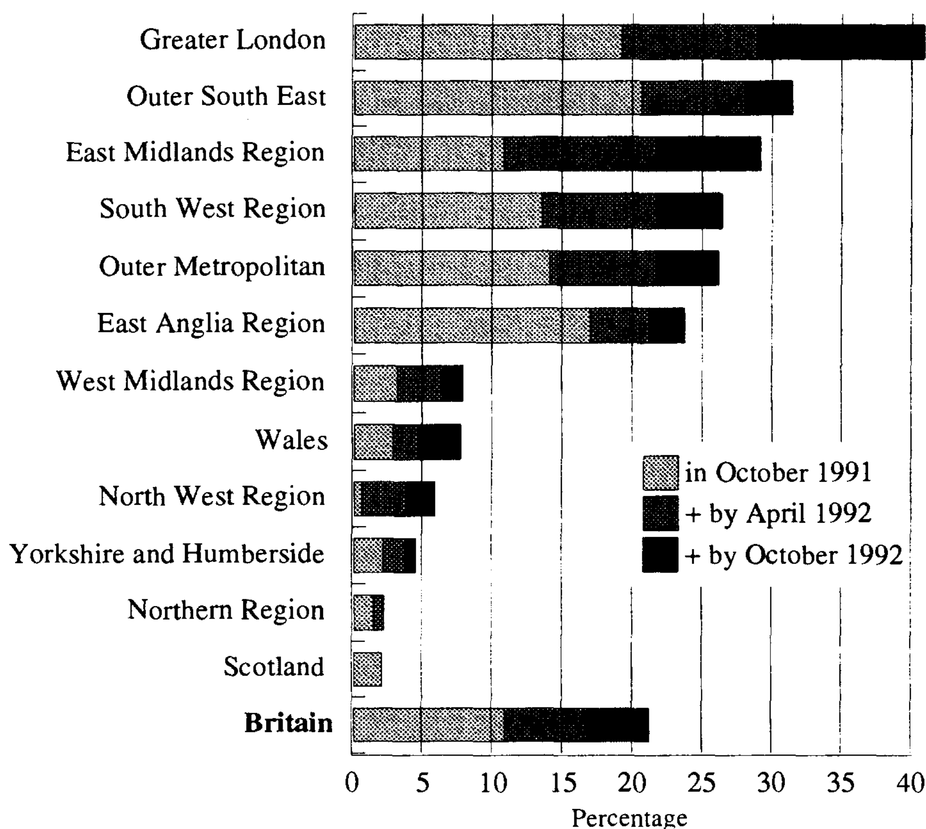

Figure 3. A regional breakdown of negative equity (1988–91 buyers with unsecured mortgages). *Source*: Building society lending records and Halifax Building Society third-quarter figures.

borrower is (Table 7). What these constituencies most clearly have in common is their geographical location in and around London.[4]

We were further able to sub-divide the sample according to a four-fold classification of property types. The four categories are: housing with three or less bedrooms and without central heating; housing with central heating, three or less bedrooms and not detached; detached housing with three or less bedrooms and central heating; and, all housing with more than three bedrooms. Overall, 27 per cent of people who bought in the least-expensive category (smaller houses without central heating) now hold negative equity, compared with only 4 per cent of those who bought houses with more than three bedrooms. This result might appear quite surprising as we know it is the more expensive housing types which have fallen most in price. However, buyers of these dwellings tended to provide a larger deposit when purchasing, and so could afford to see the price of their houses fall slightly without falling into negative equity.

In short, then, negative equity most seriously affects people with 95 per cent (or higher) mortgages, living in the South East who have bought poorer quality housing in recent years. Within regions and housing types, the picture of who is most likely to find their home becoming worth less than their mortgage is very much based on their sub-regional location. Far from the stereotype of the 'stricken yuppie' in her/his Docklands apartment, it appears to be the owner-occupier in poorer quality housing in the less prosperous parts of the South who is most likely to have significant negative eq-

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Table 6. Estimates of levels of unsecured mortgage debt in Britain amongst 1988–91 buyers, by region

	By October 1991		By October 1992	
Region of purchase	Percentage of recent borrowers	Mean equity of this group (£)	Percentage of recent borrowers	Mean equity of this group (£)
Northern Region	2	− 2054	2	− 1312
Yorkshire and Humberside	2	− 2495	5	− 1657
East Midlands	11	− 2988	29	− 3565
East Anglia	17	− 3779	24	− 4076
Greater London	19	− 3273	41	− 5468
Outer Metropolitan	14	− 4254	26	− 4996
Outer South East	21	− 3821	31	− 4202
South West	14	− 4098	26	− 4347
West Midlands	3	− 2031	8	− 2076
North West	1	− 2750	6	− 1246
Wales	3	− 2327	8	− 2194
Scotland	2	− 1748	1	− 2249

Source: Unpublished building society records and the third-quarter Halifax Building Society price estimates.

uity. What is more, these are thought to be the properties whose prices will climb most slowly in the future and therefore negative equity may well persist longest amongst this group of purchasers.

Conclusions

The most important point to emerge from this paper is that the probability of an individual holding negative equity is highly differentiated in terms of a number of factors. As we have shown, the proportion of purchasers holding negative equity varies significantly by purchase date, the size of the deposit, geographical location and housing type. The conjunction of the features has led to the creation of a particular group of people who are far more likely than others to have negative equity. What our findings challenge, then, is the idea that negative equity could have happened to anybody: certain social groups were far more likely to have negative equity than others. What is more, we suspect, it is those people who are least able to absorb the problem of negative equity (through savings, through increased earnings, through borrowing or inheritance within kin networks) who were most likely to suffer with negative equity.

In attempting to tackle this situation, many argue that the government now has an opportunity to reorientate housing policy towards a more balanced and economically viable pattern of tenure. For example, a *Financial Times* editorial has argued that "the government needs a new policy for housing that would create a more balanced market and offer real choices of tenure" (23 November 1992). More specifically, Newton has argued that "housing opportunities for low and middle income households should be enlarged by the development of a variety of tenure forms, other than council renting and owner-occupation" (Newton, 1993, p. 13). How could such a policy be pursued?

One root of the negative equity problem is the British system of mortgage-interest tax relief (MITR): 9.4m mortgage holders (i.e. almost all of them) were receiving MITR in 1990/91, worth an average of £820 per annum to each debtor (but heavily skewed towards the higher-income groups). The total cost of MITR to the exchequer in that (financial) year was estimated at £7.7bn (see Figure 2). Thus, "the idea of a subsidised public sector and an unsubsidised free market is completely inaccurate" (Malpass and Murie, 1990, p. 294). Up to 1969, interest payments on all personal borrowing were

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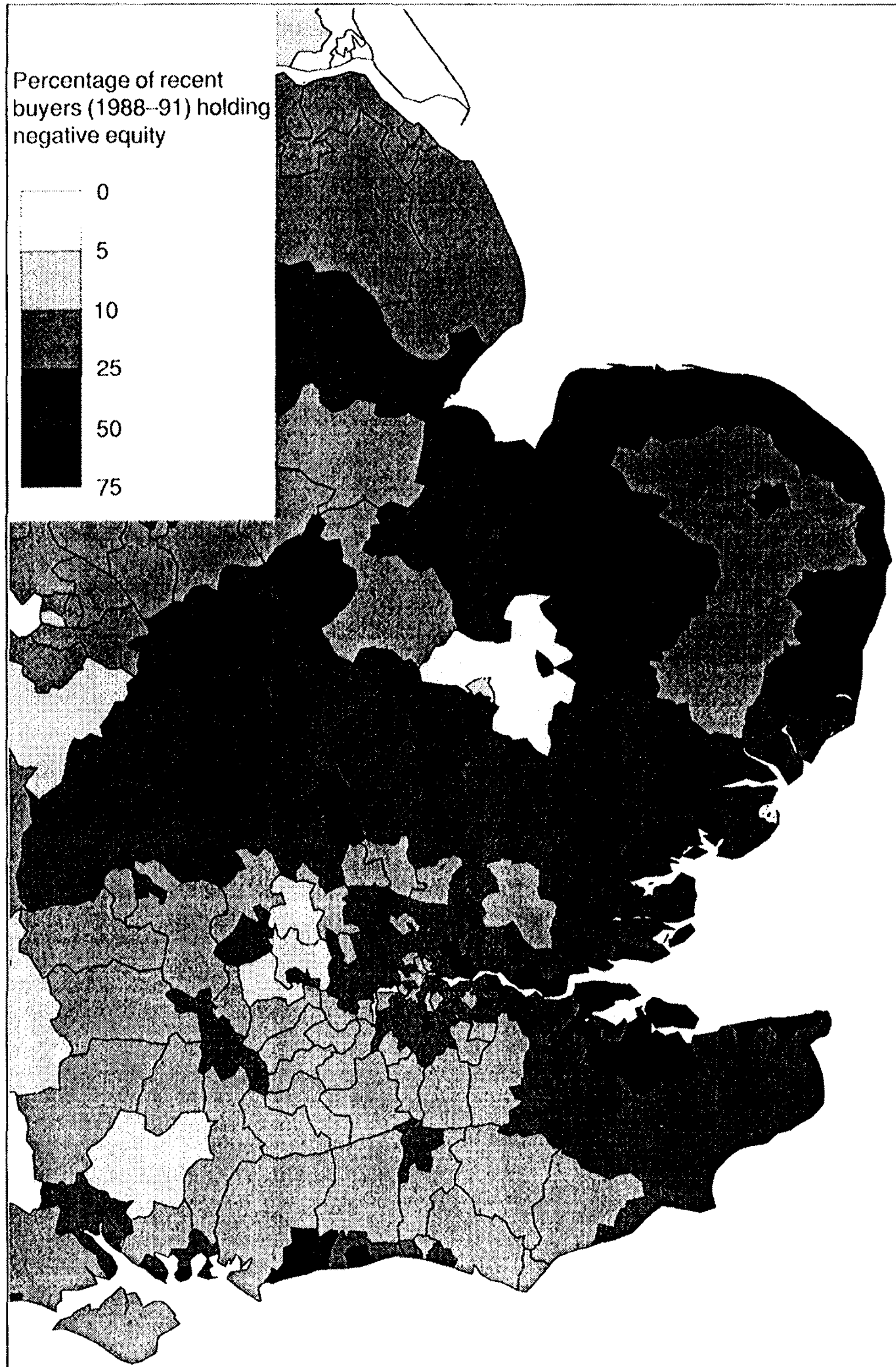

Figure 4. Negative equity in the South East in 1992, and by parliamentary constituency. *Source*: Unpublished building society records and Halifax Building Society third-quarter figures.

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Table 7. Parliamentary constituencies with highest negative equity: recent (1988–91) home-buyers who had most negative equity in October 1992

	Area	Percentage of home-buyers	Average negative equity of these (£)
1	Luton South	72	6700
2	Newham South	69	5600
3	Southend East	66	6600
4	Leyton	65	5800
5	Newham North East	61	5200
6	Newham North West	61	5700
7	Basildon	60	6500
8	Erith and Crayford	59	5100
9	Walthamstow	58	5600
10	Croydon North West	57	4600
11	Brighton Pavilion	57	4000
12	Peckham	57	4300
13	Woolwich	55	4800
14	Lewisham Deptford	55	4800
15	Brent South	55	5600
16	Southend West	55	6600
17	Southwark and Bermondsey	54	7600
18	North Luton	54	6000
19	Dagenham	53	5800
20	Hove	53	4800

Source: Unpublished building society records and the third-quarter 1992 Halifax Building Society price estimates.

tax-exempt. In 1969, this relief was abolished for all loans except those secured on housing. The tax situation of mortgage debt-holders is thus highly attractive. Even Peter Saunders, perhaps the staunchest academic defender of owner-occupation, suggests that the tax position of owner-occupiers is anomalous:

> At present, owner-occupiers are getting the best of both worlds—unlike other investors they pay no tax on their imputed income, yet unlike other consumers they can claim tax-relief on their interest payments. (Saunders, 1990, p. 358)

This situation arises because housing is taxed as an investment where borrowing to finance home-buying is concerned (e.g. MITR), but housing is then regarded as a consumption good when the capital gains from rises in house prices are realised. Hence borrowers get tax relief on borrowing, but pay no tax on capital gains.

MITR has the further effect of pushing up house prices and therefore, in a sense, cancelling itself out as a subsidy while distorting the housing market in favour of the better-off. This point is also widely accepted by advocates of wider home-ownership:

> The problem of treating owner-occupied housing differently from all other goods is that the tax system is skewing the housing market, is subsidizing the relatively better off at the expense of the worse off and is pushing up house prices. (Saunders, 1990, p. 358).

In recent years, then, up to £7bn per year has thus been lost in the rising cost of housing rather than being pushed back productively into the economy. What is more, because of the differences in house prices, and in the pattern of tenure, between regions, the net effect of MITR has been to subsidise southern house-buyers more than northern ones. The present distribution of tax relief is, then, unjust economically, socially and geographically.

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One key priority, therefore, is to create a 'level playing-field' between tenures in which either MITR is removed (that is, houses are treated as a consumption good) or capital gains taxes are introduced (in which case housing is regarded as an investment good). The first of these is generally favoured. There are two reasons for this. The first is ethical: why should unproductive housing enjoy the tax advantages of productive investment? The second is more practical: the step-by-step phasing out of MITR for new (and moving) purchasers would force buyers into the market as they saw the volume of tax relief diminishing with every passing month. Evidence that the government is beginning to acknowledge this point has been provided in the Lamont Budget of March 1993 in which it was announced that the rate at which MITR is levied is to be lowered from 25 per cent to 20 per cent from March 1994.

The removal of MITR can only be one part of a more sustainable policy. Traditionally, British housing policy has been based around a dichotomy between 'owner-occupiers' and tenants. Government policy treated each group in totally different ways. Roughly speaking, 'owner-occupiers' were offered support though the fiscal system in the form of MITR which disproportionately benefited the better-off within this group. Meanwhile, tenants were offered support through the benefit system in terms of housing benefit, targeted at those most in need. This system may have made a certain kind of sense during a period when 'owner-occupiers' could be regarded as a relatively homogeneous and privileged group. Now, however, as owner-occupation has widened, whatever validity such assumptions once had has now gone. The experience of 'owner-occupation' is now highly diverse: as is shown with regard to the emergence of negative equity, it varies widely by region, the date at which purchase is made, the size of the advance secured and the type of housing that is 'owned'. To move to a truly tenure-neutral housing policy, therefore, requires not only the removal of MITR, but also the extension of housing benefit to those owner-occupiers most in need (a move which could most obviously be financed by the proceeds of the gradual removal of MITR).

These are, of course, only part of more rational housing policy. The question of the shortfall in the numbers of, and the geographical mismatches between supply of and demand for, rented housing, are also pressing issues. What is more, the question of the re-regulation of domestic housing finance will also need to be addressed (see Hutton, 1991). Nevertheless, what is clear is that Britain needs a major change in housing policy, if in future years every economic recession is not to result in millions of households trapped within their 'own' four walls, as a result of negative equity.

Notes

1. A premonition of what was to come occurred around Aberdeen in the mid 1980s when house prices fell sharply due to falls in the price of oil. Negative equity among local home-buyers was widely reported at the time (see, for example, Hunter, 1986), but was seen as unique to the special circumstances of North East Scotland and its particular dependence on North Sea oil.
2. Our estimate of the total value of negative equity (but not of the proportion of home-buyers involved) differed starkly from the estimates produced by the Bank of England (Bank of England, 1992). The Bank of England suggested that total negative equity totalled around £6bn in the second quarter of 1992 compared with our estimate of just £2.68bn 6 months later. We have almost certainly underestimated the total value of negative equity by making highly conservative assumptions throughout our calculations (for example, we have not included equity withdrawal through second mortgages). Equally, relying on the figures from a single lender who may not be fully representative may have also caused us to underestimate. On the other hand, the Bank may have over-estimated the total value of negative equity as it was forced to rely on regional average figures rather than having a sample of individual borrowers. One explanation for the discrepancy is that the house prices of those with the highest percentage mortgage advances fell least in relative terms over the period (for evidence of this see Coombes and

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Dorling, 1993) and that such effects will be lost in the use of crude regional averages which do not differentiate between dwelling type. In general, we can feel fairly sure that the real value of negative equity lies somewhere between our estimate and that of the Bank of England, and probably closer to the former than to the latter. Although the discrepancy appears large, it should borne in mind that the net total equity in UK housing has been estimated at £771bn in 1992. In a rapidly changing situation, we can expect independent estimates of new phenomena to vary markedly.

3. The numbers of households holding negative equity have been consistently presented as percentages of recent (that is, 1987–91) buyers, rather than as absolute numbers. There are a number of reasons for this approach. The first is that in order to calculate absolute numbers we would require accurate figures for the total number of households which took out mortgages in that period. Reliable figures for that number are not available, in particular at sub-national level and differentiated by housing type. A further problem would be raised by the known and unknown biases in our sample. Thirdly, our major concern is with exploring the types of households—in terms of their location, type of housing, etc.—which are most likely to hold negative equity, rather than trying to estimate the total numbers. From many other estimates, however, we can be fairly sure that the total number of households with negative equity at the end of 1992 was somewhere between one and two million. Finally, we would hope that any bias in our sample is systematic, so that calculations of change over time were independently reliable.
4. Indeed, we have calculated that it is those areas which have most solidly voted Conservative which have suffered most: for example, the 27 per cent of constituencies that saw a net rise in the Conservative share of the vote between the 1979 and 1992 elections accounted for some 38 per cent of borrowers with negative equity in October 1992. Moreover, the average level of negative equity was higher for these borrowers. These areas tend to be those where home-ownership took off most recently and in which there has not been the build-up of inherited wealth which allows many people to put down larger deposits against their mortgage, and where social housing has declined significantly. They are also frequently areas which the Conservative government needs to retain if it is to stay in power.

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