13th April 2015

Housing Market Note

Residential Research

PENSION REFORM & THE HOUSING MARKET

A Wall of Money?

Neal Hudson
Associate Director
07590 531150
nhudson@savills.com
@resi_analyst

There is a lot of debate around just how much of the £3.6 trillion of private pension wealth will hit the housing market thanks to pension reforms. The reality is that no one really knows but that hasn't stopped us taking an educated guess. Using ONS data, we have looked at pension wealth held by people aged 55 to 64 as they stand to benefit most from the changes and offer the best indication of pension wealth for those approaching retirement.

29% of people aged 55-64 have a current defined contribution pension (i.e. not already paying out) and their median pension pot is worth £25k. In total, we estimate that this age group holds defined contribution pensions worth £120 billion. That is half the value of annual residential property transactions (£254bn in 2013) but there are two important factors to consider when assessing the likelihood of that wealth making its way into the market.

The first factor is the distribution of pension wealth. Figure 1 below demonstrates the skewed distribution of wealth. Once income tax liabilities are taken into account (we have assumed no other income), it is only the top 7% of those pension holders that could afford to buy an average priced property outright. This is further demonstrated by Figure 2 which highlights the geographic distribution of potential investment with lower value markets in the north much more accessible.

The second factor is the actual propensity to invest in residential property. This will clearly be determined by the availability of pension wealth but also linked to current property holdings and potential income tax liabilities. Holders of larger pension pots are more likely to have existing investments in residential property and therefore may be less inclined to further concentrate their investments in the sector. Some people may instead use their pension wealth to pay down any debt held against existing investment properties and so maximise their income.

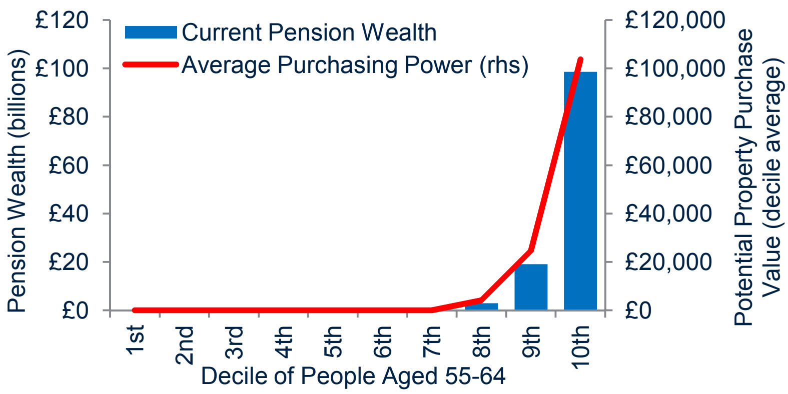
The main attraction of the pension reforms is the ability to minimise income tax by withdrawing from pensions over a number of years. That has implications for anyone already in higher income tax brackets and so will further reduce any propensity to withdraw from pensions in order to invest in property. Given the income tax implications of withdrawing large amounts, we may see the emergence of new financial products allowing pension holders to take out mortgages for short terms in early retirement and repay in large chunks with pension withdrawals while minimising their income tax liability.

Based on these factors, we've made the simple assumption that 10% of defined contribution pension wealth held by those aged 55-64 could make its way into the housing market. Dividing that figure over 10 years gives a possible investment of £1.2bn per year. That equates to 0.5% of recent market turnover and around 10k transactions per year. At those levels, the reforms will have a limited effect on national house prices although we may see a short-term burst of activity in lower value markets.

The geographic distribution of potential investment also matches that of income yields, with lower value markets offering higher yields. Higher yields may be attractive but also indicate higher risk.

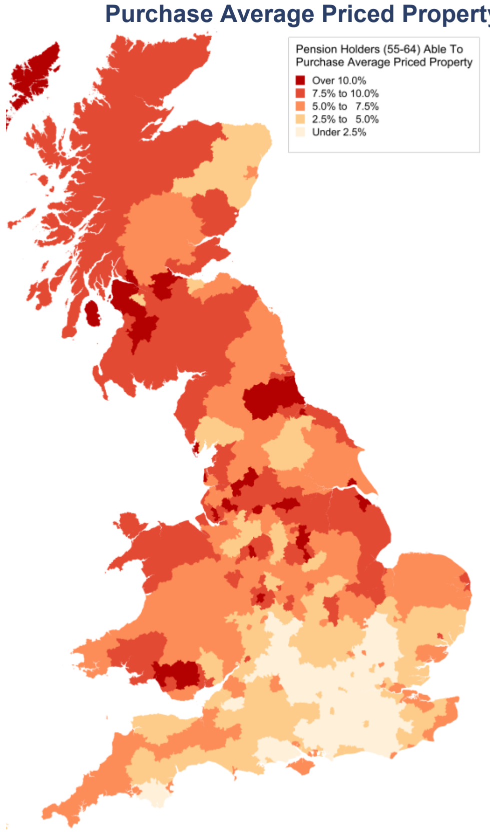
With many of the wealthiest pension holders living in London and the south of England, it remains to be seen how many will want to deal with the hassle of investing outside of their local markets.

Figure 1– Current Defined Contribution Pension Wealth: Aged 55-64



Source: Wealth and Assets Survey, ONS

Figure 2 – Percent of Current Defined Contribution Pension Holders (55-64) Able To Purchase Average Priced Property



Source: Savills Research