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Analyzing the Renting Decision made by Tenants Instead of Owning their Own Homes

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ABSTRACT

Homeownership is one of the most important investments for most households. A significant number of the households in the inner-cities of most developed world are found in rental accommodation. With the increasing population in most urban areas, house prices have been on an increase such that affordability has been an issue of concern. This research aims to explore the reasons why despite high rental charges in the cities of London, New York and Toronto, there is still an increasing number of tenants relative to homeowners. Primary method of data collection was used in carrying out this research. This involved the use of questionnaire survey involving 850 respondents from the USA, UK and Canada. The findings revealed that 75.3% of the tenants were unsatisfied with their status as tenants. furthermore, findings by Leece in 2006 that income was insignificant in the determination of homeowners was discovered to be inapplicable in the current context.

Keywords: *Households, Homeownership, Housing finance, Affordability*

INTRODUCTION

This paper aims to explore the growing concern why the number of tenants keeps increasing in spite of high rental charges. In March 2010, the authorities concern tried to increase homeownership by removing stamp duty for first-time buyers on properties worth £250,000 (Acharya et al., 2009). This is still however not a remedy to reducing the number of tenants, given the supply elasticity situation in the economy. Rather, it led to higher property prices which enrich the sellers of property rather than the households or those looking forward to climb up the property ladder. For many years now, housing demand has been growing at a faster rate than supply. The results have been rise in house prices at 2.7% in real terms while earnings rose at 2% only (Wilcox, 2013). House prices keep increasing at an exorbitant rate due to deficiency in the supply side hand of housing.

Housing is an essential sector of the economy as shelter is traditionally thought of to be one of the basic needs of mankind. As an economy develops, it is expected that there will be a corresponding deepening and growth of the housing market. In many societies, a majority of households tend to hold wealth in the form of their homes rather than in financial assets which is considered an important component of investment. In view of its importance, financial institutions have provided financial sources to facilitate homeownership particularly for those who cannot buy a property outright (Min, 2014). The importance of the housing sector cannot be underestimated as it has been the source of the recent global financial crisis. To many individuals, housing forms the largest investment for households, thus requiring huge capital investments (Vuluku and Gachanja, 2014).

Since after the 2007/8 financial crisis, homeownership declined relative to the periods before the crisis (Anu, 2016a, 2016b). At the epicenter of the 2007/08 global financial crisis was the USA. Many other countries were exposed to the crisis, though different countries had different or slightly similar consequences (Acharya et al, 2009). The financial crisis was exacerbated by problems in the US domestic subprime mortgage markets where the cumulative loss rated of securitised subprime loan portfolios was more than 20% by the end of 2010. The housing boom in the US reached its peak between 2005-2006 as sub-prime mortgages and adjustable-rate mortgages increased rapidly (Willmott, 2010b; Dymski, 2002). Banks gave out loans to potential homeowners and housing prices began to rise. The decrease in interest rates and the large inflows of foreign funds made credit conditions easier and fueled the housing construction boom. Thus, types of loans like mortgages, credit cards and auto loans were made very easy to obtain as consumers assumed an unprecedented debt load.

Agreements on these loans such as mortgage-backed securities (MBS) and collateralized debt obligations (CDO) greatly increased at that time (Caplan et al., 2012). According to Ambler et al. (2009), regulations were introduced by the Carter and Clinton presidencies in the US for alleged social reasons which encouraged banks to lend more money to weak credit customers. After all, the banks were selling on the subprime loans and not holding them in their own balance sheet. Reinhart and Rogoff (2009) emphasized on the fact that in the sub-prime mortgage market, more than 1000 billion $US was invested into it. This was made up of the least creditworthy borrowers and the poorest people in the US. They also showed that since the mid-1970s, the six major historical episodes of banking crises in advanced economies were all associated with the rapid increases in the mortgage market. Furthermore, they documented that besides countries like the US, UK, Sweden and Ireland which have experienced this housing crisis, the pattern could also be found in many emerging markets crises like Asian financial crisis of 1997-98. In these Asian markets, the magnitude of house price decline was broadly similar in both advanced and emerging market countries.

The problems were compounded when these MBS were given as sub-prime mortgages – mortgages to individuals with non-standard credit history or low income. It reached its peak when these MBS and CDO fell as securities thought of by investors as being low-risk were downgraded as assets underlying those securities suffered a great loss. The credit rating agency made matters worse by rating as safe with AAA rating for some risky securities (Prager, 2013; Rom, 2009). It did not come to the notice of many people, yet when comparisons were made in April 2007 by the Bank of England between the US sub-prime breakdown and the commercial property market in the UK (Scanlon et al., 2012). Most of the European countries viewed this collapse initially as a US problem and not a global problem until fifteen months later when the global implications became too apparent.

Banks and other lending institutions around the world incurred huge losses, though it is still not very clear which bank's balance sheet were more affected. Trust and confidence were lost among lenders. Uncertainty increased suspicion in the banking industry, which prompted most banks to stop lending to each other as they could not guarantee each other's balance sheet quality (Anu, 2016a). Thus, in an attempt to reduce risk, tightened monetary and financial conditions emerged as banks reduced their willingness and ability to extend credit. In September 2008, there was a fall in liquidity in the financial market, resulting from the near collapse of insurance conglomerate AIG and the bankruptcy of Lehman Brothers (Caplan et al., 2012 and Almeida, 2009). The collapse of insurance conglomerate AIG only raises concerns regarding the scale and spread of default risk and also the credibility of financial product insurance. What sent shock waves through the global banking industry and destroyed confidence in the financial markets was the collapse of Lehman Brothers. It actually revealed the level of integration existing within the global banking system.

The response of the market to the collapse of Lehman brothers was intense, swift and broad based. In one week, prime money market funds which invest in asset backed securities and corporate debt experienced $320 billion redemptions. This made them unable to provide $2 trillion of credit, which they extended on daily bases. This made it very difficult for nonfinancial corporations which need refinancing and financial institutions depending on wholesale funding (IMF, 2011). With the unavailability of these traditional sources of finance, banks thought that the best way to repair their financial liquidity was to cut back on their lending activities to customers (Cho et al., 2012). Borrowing thus became more expensive and even harder to arrange. American housing survey (2013).

EMPIRICAL REVIEW ON HOMEOWNERSHIP

A study done by Aalbers (2008) highlighted the impact of mortgage securitization in the finance sector for households with poor credit histories and with limited and/or no documentation to prove their credit worthiness. They interrogated the sub-prime crisis directly. These households were mostly low income and/or racial minorities living in areas with high concentration of the disadvantaged groups in the society. Unsurprisingly, the continual expansion of this form of lending was a key factor occasioning the crisis when house property values began to fall (Emmons and Noeth, 2013). Aalbers (2008) found that financial institutions exploited homeownership for their own interests through mortgage securitization with greater capital mobility facilitating the development of the quaternary circuit of capital.

Wood et al., (2006) studied the difficulties encountered by tenants in acquiring a home. They looked at the transition from a tenant to a homeowner. They based this on the deposit requirement and transaction costs relating to purchasing a home for the first time. This regards whether the gap can be bridged between their savings and the up-front cash requirements that must be met. It also assessed whether the reduction in stamp duty obligations will help potential first-homeowners. Their discovery was that those with low-to-moderate permanent income earnings have a very large gap between up-front and savings cash requirements. Most important in their findings was that stamp duties typically account for 23% of total up-front cash requirements. They concluded that exempting first time buyers from stamp duty tax will increase their savings towards initial deposit and thus increase homeownership. The study of Turner and Smith (2009) found high-income families to be more likely to sustain homeownership than low-income families. Furthermore, low-income homeowners were often found to return to renting (Dieleman and Clark, 1995).

On the contrary, earlier empirical studies (Krueckeberg, 1999) discussed the issues in renting and how less privilege renters were being treated in the USA. He discovered that there was a lot of bias regarding treatment giving to homeowners as against those renting. He considered renters to be among the lowest income earners In addition to owning their homes; homeowners were given an additional subsidy while renters were less privileged. Also in many of their property tax laws, these renters were also not considered as stakeholders of their communities. He found majority of homeowners to be citizens and denied the existing fact that they are likely to be taking part in community activities than immigrants. Homeownership celebration stigmatizes these renters. Krueckeberg shares the view that renters and owners of property should be treated with fairness and equality. His view disagrees that homeownership should favor citizens only.

Leece (2006) in his study carried out a test on mortgage demand in the UK. Leece carried out his findings using Bruceckner's model of mortgage demand in the UK mortgage market data. He used the mortgage instrument in identifying patient borrowers who borrow at intermediate levels and impatient debt maximizers. His results identified two groups of mortgage holders: mortgage maximizers and borrowers. Borrowers are likely to demand for an intermediate size of mortgage debt, known as endowment mortgage holders. Those mortgage holders with an alternative investment in housing are referred to as repayment mortgage holders. He found the elasticity of the interest rate of mortgage demand may be less than 0.2. To him, income is not statistically significant in the UK equation compared to the USA. This is however not surprising given that his work was conducted at a time when obtaining a mortgage was not based on merit. That is before the financial crisis, households' income was not a limiting factor to obtaining a mortgage.

A similar study of ethnic identity and immigrant homeownership was conducted in the USA using a two-dimensional composition index of ethnic identity to incorporating attachment to both host cultures and origin. They controlled for a broad range of socioeconomic characteristics, life-cycle and housing market conditions. The analysis of immigrant housing tenure choice was done by an explicit accountability of the ethnic identity as being a potential influence on homeownership status (Constant et al, 2009). The case of Germany proved that immigrants who already have a strong commitment to the host country are more likely to achieve homeownership for a given set of demographic and socioeconomic characteristics regardless of their level of attachment to their home country. Forrest and Lee (2004) debated on the volatile nature of house prices and the uneven benefits of homeownership for different cohorts of homeowners.

Likewise, Borjas (2002) in his empirical study analyzed the determinants of homeownership in the USA between the period 1980 and 2000. His study focused on the native born and immigrants from Mexico, Germany, US, European countries and other less developed countries of Asia and Latin America. He used descriptive statistics and found that most immigrants have much lower homeownership rates than the natives with the homeownership gap widening significantly within the period of study. The reasons for the nature of homeownership were as a result of two important factors. He identifies these to be associated with the differences in the national origin of the immigrant population and the differences that exist in the location decision of both immigrants and native households. The data collection for this work is limited to 2000. That is it does not include the financial crisis period.

According to Schwartz and Seabrooke (2009) and Dymski (2008), 'residential housing and housing finance systems have important causal consequences for social stability, political behavior, macroeconomic outcomes and the structure of welfare states. To them, mortgage securitization enables the liberal supply of mortgage loans. The resultant liberal housing finance system is entrenched within the liberal market capitalism. A main characteristic of this form of residential capitalism is the continual inflation of equity values sustained by the liberal system which enables homeowners to cash out their gains for general consumption, welfare expenses of their families and in their old age. Levels of government welfare spending were not considered a priority, since purchasing power is diminished by mortgage payments and political pressures which keep tax rates at lower levels. A relatively low level of public welfare minimizes the possibility of tax rises. In addition, to ease the burden of mortgage payments, homeowners favor low inflation rates and low interest rates. This form of mass homeownership creates a population hostile to the welfare state. The limit of this study is the consequences of mortgage repayment only.

Similarly, Crawford and Faruqui, (2012) in their article tried to measure the trend of household indebtedness in Canada. Their finding revealed that over the past thirty years, there has been an upward trend of growth in household lending. They discovered that population ageing had a moderate effect on the overall growth in credit over this period. This is, however offset by the strong positive cohort effect. According to their finding, the widespread nature of the increases across every age group and in both mortgage and consumer credit suggests that a variety of factors contributed to the growth in total household debt. This research work is based solely on the ageing aspect of the population in relation to mortgage loan. Sinning (2010) and Zhou and Myers (2007) disputed that the younger the immigrants enter a country, the more likely they are able to adapt to the system thereby increasing their chances towards homeownership.

Future of the Housing Market

The 5% yearly increase in house prices and a shortage of affordable homes suggests that over the next decade (by 2015), more than half of the population under 40 will be living in properties owned by private landlords (Osborne, 2015). Private renting has become the norm and the default option for those who cannot afford to buy and do not qualify for social housing. Therefore, the predictions by 2015 is that 7.2 million households will be in rented accommodation, compared with only 2.3 million in 2001 and 5.4 million today. 35% of homes are estimated to be owned outright by 2025, compared to 71% in 2003. By 2025, the average home in the UK will be worth about £360,000, compared with £279,000 today, even though the rate of house price growth is set to fall to 5% yearly. The chief economist of PwC (Power water house Coopers), John Howksworth's suggestion indicates that homeownership does not need to increase. Instead, tenancy should be made more secure and improvements made to the quality of rented homes.

Without interventions by the government, about a third of people aged over 60 will be living in rented accommodations in 35 years' time (Osborne, 2015). The struggle for a deposit will continue to be thwarted, given the continuous rise in house prices that outpace earnings growth. After considering the trend in the pattern of housing for young people from 1999 to 2008, Clapham et al. (2014) concluded that in the near future, there will be the growing demand for private rented sector by young families and very vulnerable young people. In order to create market confidence which would result in greater local knowledge and stimulate growth in the UK mortgage market, it was recommended by Khansalar et al. (2015) that a separation be made between banks and building societies. White (2015) suggested that help-to-buy may help overcome the limitations created by the reaction of the mortgage lending sector.

Findings and Discussion

The survey was carried out on 850 respondents with 302, 294 and 254 respondents from London, New York and Toronto respectively. The responses on their status of homeownership were as follows.

It was observed in Table 1 that up to 60.9% of the respondents did not own the houses they live in. Both London, New York and Toronto had high number of tenants than homeowners. When asked about their intention to own a home in the near future, their responses were displayed below.

Table1. *Summary of Homeownership Status*

Home ownership status	London (%)	NewYork (%)	Toronto (%)	Average Total (%)
Tenants	65.6	66.7	50.4	60.9
Home owners	34.4	33.3	49.6	39.1
Total Population	35.5 (302)	34.6 (294)	29.9 (254)	100 (850)

Table2. *Intention to Own a Home in the Near Future*

Response Type	Percent
Yes	75.3
No	16.1
Not Sure	8.6
Total	100

From Table 2, 75.3% of these households declared that they would like to become homeowners as they were not happy with their homeownership status. The remaining group of respondents were those who were not sure of their continuous stay in the country in the nearest future, given that some of them are visitors while others were oversea students who intend to return to their home countries after the purpose of their visit. This finding is in agreement with findings by Anu, (2016b). The following are reasons why there were high and increasing number of tenants in these inner cities.

Table3. *Respondents' reasons for Renting Instead of Owning their own homes*

Criteria	Not important at all (%)	Low importance (%)	Slightly important (%)	Neutral (%)	Moderately important (%)	Very important (%)	Extremely Important (%)	Mean
Increasing house prices	0.5	0.5	0.5	5.5	8.3	33.0	51.8	4.27
High initial deposit	2.2	2.2	5.0	7.4	10.55	36.2	36.2	3.92
Income	2.2	1.0	1.8	6.9	11.9	33.5	42.7	4.06
Nationality	4.6	2.8	1.8	6.0	11.9	33.9	39.0	3.92
Affordability	2.8	2.3	3.2	8.3	13.3	34.4	35.8	3.91
Marital status	9.2	9.2	6.9	7.8	11.0	27.1	28.9	3.40

Table 3 depicts that increasing house prices and high initial deposit is one of the main reasons why they are still renting. In recent years, house prices have been on an increase. More than half of these respondents considered initial deposit to be of extreme importance, majority of whom were the youths of less than 35 years old. Despite the fact that the government intervened through the help to buy scheme by offering customers an opportunity to obtain a mortgage with only to 5% deposit as the situation in the United Kingdom, it was still not favorable for everyone (Howard, 2013). Besides the initial deposit, there are other sunk costs required prior to the applicant being granted access to the mortgage like stamp duty charges (for property above £125,000), solicitor/conveyance fees, land registration, lenders' valuation and many other costs involved While this study found high house prices and initial deposit to be the most important determinants in obtaining a mortgage in the UK, Wesutsa (2014) and Gachanja (2014) found interest rates to be the main determinant in Kenya.

Some households attested that their homeownership status was not a matter of choice but because of their nationality status. Climbing up the property ladder has become a nightmare for them. Although they were qualified for the mortgage loan, the bank refused giving it to them because they were neither native born nor naturalized. These group of respondents were limited form gaining access to housing finance. Another study disagrees with the issue of nationality as a criterion for mortgage loan. To the researcher (Krueckeberg, 1999), everyone should be given equal opportunity in the mortgage market. Besides, most of these immigrants have already established strong commitments to their host country which they now consider as their home (Constant et al, 2009).

The increase in affordability checks and other criteria necessary for housing finance to be made available have also contributed to the homeownership status among tenants. Due to the lingering effect of the 2007/08 financial crisis there has been great scrutiny placed by most mortgage lender in these advanced economies. Respondents with imperfection on their credit history were found to be unable to obtain housing finance. Earlier studies also support that the financial crisis led to affordability scrutiny and prolong affordability pressure in the near future (McCord et al., 2014). Interest-only mortgages are no longer offered by most high street banks. Borrowers' ability to repay is now well scrutinized by lenders making sure that the customer can still be able to repay if interest rates further increase. Tables 4 and 5 highlights the importance of income.

Table4. *Cross Tabulation between Affordability and Homeownership status*

	Do you own the flat/house you are living in?			Total
	Renting	Own a house	Own a house/share accommodation	
Afford just what I need with nothing left over	74.3%	23.0%	2.7%	100.0%
Afford what I need with little left over	73.5%	20.0%	6.5%	100.0%
Afford what I need with much left over	47.9%	47.9%	4.2%	100.0%
Cannot afford what I need and struggle to survive	75.0%	25.0%		100.0%
Total	68.1%	27.2%	4.7%	100.0%

Respondents' residual income enlightens our scope of understanding of their attitude towards homeownership status. From Table 4, More than 56% of those renting were those found to be low income earners. These are households who can afford just what they need with very little or nothing left over or those who only struggle to survive. Majority of those renting were found in the age range of less than 35 years old with 69% of them being singles. Also, some tenants are unable to change their homeownership status because their employment status is either not stable or they are not in full time employment. The banks often check the applicants' ability to sustain repayment in order not to repeat the mistakes of what led to the 2007/08 financial crisis. Thus majority of low income earners were tenants while most high income earners were homeowners. Table 5 explains the evidence of the relationship between income and homeownership status.

Table5. *Chi-Square test for significance*

	Value	Df	Asymp.Sig. (2-sided)
Pearson Chi-Square	40.288[a]	75	.000
Likelihood Ratio	41.219	75	.000
Linear-by-Linear	10.061	1	.002
Association	850		
N of Valid Cases			

Table 5 is the chi-square table which shows evidence of the relationship between income s and homeownership status. The significance or p-value is 0.002 which is less than the standard p-value of 0.05. This means that the result is statistically significant. Therefore the claim by Leece (2006) that income is statistically insignificant for consideration of mortgage loan application is no longer applicable nowadays. At the time of Leece's research, the income was insignificant because of the interest of most economy to increase homeownership. However, the catastrophe from the 2007/08financial crisis led to the increasing importance of income in the granting of mortgage loan.

However, a small percentage of these households from Table 3 said they were comfortable with their status as tenants. These are those who are still renting due to their marital status, ethnicity or age limit. Thus, some respondents explained that it is more worthy to obtain a mortgage when married or when expecting children than when single. Moreover, 35% of those renting who do not value homeownership expressed their view that housing finance is not of any interest to them as their stay in their host country is only a short term issue. Also, those in the younger age prefer to rent because they think that they still need time to be able to save enough to acquire a home.

Contribution to Knowledge

This study has helped to identify the missing gap in literature for a comparative study on the reasons why most people remain as tenants in the inner-cities of the developed world. Secondly, contrary to the viewpoint of Leece (2006) that income was not a significant factor for the consideration of a mortgage loan, this study found income to be statistically significant. However, Leece's view that income was insignificant is not very surprising because his research was done before financial crisis where a lot of attention was not placed on the affordability criteria but on increasing the number of homeowners.

Recommendations

Homeownership could be increase by tackling the problem of initial deposit faced by most first-time home buyers who are mostly those found in the younger age group of less than 35 years. Furthermore, it could be made better if housing finance providers develop other strategies to improve the situation by offering other lending services like no initial deposit with increase in the monthly repayment. This is because more than half of the household tenants attach a lot of importance on this factor. By taking off this constraint could therefore redress the situation. As an alternative however, these financial institutions could increase the provision of cheaper and attractive products such as shared ownership, which is already on offer by Santander - one of the high street banks in the United Kingdom.

There is the need to build more homes to reduce the gap and bring about equilibrium in the mortgage market since the issue of excess demand over supply has remain of great concern especially in the United Kingdom. They could emulate the homebuilding strategy in Canada where demand is never in excess of supply. The population of the United Kingdom is almost twice that of Canada but the number of new homes build each year is twice less than the number in Canada. In addition, the immigration status or the nationality of households should not be the limiting factor towards housing finance as portrayed by the situation in most of these developed countries. Immigrants who indicate interest in obtaining a mortgage should be granted access if they fulfill all the other lending criteria. There is no need to restrict immigrants on this, given the fact that the mortgage can still be repossessed if they fail to meet the terms and conditions of repayment. This viewpoint is also recommendation by Krueckeberg (1999).

Conclusion

Generally, there has been growing demand and relatively limited supply in most inner-cities of developed worlds, with outrageous increases in house price which limits homeownership. Increasing house prices coupled with high initial deposit, income verification and applicants' nationality were identified as the main determinants. The situation somehow slightly differ between the three countries. In Toronto and New York, demand is very high rarely exceed supply. In Toronto, home building has always been of great priority such that in many years to come, demand will hardly be in excess of supply. In London, the demand for houses has constantly been in excess of supply.

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