Housing equity and consumption: insights from the Survey of English Housing[1]

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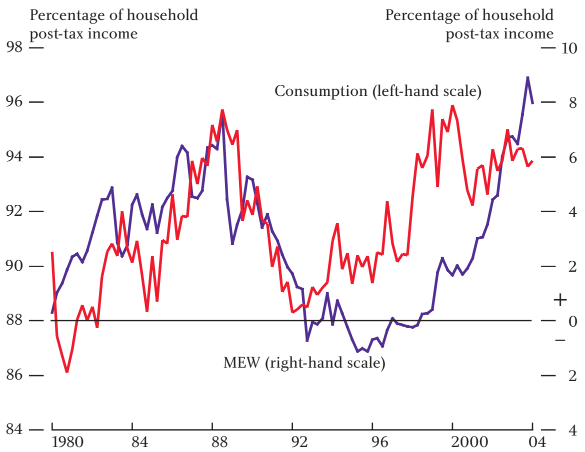
This article examines data from the 2003 Survey of English Housing (SEH) in order to shed light on the link between gross equity withdrawal and spending. Our analysis suggests that the bulk of gross withdrawals is not consumed in the near term. Those who sell a property without purchasing another one and those who trade down are more likely to pay off debt or save withdrawn equity than spend the proceeds. Remortgagors and those who obtain further secured advances are likely to spend the equity, but we estimate that their equity constitutes only about a quarter of total gross withdrawals. Of those who spend equity, financing home improvements rather than purchasing consumer goods appears to be the most important use of funds. That is consistent with the relatively weak relationship between consumption and mortgage equity withdrawal recently observed in aggregate data.

Introduction

Housing equity withdrawal plays a potentially important role in linking developments in the housing market with consumer spending.[2] But the relationship between equity withdrawal and consumption is not clear-cut. In recent years, the Bank of England's measure of mortgage equity withdrawal (MEW) has risen sharply without being accompanied by a sharp rise in consumption (see Chart 1). That is consistent with the view in the latest issues of the *Inflation Report* that the relationship between house prices and consumption has been weaker recently than it had been in the more distant past.[3]

Chart 1
MEW and consumption



It is difficult to interpret the relationship between these aggregate quantities as equity withdrawal reflects the behaviour and actions of different types of households. The stereotypical withdrawer is someone who remortgages or takes out an additional secured loan to finance consumer spending. But there are instances of equity withdrawal that do not increase the indebtedness of the individual withdrawer, most notably the equity withdrawn by those who exit the owner-occupied housing market and those who trade down. Such withdrawers might have a different motivation for withdrawing equity and hence a different propensity to consume out of those funds compared with those who borrow.

Information on the nature and motivation behind equity withdrawal is scant. The Bank's estimate of MEW, which in broad terms is measured as secured borrowing that has not been invested in the housing stock, is a top-down measure of equity withdrawal.[4] It cannot shed light on the different channels of withdrawal. In

(1) The authors would like to thank the Office of the Deputy Prime Minister and the Council of Mortgage Lenders for helpful discussions on using the Survey of English Housing.
(2) See for example Catte *et al* (2004) and Aoki *et al* (2002) on the link between housing and consumption. See also Davey (2001), pages 10–11 of the August 2004 *Inflation Report*, and the article on pages 291–301 of this issue of the *Quarterly Bulletin*.
(3) See for example page 44 of the May 2004 *Inflation Report*.
(4) The Bank's estimate of MEW is calculated as net secured lending and capital grants for housing paid to the household sector less housing investment, net transfers of land to the household sector and the costs of transferring dwellings to the household sector. See www.bankofengland.co.uk/mfsd/mew/mew.htm for details of the Bank's estimate of MEW.

this article we use microdata from the Survey of English Housing (SEH) to find out the relative importance of different types of equity withdrawal and how likely it is that those funds are spent. In the box on page 304 we use the survey data to examine the incomes of those who withdraw housing equity. The survey examines gross equity withdrawal. This differs from the Bank's estimate of MEW which is measured net of injections of equity, such as repayments of loan principal and spending on home improvements.

The Survey of English Housing

The SEH is an annual household survey in England conducted for the Office of the Deputy Prime Minister by the National Centre for Social Research. Its core purpose is to provide descriptive information about housing in England. In the 2003 survey, a module was added about gross equity withdrawal. The survey covered almost 15,000 households in England. As this was the first occasion that a set of questions on equity withdrawal had been included in the SEH, respondents were asked about all gross withdrawals they made during the preceding five years.

Incidence of gross withdrawal

Table A outlines the ways in which individuals can withdraw equity.

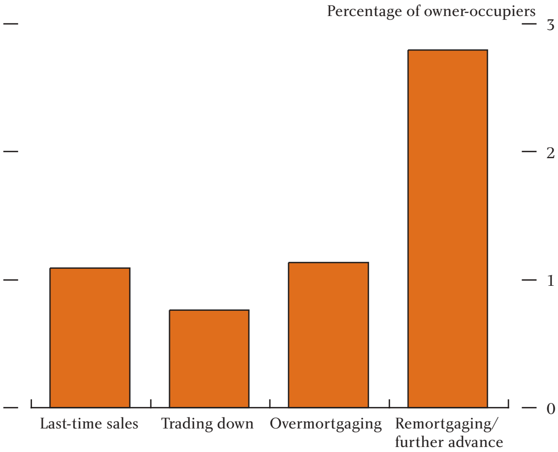
Table A
The components of gross withdrawals

Component	Description
Last-time sales	A seller does not buy a new property. Proceeds of the sale are released from the housing market.
Trading down	A seller moves to a cheaper property but reduces the mortgage by less, to leave a cash sum.
Overmortgaging	A moving owner-occupier increases their mortgage by more than the difference between the old and new house prices.
Remortgaging	A borrower takes a new mortgage and increases their debt without moving properties or improving the property to the same extent.
Further advances or second mortgages	A borrower raises a further advance on an existing mortgage or takes a second mortgage without moving properties or improving the property to the same extent.

Generally, the SEH microdata allowed us to identify the incidence of gross equity withdrawal as outlined in Table A. But information on last-time sales is incomplete. It is restricted to those who exit the owner-occupied sector by selling a property and who are currently renting. According to Holmans' (2001) component flows analysis of equity withdrawal, those cases account for about 20% of total last-time sales (the bulk being the equity withdrawn from the sale of inherited properties).(1) So, in order to create a more accurate estimate of relative incidence we scaled up the recorded data on last-time sales by a factor of five. Within the data, it is also difficult to separate the incidence of equity withdrawal that occurs through remortgaging and through further advances. So we merged those channels of withdrawal.(2)

Chart 2 shows the incidence of equity withdrawal in 2002 (the most recent full calendar year for which we have data). 4.1% of households (5.8% of owner-occupiers) withdrew equity in 2002. Withdrawing equity by remortgaging or by obtaining a further advance was the most common form of withdrawal, accounting for just under half of all cases. Last-time sales and overmortgaging each accounted for just under one fifth of total incidence (the last-time sales data have been scaled up). Trading down accounted for about 13% of total incidence.(3)

Chart 2
Incidence of gross withdrawal in 2002



Note: Number of observations: 516.

But information on incidence does not tell us the actual amounts withdrawn through each channel. Table B shows the mean and median amounts withdrawn. Typically, last-time sales and trading down involve the

Table B
Gross withdrawals in 2002

£ thousands

	Last-time sales	Trading down	Overmortgage	Remortgage/ further advance
Mean	77.7	75.7	23.8	22.8
Median	60.0	55.0	16.0	13.8

(1) See Davey and Earley (2001, page 8).
(2) It is likely that both groups have similar characteristics (at least with respect to their propensity to consume out of withdrawn equity). Both groups borrow to withdraw equity and neither require a house move.
(3) In 2002, sales of houses were equivalent to 7% of the number of households.

How does equity withdrawal vary by household income?

What are the incomes of those withdrawing equity? This may be important for assessing the potential vulnerability, particularly of borrowers, to asset price or income shocks.

It is useful to consider two categories of withdrawers:

- Borrowers—those who borrow to withdraw equity (overmortgagors, remortgagors and those who take out a second mortgage).
- Other withdrawers—those who withdraw equity from the proceeds of the sale of their property (those who trade down and last-time sellers).

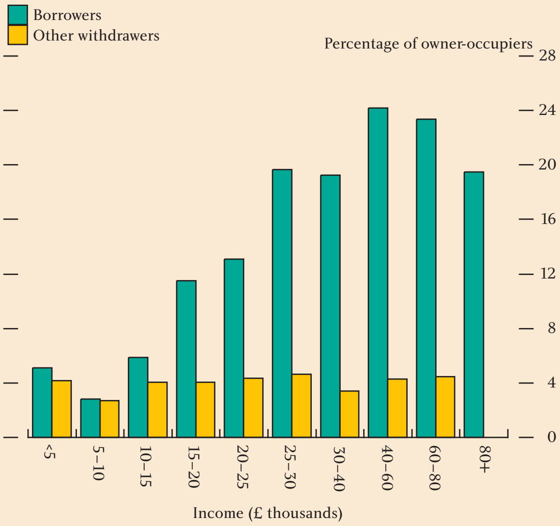
We consider these two groups separately for two reasons.

- The characteristics of both groups are likely to differ. We know that borrowers are more likely to withdraw smaller amounts of equity and more likely to spend it than the other group.
- Borrowers are more important from a financial stability perspective; so it is useful to consider their financial and demographic characteristics in isolation.

Chart A shows the percentage of owner-occupiers who withdrew equity during the past five years broken down by income. Other withdrawals, that is trading down and elements of last-time sales, are evenly distributed across income groups; those withdrawals are as likely to occur in high and low income groups. However, information on last-time sales of those moving into the rental sector, on which our information is based, may not be representative of all last-time sales.

Borrowing is concentrated primarily among high income households. The median income of borrowers is £33,600, higher than the median income of owner-occupying households. We estimate that nearly one quarter of all owner-occupying households earning £40,000 or more have borrowed to withdraw equity during the past five years. That is a much higher proportion than the 3.5% of households earning less than £10,000 who have borrowed (households earning less than £10,000 make up 18% of owner-occupying households).

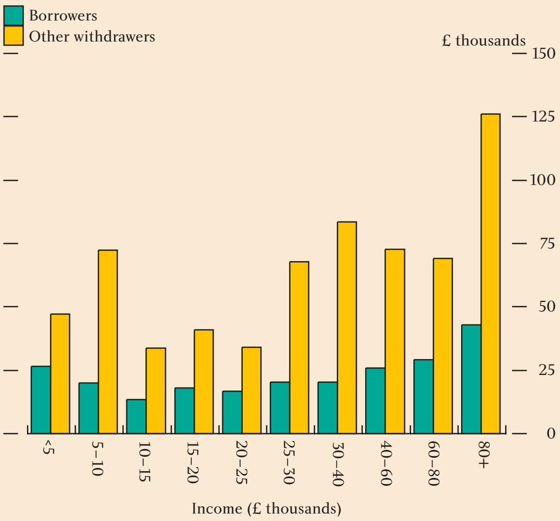
Chart A
Incidence of gross withdrawals in past five years by income



Note: Number of households: 346.

When low income households do extract equity, the survey suggests that they tend to withdraw relatively large amounts (see Chart B). Sums withdrawn by those households are comparable to withdrawals by medium-income groups regardless of whether they are borrowers or other withdrawers. Caution is required when interpreting this particular statistic; few low income households withdraw equity (see Chart A), so the data are subject to the influence of outliers. Beyond those on the lowest incomes, the average amount withdrawn tends to increase with the income of the household.

Chart B
Average amount withdrawn in past five years by income

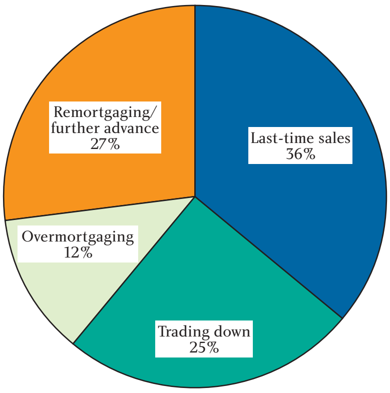


Note: Number of households: 346.

extraction of much larger amounts of equity than remortgaging and overmortgaging (the mean amount is over three times greater). That is intuitive, as in both cases the house is being sold and the withdrawers are not taking on additional debt.

Chart 3 indicates the share of the total value of funds extracted by the various means in 2002.(1) Last-time sales was the largest component of gross withdrawals, accounting for 36% of the total sum extracted in 2002. Remortgaging and trading down each accounted for around one quarter of total gross equity withdrawal. Overmortgaging accounted for 12%. So these data imply that only about 40% of total gross withdrawals represented funds that had been actively borrowed by the individual withdrawer.

Chart 3
Value of gross withdrawals in 2002



These data can be compared with those in Holmans' (2001) component flow analysis of equity withdrawal. For 2000 (the most recent year for his data), last-time sales accounted for 45% of gross withdrawal, while remortgaging and further advances accounted for 27%. This is broadly in line with our results. However, he found a much lower figure for trading down (3.4%) and a higher figure for overmortgaging (24%) than we did. At face value, his results therefore suggest that about 50% of funds were borrowed by the withdrawer—higher than our derived results. That is puzzling. It could be that house price inflation has mechanically boosted the non-borrowed elements of equity withdrawal in recent years. But this comparison of our results with Holmans' highlights that estimates of component flows are subject to uncertainty. Results produced in this analysis should therefore be treated with some caution.

Uses of funds raised

Respondents to the SEH stated what they used the withdrawn equity for, or their motivation for withdrawal. Assessing the information on uses of withdrawn equity is complicated by the design of the survey questions, which differed across each category of withdrawal. We consider information given on all withdrawals during the past five years. Our key findings are:

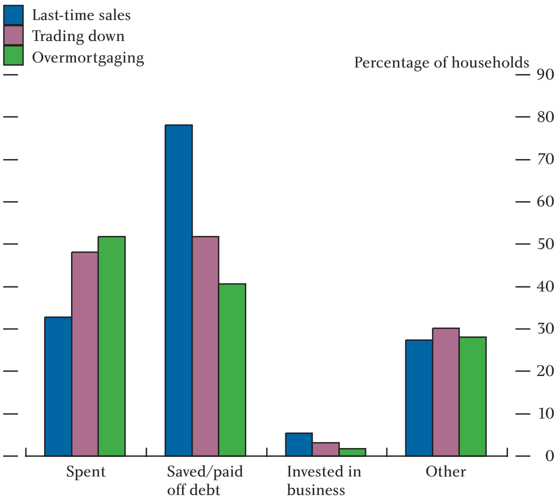
- Last-time sellers and those who trade down, which we estimate account for about 60% of the value of gross withdrawals, are more likely to pay off debt or save than spend the equity.
- Those who borrow to withdraw equity are more likely to spend the funds. Nevertheless, a substantial proportion of overmortgagors (ie those who move house and increase their mortgage) also use the funds for purposes other than spending.
- Withdrawers often mention unidentified uses for their withdrawn equity. It is possible that this could reflect gifts or transfers to other members of their family/household.
- Regardless of the channel employed, home improvements are the most important individual item of spending for those who spend the equity.

Last-time sales, trading down and overmortgaging

We estimate that these channels together covered over 70% of the value of total withdrawals in 2002 (or about 50% of the total number of withdrawers). Respondents were asked whether they spent, saved, paid off debt, invested in a business or did something else with the equity. Respondents were allowed to mention more than one use but the relative amounts allocated to each category were not given. Chart 4 illustrates the various responses. Last-time sellers were the least likely to spend withdrawn equity. Less than a third of them indicated that they spent some of their equity, while nearly 80% said they saved some or paid off debt. However, it is worth reiterating that the last-time sellers considered here are those who moved into the rental sector, which constitutes only a subset of total last-time sales. Their motivation to move into the rental sector may reflect a forced move due to a change in household circumstance or structure. So their propensity to consume out of those funds

(1) Smith *et al* (2004) have also produced estimates of the size of the components of gross withdrawal using SEH data. Their analysis considers the period 1998–2003. Their results are similar to ours.

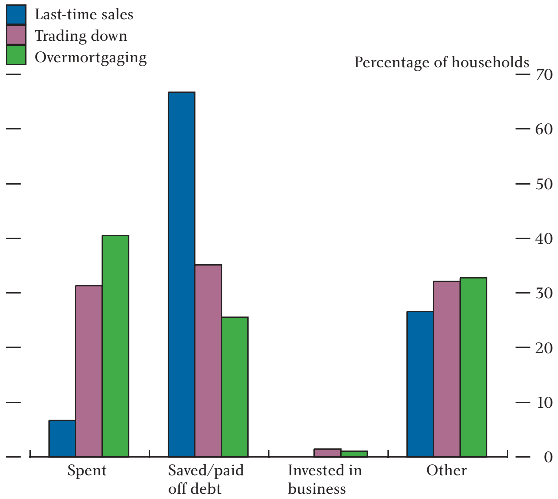
Chart 4
How the proceeds were used[(a)]



Note: Number of households: 507.

(a) Households can give more than one response.

Chart 5
How the proceeds were used by those only citing one use



Note: Number of households: 359.

might differ from that of the recipients of inherited funds.

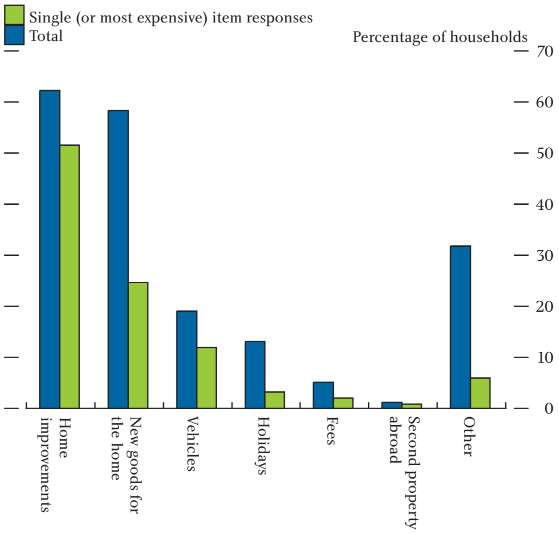
Similarly, a greater proportion of those who traded down said that they either saved or paid off debt rather than spent some of the equity. In contrast, overmortgagors were more likely to spend the equity than save or pay off debt. The survey suggests that withdrawers rarely used their funds to invest in a business (less than 6% mentioned investing in a business). Surprisingly, 25%–30% of the withdrawers mentioned other unidentified uses of the withdrawn equity. It is possible that those funds were used as gifts or transfers to other members of their family (eg as a deposit for a child's new home). The age profile of those who mentioned they had used the equity for 'other purposes' is older than the typical withdrawer, possibly suggesting some intergenerational transfer.

Respondents were allowed to mention more than one use. In order to gauge better the relative importance of each item, we can analyse the distribution of responses for those who only mentioned one use (see Chart 5). This covers about 70% of the original sample, so we can still consider this group to be informative. The results are similar to those in Chart 4 but more striking. Less than 10% of last-time sellers who only mentioned one use said they spent the proceeds. Overmortgagors were still more likely to spend the proceeds than the other two groups. Nonetheless, about 60% of them mentioned uses other than spending. And for each channel of withdrawal 25%–35% of households still mentioned unidentified uses of the funds.

Of those who spent the proceeds, the survey identified how they spent their equity. As sample sizes were small we combined the responses of last-time sellers, overmortgagors and those who traded down. Response options included home improvements; new goods for the home; vehicles; holidays; fees (school, university, nursing home); a second property abroad; other goods (which we assume to be other expensive durable goods); general expenditure; and other. For simplicity we combined the last three responses. Households were allowed to give multiple responses, but if they did so they were asked to identify the most important item of spending.

Chart 6 shows the various items on which the proceeds were spent. The blue bars show the raw responses. The

Chart 6
How the proceeds of last-time sales, trading down and overmortgaging were spent



Note: Number of households: 252.

green bars reaggregate the responses by including those who identified just one item, or the most expensive item if more than one response was given. That should give a better indication of the relative importance of each item. About 50% of respondents said they either spent all the proceeds on home improvements or mentioned that these formed the most expensive item. The remaining 50% mentioned other items of expenditure, the most important being new goods for the home. The survey suggests that buying properties abroad was not an important use of withdrawn funds.

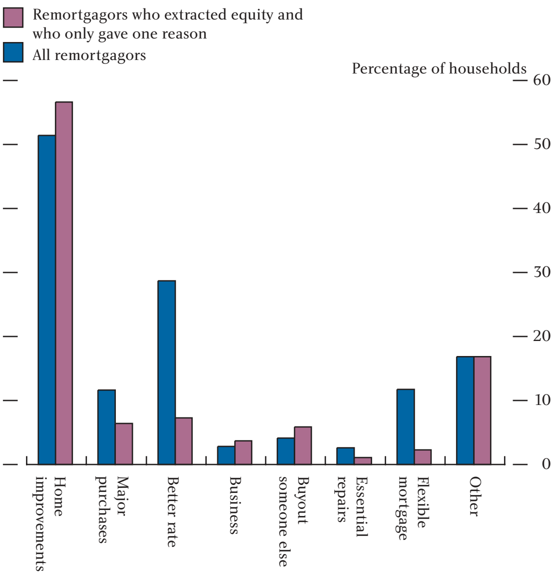
Remortgaging, further advances and second mortgages

Remortgagors were asked their motivation for remortgaging. Options included to make home improvements; to help to purchase a major item (car, boat, caravan, second home); to secure a better or fixed rate of interest; in connection with a business;(1) to buy out another person's share in the property; for essential repairs to the property; to move to a more flexible mortgage; or some other purpose. Once again households were allowed to give more than one response. Their responses are shown in Chart 7. But some of those who remortgaged did not extract equity. It is likely that their motivation for remortgaging was different from those who also withdrew equity. So to get a better handle on the motivation behind those who withdrew, Chart 7 also shows the responses of those who remortgaged, withdrew equity and gave only one motivation.

Remortgaging in order to finance home improvements appears to be the most important individual motivation, mentioned by over half of the respondents. Securing a better rate was the next most popular motivation for the full set of remortgagors. But unsurprisingly, as this is not related to equity withdrawal, it was not as popular among the restricted sample, being mentioned by only 7% of respondents. Among the restricted sample the other named motivations were individually small. But 17% of the respondents in both samples gave some other unidentified motivation for remortgaging. That may reflect either paying down debt, gifts to others, or other general expenditure. Some of these results chime with those from a study on mortgage refinancing in the United States (Canner *et al*, 2002). That work found that over 40% of refinancers used equity to make home improvements, in line with SEH estimates for the United Kingdom. That study also found that paying off other debts was an important motivation behind refinancing.

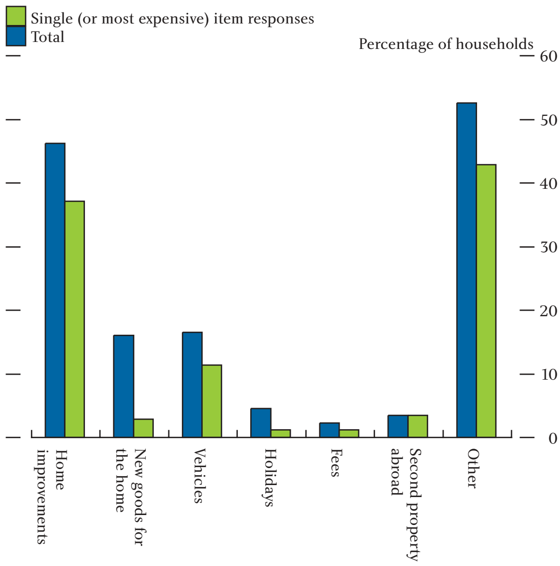
The SEH also identified those who had taken out a second mortgage. Similar to overmortgagors, last-time sellers and those who trade down, respondents were asked how they spent the proceeds. If they gave more than one reason they were asked what the most important item of spending was. But unlike the overmortgaging, last-time sales and trading down groups, they were not initially asked whether they saved, spent or paid off debt with the equity. Chart 8 shows the raw

Chart 7
Motivation for remortgaging and further advances



Note: Number of households: 1,291 (full sample), 659 (restricted sample).

Chart 8
How the proceeds of second mortgages were spent



Note: Number of households: 175.

(1) It is not clear what exactly 'in connection with a business' means. It probably refers to equity withdrawn in order to invest in a business.

responses and, like Chart 6, a set of reaggregated responses that considers only the most important items.

Almost 40% of respondents said home improvements were the only, or the most important, named item of spending. About 20% mentioned other items of expenditure, with vehicles being the largest category. The remaining 40% mentioned other items. As respondents were not initially given the opportunity to state whether they had actually saved, spent, or paid off debt with the funds, it is possible that this 'other' category reflects funds that were not actually spent. It is also possible that gifts and transfers show up in this category.

Some conclusions

Equity withdrawal does not only occur when individual households borrow against the value of their home to finance consumption. In this article we have shown that equity withdrawal occurs through several channels, some of which do not necessarily involve borrowing by the individual withdrawer, and that the use of withdrawals varies (spending, saving, paying off debt, and possibly transfers to others). Funds that are released through borrowing are the most likely to be spent; but such advances only account for about 40% of total gross withdrawals. Last-time sales and trading down together account for more than half of gross withdrawals; those funds are more likely to be saved or used to pay off debt than spent. And, for all categories of withdrawal, respondents mentioned other uses for the funds. We conclude therefore that the bulk of gross withdrawals is unlikely to be spent in the near term.

Where funds are spent, the survey data suggest that home improvements are the most important item of spending. Home improvements do not form part of consumption. In the National Accounts they are treated as housing investment, although, in practice, certain home improvements (such as a self-installed new kitchen) may be picked up in consumption.(1) But there are difficulties in measuring this accurately.

As noted previously, the information on gross withdrawals analysed in this article is not the same as the Bank's estimate of MEW, which is net of injections of equity. However, the broad conclusion that equity withdrawal is not synonymous with secured lending for consumption holds for the Bank's estimate of MEW. Withdrawal of housing equity is largely generated by mechanisms (exiting and trading down) that give rise to a tendency for it to vary with movements in house prices. But we have shown that these types of withdrawal have lower consumption propensities. It is possible therefore that some of the increase in measured MEW funds in recent years has in aggregate flowed into financial assets if those funds have been saved: the households' financial balance has been roughly stable during the past six years despite the increase in household debt.(2)

In the past, when a strong correlation between equity withdrawal and consumption was observed, this is likely to have reflected house prices and consumption responding to a common shock such as changing income expectations.(3) The lower correlation observed now suggests that such a common shock may have been a less important factor behind the recent upturn in the housing market.

(1) The Bank's regularly published estimate of MEW should be unaffected by spending on home improvements as they simultaneously represent both a withdrawal and an injection of equity.
(2) See Section 1 of the August 2004 *Inflation Report*.
(3) See for example Attanasio and Weber (1994).

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