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Sector Article

Real estate

To buy or to rent? A question

of income but particularly of savings capacity

In this article we use a novel approach to analyse the potential of Spanish renters who could afford to buy a property. For Spain as a whole, we estimate that around 49% of renters have a high enough income to purchase a home. However, only 13% have the necessary savings. While there are significant differences between provinces and municipalities, in all regions it is clear that insufficient savings capacity is the main constraint faced by renters to buying their own home.

Content available in
Spanish Catalan



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Can Spanish renters afford to buy a home?

The sharp increase in rents in recent years has led many renters to consider buying a property.¹ The decision to rent is less attractive when an amount similar to the monthly rent can be paid to buy an equivalent home. But in addition to the income needed to meet monthly mortgage repayments, the purchase of a home also requires considerable savings at the time of purchase.² In general, it is necessary to save at least 20% of the property's value as a mortgage is usually granted for 80% of the price. Given these conditions, can Spanish renters afford to buy a home?

The most common way of measuring whether someone can buy a property is by means of the affordability index, which is simply the ratio between the price of a representative dwelling and the gross disposable income of an average household. According to data published by the Bank of Spain, this ratio stood at 7.0 in 2019;

i.e. the average Spanish household must allocate 7 years of its entire income to buy an average home.³ However, this simple measure does not reflect the reality of many households, especially those living in rented accommodation which are precisely the main potential buyers of housing. Firstly, the index is calculated using the median income of all households, including those that already own a home which tend to have higher incomes than renters. Secondly, it uses the price of an average home, which may not be representative of the price in different locations. Even within the same market there is a wide variety of homes (in terms of size and other characteristics) with prices that can vary greatly. Finally, this highly generalised calculation does not take into account whether households have the necessary savings to purchase a home.

1. According to the indicators available from real estate portals, based on the prices offered, in the past 5 years rent has increased by around 50% in Spain as a whole, although the most recent data suggest the trend is moderating, which may be accentuated by the COVID-19 crisis.

2. In this article, savings refers to the stock of resources (total balance of savings products).

3. The Bank of Spain calculates the average house price from the price per square metre (based on the National Statistics Institute's house price index) multiplied by 93.75 m² (average surface area for homes).

While the affordability index is calculated from the median gross household disposable income

the HARI takes into account the distribution of renters' income to calculate their potential to buy a home.

Therefore, in order to answer our initial question about whether those living in rented accommodation can afford to buy a home, we present a different approach to the classic affordability index. Specifically, we use the methodology developed

by Goldman, Li and Zhu,⁴ that consists of calculating the HARI (Housing Affordability for Renters Index), which takes into account whether renters' current income is enough to become homebuyers. We have also extended this index to take into account whether the savings of these renters are enough to buy a home (HARI-Savings).

4. Goodman, Laurie, Wei Li and Jun Zhu, «Housing affordability. Local and national perspectives». Research Report Urban Institute (2018).

Some details regarding the methodology

The HARI measures the share of renters with enough income to buy a home. This index is calculated by comparing the income distribution of households renting their accommodation with the income distribution of those recently purchasing their first home using a mortgage. In other words, we consider that a renter could buy a certain property if their income level is the same or higher than the income of this property's buyer.⁵ Note that, in order to carry out this calculation, we do not need to define the price of an average home as the highly heterogeneous nature of house prices is implicitly taken into account through the variability of income of the buyers.⁶

5. We consider income from salaries and unemployment benefits or allowances allocated to the first holder of each account. The comparison of distributions has been produced using income intervals of 500 euros.

6. The HARI has some limitations as it only takes into account the level of income of the household (or the balance of resources in its extended version) while other criteria are also relevant for a mortgage to be granted, such as the type of employment contract (people on a permanent contract usually find it easier to get a mortgage) or the age of the person.

We have extended the HARI by adding the

factor

of savings as this is a key element that determines the ability to purchase a home, apart from income.

We have also added the factor of savings to the index because, as we have already mentioned, this is a vital factor in the ability to buy a home. Specifically, the HARI-Savings measures the share of renters with sufficient income and savings to buy a home. In other words, this extended index not only takes income into account but also considers whether a renter could buy a certain property if he or she has the same or higher level of resources as the actual buyer of that property.⁷ Note that the difference between the HARI and the HARI-Savings indicates the share of renters with enough income to buy a home but insufficient savings.

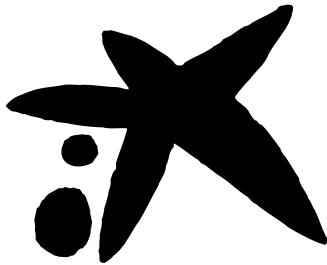
7. This is calculated based on the median income of home buyers in the month prior to taking out the mortgage in each income interval.

National results

Using the methodology defined above, we are able to answer the question regarding the potential of Spanish renters to become homeowners. First, however, it is important to look at the following chart, which shows the income (left) and savings (right) of home buyers and renters in 2019 for Spain as a whole, produced from internal CaixaBank data.⁸ Clearly renters tend to have a lower income level than buyers (the renter distribution curve is more to the left) but the differences are much more marked in the case of savings.

8. Buyers are defined as those who took out a mortgage to buy their first home in 2019 and never

had a mortgage before. Renters are identified from recurring transfers issued from the bank account of individuals to the same destination account during the first seven days of the month and for an approximately constant amount over time.



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From the income distribution, we get a national HARI of 49%. This means that approximately half of Spain's renters have sufficient income to buy a home. This figure is relatively high compared to the 27% obtained by Goldman, Li and Zhu for the United States. Therefore, it would seem that a large proportion of Spanish renters are in a good position to buy a house when we take their income into account. But do they have enough savings to make the purchase?

Including the distribution of savings, we obtain the HARI-Savings with a much lower value of 13%. In other words, we estimate that only 13% of Spanish renters would be able to buy a property given their financial situation. This means that 36% of renters would have enough income to buy a home but do not have sufficient savings capacity. This share rises to 41% for young people (aged 18 to 35), a group with the greatest difficulty in becoming homeowners due to their inability to save.

Insufficient savings capacity is the main limitation faced by renters in terms of home ownership,

especially young people. 49% of renters have enough income to buy a home but only 13% have the necessary savings.

Note that the results at a national level assume full geographical mobility. In other words, we are comparing buyers and renters irrespective of where they live: we are comparing, for example, the financial situation of renters in Madrid with buyers anywhere in Spain. However, the real mobility of renters is not so extensive. For this reason we have also carried out the same exercise at a provincial level and for large cities.

Results by province and large cities

To take into account the fact that the geographical mobility of potential buyers may be limited to areas smaller than the whole of Spain, we calculated the HARI and HARI-Savings at a provincial level and for the 10 most populated cities in Spain. The following maps and charts show the results.

At a provincial level, we can see that there are significant regional differences in terms of potential home ownership for renters. This can be seen in the wide range of HARI values, from 40% in Valladolid to 65% in Segovia. The map on the left shows that the rate is usually lower in the northern provinces. The Community of Madrid has a relatively low HARI (44%), while most of the surrounding provinces have higher affordability indexes.

The HARI-Savings also shows marked regional differences, albeit to a lesser extent. In this case, the index lies in a somewhat narrower band: around 5% in Huesca and Zaragoza to values close to 25% in Segovia and Ciudad Real. While there is a positive correlation between the two indexes, comparing the two maps

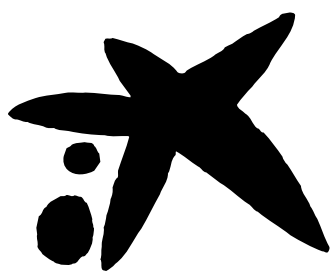
we can see significant variations in affordability when savings are taken into account: for example, Asturias has a HARI of 46% (below average) but a HARI-Savings of 18%, in the high band.

One important conclusion from this analysis is that a lack of savings is the main limitation faced by renters in terms of home ownership in all provinces. This is evidenced by the fact that the HARI-Savings is significantly lower than the HARI in all provinces, with a difference of at least 30 percentage points. The case of Cuenca stands out in particular, a province where about 65% of renters have enough income to buy a home but only 13% have the necessary resources. Ávila, Toledo and Castellón would be similar cases.



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In our analysis of the 10 most populated cities in Spain, these indexes show that it is particularly difficult for renters to become homeowners in some large cities because of a low capacity to save (no doubt partly related to the high rents). We have therefore estimated that fewer than 10% of renters could buy a home given

their level of income and savings in cities such as Zaragoza, Bilbao, Barcelona and Palma de Mallorca (see the bar chart on the left).

According to the HARI-Savings, fewer than 10% of renters

could buy a home in large cities such as Zaragoza, Bilbao, Barcelona and Palma de Mallorca.

Finally, one recurring finding, at both a provincial and municipal level, should also be noted; namely that, among the younger population (under 35), the main limitation to buying a home is a lack of savings capacity. Although the gap in income levels between young buyers and young renters is not so large, the difference between the two groups lies in their savings. For instance, in the cities of Bilbao, Malaga and Valencia, more than 45% of young renters have a high enough income to buy a home but do not have the necessary savings (see the bar chart on the right).

In designing a strategy for the recovery of the real estate sector after the severe blow dealt by COVID-19, one of the proposals being considered is to set up a programme to guarantee loans for first-time buyers similar to the UK's Help to Buy scheme, so as to reduce the initial amount the buyer needs to contribute in order to purchase a home. Such a scheme could stimulate the demand for housing since, as we have seen in this article, a lack of savings is the main limitation faced by renters when buying a home. However, given the current situation, the ability to

stimulate demand will be mitigated by rising unemployment, which is more concentrated among the younger population, as well as the greater uncertainty regarding their ability to secure a stable income in the future. It is also important to stress that a scheme to promote the supply of affordable rental accommodation would not only help people access rented properties but also improve the savings capacity of households and thereby their ability to buy their own home after a few years.



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