

To  
Kate Barker  
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Dear Kate Barker

### Review of Housing Supply

Attached are some observations in response to your public invitation for comments on the housing problem.

For your information, I am a Chartered Surveyor, having qualified in Chester through Articles in 1955 and have spent a total of seven years in private practice, ten years in the Inland Revenue Valuation Office, and my remaining 30 years in teaching, latterly as Lecturer in Valuation in the Department of Land Management, The University of Reading. Much of my time in private practice was concerned with valuations for mortgage of residential properties. Since I became a lecturer I have of course kept in touch with my profession and its members.

Please let me know if you would like me to elaborate on any of the points which I have made.

Yours sincerely,  
Philip Bowcock

### THE HOUSING PROBLEM

Philip Bowcock

Although the Barker Review is primarily concerned with housing supply this is only one half of the housing market and it would seem that the price of housing and in particular its volatility must have a substantial effect on that supply. In this respect there are some questions which never seem to be considered, for example :

- 1 Why do prices rise
- 2 Who influences the level of prices?
- 3 Where does the money go?
- 4 Is it in the interest of the community for prices to rise?
- 5 What actions could be taken if it were thought desirable to curb price rises?

1. Why do prices rise?

Basic economic theory dictates that price is the consequence of the interaction of supply and demand. In the case of housing, the supply in the short term (which for the present purpose can be considered in monthly terms) is fixed. Although houses and flats are constantly being built or created from conversions, the total annual proportional increase is small in comparison with the amount already in existence of around 21M . Building even 300,000 units a year may not be considered adequate, but whether the building industry could produce so many without creating other long-term problems is questionable (consider the planning and maintenance problems which have resulted from the large-scale production in the 1950s and 1960s).

Demand in the short run is not fixed. People are constantly leaving home, marrying, having children, breaking up, moving, etc.

Economic theory also states that the value of land (which in this context includes the buildings on it) is the residual element after paying for other outgoings. This may be

debatable in general economic theory, but in the context of an individual's or partnership's bid for a property it would seem to be highly relevant. A buyer will surely consider total income and deduct the cost of food, travel, tax, etc, when calculating how much is left to finance a loan.

A simplistic model of the market can be considered in terms of a row of houses and a queue of people. The row of houses is fixed, but the queue can change for numerous reasons as noted above. What is significant however is that the amount of money which any individual can bid for a house depends very largely on the amount which can be borrowed. If the rules are changed by, for example, reducing interest rates or extending repayment periods, then it is possible for everyone to borrow more and thus to offer more. Over the last 50 years repayment terms have changed from 20 years based on three times husband's income alone to 30 or more based on the income of two partners. These changes quite simply have enabled purchasers to borrow more, and the current low interest rates have added to this pressure.

## 2. Who influences the level of prices?

Doubtless there will be differing views on this, but if responsibility for the recent rapid increase in housing prices is to be established the interests of the various organisations concerned should be considered :-

(a) Successive governments - all of them. Over the last century they have interfered with the housing market piecemeal - Rent and Mortgage Interest Restrictions Acts and their successors, and Disadvantaged Areas Stamp Duty Exemption to take just two examples - without regard to the overall management of a very large and essential national asset. Politicians are notoriously primarily interested in elections.

(b) The banks and building societies. Money flows into their coffers without restriction and they obviously have the greatest incentive to lend it having regard only to whether their loans are secured. More funds - more organisation - more staff - higher salaries for managers etc - Parkinson's law. They have no incentive to take the overall effect on price levels into account.

(c) The Royal Institution of Chartered Surveyors and its members.

It is frequently stated that the role of the valuer is to "interpret the market". The "Red Book" of mandatory guidance to members valuing for mortgage requires "An opinion as to the amount of cash consideration . . . assuming . . . that completion will take place on a future date . . .". In times of strongly rising prices this can be interpreted as an expectation that the value will be greater than at the date of the valuation, and hence the lender can be recommended to offer a greater loan than for properties recently purchased, which of course formed the basis of the valuer's opinion in the first place. There is thus a circular effect - mortgage offers are based on estimates of value of previous transactions plus allowance for the rising values - prices rise and produce 'market evidence' on which even higher valuations can be supported. In a rising market therefore individual valuers are giving their support to the situation because they look at recent transactions which are themselves the result of mortgage advances based on the valuations of other valuers!

However it gets worse than this. If a valuer regularly reports conservative valuations to a mortgagee company they will lose deals to companies advised by other valuers. There is thus considerable pressure to give advice which will support the mortgagee's wish to lend, regardless of any long-term consequences. Any valuer who takes the view that there will eventually be a slump in the housing market and adds such caveats can restrict the amount of a mortgage offer. If this does not suit the institution whose lending is therefore restricted it is likely to instruct other valuers who do not take that view. It follows from this that valuers, following the RICS' "Red Book"

directions have been giving added support to the price boom. (This is not supposition - a number of chartered surveyors who carry out mortgage valuations have said exactly this to me, but for obvious reasons would not wish to state their opinions publicly.)

3. Where does mortgage money go?

Well two possible destinations are :

(a) Inheritance Tax and Capital Transfer Tax.

At some point all householders will cease to need their properties, and there are broadly two situations where this will happen. Obviously the death of the householder (or surviving householder) is one, and normally the estate will pass to beneficiaries. However the high values of houses, particularly in the South-East, will result in a very large proportion going to the Exchequer as Inheritance Tax.

The other possibility is that householders will move down-market from properties in which they may have raised their families and have had the energy and enthusiasm to maintain their house to retirement flats, or in ill-health situations, to care homes. Here again there will be a transfer of ownership with possible tax implications.

To put it shortly, the Treasury is likely to benefit noticeably from a high level of house prices at the expense of purchasers lower down the property ladder who have had to borrow substantially to finance their purchases.

(b) Beneficiaries

Clearly there will still be a substantial chunk of value going to beneficiaries - frequently members of families. What they do with it will vary, but one might suppose that at least a part will be saved and will find its way back into the hands of the lending organisations, further enhancing the sum available for mortgages and increasing their incentive to lend. Similarly those individuals who earn very high salaries may well place some of their surplus income with lending institutions.

4. The interests of the total community

Whether it is in the interests of the community for house prices to rise as they have done recently raises many questions, not least of which is the problem which arises if the market suddenly turns down. This is not hypothetical - one only has to look back to previous examples, where householders found that they could not service their loans and could not sell without making a substantial loss of their own equity.

Some people no doubt believe that things should be left to sort themselves out, and consider that house owners who have got into difficulties have only themselves to blame. Others may consider that some control over the mortgage market is desirable to avoid past problems from re-occurring

The direct control of prices would be impossible, but the following are suggested as possible actions to modify price levels if the community considered it desirable :-

(a) Valuations for mortgage to assume a maximum length of mortgage of say 25 years, regardless of the actual terms offered. It would not be difficult for valuers to include this assumption in their valuations. (There are many other valuation problems which require a valuer to make assumptions which differ from the actual market situation.)

(b) Require that loans should be based on only one income though it would not of course be considered politically correct these days for loans to be based on that of the man in a partnership.

It would of course be impossible to make such changes to the rules without causing severe disruption to the housing market unless they were graduated over a long period, probably several years. However if a marked downturn in the property market should occur such a change of policy might be adopted to prevent the level of prices

rising again significantly. Furthermore, variations in a policy to restrict the level of price rises might be adopted in different parts of the country.

So long as the incomes of both partners are taken into account it is likely to be necessary for both to carry on working regardless of whether they wish to raise a family. Conversely, should they decide to have a family there will be the problem of child care, and though crèches etc may make early provision there is later the situation of the "latch-key" kids which in so many areas has contributed to juvenile crime. Put simply, the necessity for both partners to work is likely to have a detrimental effect on the family, and resulting financial strain may contribute in many cases to breakup with further effects on social problems - and of course on the demand for more housing units.

#### 5. The effect on the supply of housing

The volatile housing market must surely have an effect on the supply of new dwellings. It is frequently suggested that high land prices are the cause of high prices for houses. This misses the point that the price of land is the residual element - the difference between the price of the finished product and the cost of building it, including of course all the ancillary costs and profit. Landowners may base their expectations on their view of property prices and be willing to sell only when those prices are sufficiently attractive. Developers on the other hand are likely to consider the higher risk involved in purchasing at such a time when the housing market might turn down and leave them with a loss. A more stable housing market could reduce some of this risk.

#### 6. Education

Finally of course there is the question of the necessary skills to provide more housing. If the Government ambition that half of all school leavers should progress to higher education is realised then some school leavers are likely to be tempted to look for "management" opportunities rather than a building trade. (The shortage of plumbers is often quoted, but I am told by a College lecturer that funding of his department is now so restricted that he does not have the necessary plumbing materials to allow his students to practice!)

Perhaps the "new" universities should revert to their previous Polytechnic status and set out to provide courses for more practical skills.

#### 7. Conclusion

The ultimate question remains - is the community happy to allow organisations with a vested interest to support a volatile property market with consequent effects on new building or should there be a global management policy to modify this?