HollAnd Advisors

Holland Views – UK Housing

The Bank of Mum and Dad

We aired a few views on Mr Carney and his relationship with the UK housing market last month. Post last week's intervention by the Bank of England in the mortgage market the topic has become much discussed. We re-attach our earlier comments and add a few more views.

Mark Carney is every bit the modern central banker. If he sees an excess building in a part of the economy he likely wants to slow it, but crucially not to do so in a way that might upset anyone or make him unpopular! Earlier generations of central bankers were far less accommodative. We listened last week to the press conference at which the cap was imposed for banks to have no more than 15% of their book in loan that are above 4.5x income. We reflect with a few further thoughts following it:

- When asked if the 4.5x income cap was a level at which the committee considered it risky for people to borrow, the response was measured but in essence a "yes this is a level around which repayment can become more challenging when 'normalisation' of interest rates inevitably occurs". We note with interest that the current ratio of house prices to incomes (not loans) is c.5.5x at a national level (i.e. 20% above 4.5x) and clearly way above that multiple in London. We observe that this speaks volumes towards the long term attractiveness of Residential property as an asset (i.e. something the next buyer needs to be able to afford at a date in the future to buy off of you). We also realise that few are interested in listening to such a view
- Also of note is the assumption, as we outline in our piece, that anyone (i.e. the man on the street) is listening to the subtlety of the Governor's message. The message getting through to the bill boards is not: "*watch out, wise men think housing is a bubble*", but a far far more muted one. As the kids like to say… "*Party on*"
- There is often much debate between bulls and bears of house prices on affordability. Bulls citing interest rate affordability and bears income multiples. It is interesting, therefore, that the bank chose the latter for its cap not the former
- Our last observation is the complete ignoring of the second order effect from these and other housing policies that have come before. To test my theory on this point, when I has finished listening to the governor speak last week I went and asked a friend (without any prompting) the following question. "*If the 25-35 year olds you know want to buy a property but cannot get a mortgage big enough what do they do*"…After a brief reflection I received a clear answer "*they ask their mum and dad*". This is, of course, the right answer and is why 30 years-ago deposits were 10-15% of annual incomes, 5-10 years ago they were 30-40% of incomes and today they are a whopping c.75%. Mr Carney's new rule does not say do not buy a house over 4.5x earnings it says find a chunk of the money from somewhere else and the banks will lend you the rest. Such a market almost breeds the rarity of 'must have' but slightly out of reach asset – a dangerous trait

The population would be best served by being told a clear message that the asset that they love most could now be a dangerous investment, not because it will fall down one day but due to its starting price and thus the burden of debt that needs to be incurred to own it. That message is still not being given however, thus all generations still see UK housing as a one way bet. As a result Mum and Dad (who are likely 55-70 years old) are more than happy to help little Jimmy find the £50,000 deposit to buy a flat in Battersea because they think it will be a great investment anyway.

Just somewhere to live

At some stage if the UK population ever reflect on housing as just somewhere to live rather than a cash point machine the effect of price falls will be widespread. Overstretched first time buyers will lose money and the bank of Mum and Dad will lose a portion of their retirement nest egg too. But it may not end there as we must remember all those in the middle, the 35-55 years olds. They will not be spared exaggerated pain, despite yet being tapped by their own children for help to buy a house. How come? Well what has been their predominant investment of choice in the last 15 years (not just with excess savings but with new debt as well) - why, Buy-to-Let of course. When other housing assets have collapsed in other countries, the effect in those economies have been far bigger and wider than modelled by central banks due to such intertwined relationships.

Many discuss the wisdom of not intervening in bubbles, but imagine if the BofE had raised rates *more* in 2004-2006. House price may have stalled for a while and then fallen during the credit crisis from a lower level. The global flight of capital to London would still likely have occurred but at least today's economy might look a little more balanced with industry and housing recovering together. Today it looks more unbalanced than ever.

We could go on, but you get the message. At Holland we all own the houses we live in and are happy to do so and see them modestly appreciate. But our day job is to try to invest ours and others savings in assets that look safe, affordable and to do so without excessive leverage. UK housing ticks none of these boxes. Sadly the man on the street is not receiving this message from those he trusts to deliver it.

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