FINANCIAL TIMES

October 10, 2013 7:25 pm

Buyers beware of Britain's absurd property trap

By Martin Wolf

The government's Help to Buy scheme is really helping those who wish to keep housing costly

The British are not a nation of shopkeepers, as Napoleon said, but rather one of property speculators. This is why a government notionally devoted to fiscal austerity has decided to use its balance sheet, up to £130bn (8 per cent of gross domestic product), to guarantee mortgages as part of its "Help to Buy" scheme. The government claims it is helping first-time buyers. It is really helping those who wish to keep housing costly: today's owners, banks and housebuilders. The government is strengthening a conspiracy to keep house prices exorbitant.

The scheme has two parts. The first is for the government to finance a share in the equity. Under this, it will advance up to 20 per cent of the price, allowing buyers to put up a mere 5 per cent deposit on new properties worth up to £600,000. The cost of this scheme is expected to be £3.5bn and it is intended to help 80,000 buyers of new homes. The second part consists of mortgage guarantees – the UK equivalent of Fannie Mae and Freddie Mac in the US. The state would guarantee lenders up to 15 per cent of the value of a loan on properties worth £600,000, or less. This would cap the risk to lenders at 80 per cent of the value of a property, even if they lent as much as 95 per cent.

David Cameron, prime minister, justified the new schemes as a way to correct a "banking failure" that had resulted in lenders wanting large deposits. Is this a market failure? No, it is mere prudence, particularly when house prices are so high. Note, too, that the scheme helps not the poor, but the cash-limited. Even at a ratio of six to one, the household income needed to afford a 95 per cent mortgage on a property worth £600,000 is £95,000. This is well over twice the average income of a two-earner household.

As a way of solving the problem posed by high prices in the prosperous regions of Britain, a policy of increasing demand is absurd. It may increase supply a little, but only by raising prices still higher than they would otherwise be. If one wanted to increase supply, the solution is evident, but politically unthinkable: make a large quantity of land available for development and impose a swingeing site value tax, to compel building. Back in the 1970s, the UK built an average of 300,000 houses a year. But between 2001 and 2011, building averaged 188,000 a year, even though the population rose by some 3.5m.

It is the supply, stupid! The reason this point is not made the focus of policy is that doing so would be too unpopular and too dangerous.

It would be too unpopular because of stout resistance from the Nimby – "not-in-my-backyard" – brigade. The Campaign to Protect Rural England or, as I think of it the "Campaign for the Imprisonment of Urban England", would be up in arms. So too would owners of "land banks" available for building and today's homeowners. These lobbies are far too formidable for any government. It will not tackle them. The government initially broached liberalisation of the UK's exceptionally tight restrictions on land use, but achieved little.

Liberalisation would also be risky because it might threaten the stability of UK banking. In a brilliant lecture on money and banking delivered last month, Lord (Adair) Turner, erstwhile chairman of the Financial Services Authority, noted that the lending of UK banks mainly supports the purchase of existing properties. In 2009, an amazing 64 per cent of all bank lending was for residential mortgages. Close to 13 per cent was for commercial property, 12 per cent was for unsecured personal lending and a mere 12 per cent was for other corporate lending. In all, property-related lending accounted for 76 per cent of total loans

Yet remarkably, between the third quarter of 2007 and the second quarter of 2013, only 4.4 per cent of the total of £80bn in write-offs by UK banks and building societies was on loans to individuals secured on their houses: these loans were as safe as houses. A big reason for this was that – unlike in Ireland, Spain or the US – the post-crisis fall in house prices in the UK has been so modest. In August 2013, real house prices in England and Wales were just 15 per cent lower than at their pre-crisis peak and 140 per cent above their mid-1990s trough. Moreover, the constraints on supply that have kept prices up also curbed the pre-crisis building boom. Its egregious supply constraints actually saved the UK.

A deregulated and dynamic housing supply could spell financial and political Armageddon. The victims of this vile system are the young and upwardly mobile, who are either unable to buy at all or are trapped in a lifetime of debt serfdom. The political genius of the scheme is that it appears to help these hapless victims, while in fact helping the usual suspects: banks, homeowners, Nimbys and, if it creates another housing boom, the government.

Ministers also pretends the guarantees are a purely temporary arrangement. Nothing is less likely: it is the temporary that endures. The government has increased its commitment to frighteningly expensive housing. It is a trap from which the UK may not now escape.

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